JIKO Info 2 | 11

Wuppertal Institute for Climate, Environment and Energy

NEWSLETTER OF THE PROJECT "JOINT IMPLEMENTATION & CLEAN DEVELOPMENT MECHANISM: JIKO" · RESEARCH GROUP ENERGY, TRANSPORT AND CLIMATE POLICY

Editorial

Dear Reader!

the Carbon Markets are in a state of transition: while the 3,000th CDM project was registered recently, the future of project-based offset projects is in limbo. A continuation of the CDM beyond the 1st Kyoto commitment period is all but certain and if demand from the EU ETS will be a sufficient market driver is even more questionable.

What seems to be clear at this moment that the future offset markets will see larger, policy-oriented schemes, may be at a sectoral level. Moreover, national mitigation actions in developing countries (NAMAs) will play a crucial role.

Therefore, in this issue, we look at how this transition from projects towards NAMAs can be organised, what role current approaches such as PoAs can play, and in what way the CDM of today must be reformed (see interview with EB chair Martin Hession). I wish you an informative read!

On behalf of the editorial board,

Christof Arens

Content

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JIKO Analysis

Not enough demand for CERs?

by Dr. Silke Karcher, BMU

The Cancún climate change conference raised hopes that the Kyoto Protocol's project-based mechanisms will still have a use beyond 2012. However, many CDM/JI actors doubt that the next climate summit in Durban will provide a long-term, reliable framework to allow further use of those mechanisms and to generate sufficient demand for CERs. What is more, the policy statements being made by key parties in both industrialised and developing countries are doing little to counter such thoughts. While efforts continue in forging a new climate change regime that will secure a sustainable carbon market over time, Durban is unlikely to produce it.

Without a further commitment period, either under the Kyoto Protocol or a new agreement, the primary market for CDM and JI-generated carbon credits will grind to a halt. The uncertainty surrounding the timing of any new agreement is proving to be an obstacle to project development. While the EU provides for basic demand, there is next to no call for CERs from other regions. And future use of the CDM in Japan and the US remains highly questionable.

Continued on page 2

JIKO Interview

"A much simpler and more transparent CDM"

Five questions to Martin Hession, Chair of the CDM Executive Board

JIKO Info: The CMP has given the EB a long list of tasks to improve the CDM. What in your view are the most important steps for reforming the CDM in this time of transition? Are you satisfied with the mandate you got from Cancún or do you think important issues are missing?

Martin Hession: This year I think we have to move our focus much more towards delivering a much simpler and more transparent system, not least so that our judgements and assessments are much better understood by external stakeholders. This focus more than anything will drive improvements in the quality and efficiency of decision-making as well as access to the CDM.

Continued on page 4

JIKO Analysis

Not enough demand for CERs?

Continued from p. 1

EU demand alone is not enough to drive the market in the longer term. It can merely ensure the mechanism's survival by securing a limited demand that is closely coupled to stringent criteria. Even with the EU's own reduction target, which at present aims at a mere 20 percent cut in carbon by 2020, certificates generated from CDM and JI projects may only be used in certain quantities – both in the EU Emissions Trading Scheme (ETS) and in the EU's effort sharing requirements for sectors not covered by the ETS. The criteria which will apply to CDM/JI projects in the period beyond 2012 are very strict:

Under the EU Emissions Trading Directive, demand for certificates from new projects registered after 2012 remains limited to the least developed countries (LDCs). In addition, a large portion of the demand for certificates can be covered from existing projects which were registered within the current commitment period. The planned ban on certificates from industrial gas projects for the period beyond 2012 will have a positive impact on the structure of CER demand, but it is difficult at this stage to say whether this will be enough to stimulate demand for new projects. Apart from the EU ETS, much of the national demand in EU countries stems from the non-emissions trading sector, where CDM projects registered before 2012 and trade in AAUs supply a large portion of the certificates required.

On the whole, the opinion that the so-far predictable demand in the EU and the potential demand in some other industrialised countries is not enough to support the CDM, let alone a new market-based mechanism.

This gives rise to the question of where sufficient demand might stem from in the coming years, or rather how it might be secured. The following issues are key in this regard:

1. **Use of AAUs:**
   AAUs generated in the first commitment period may not be used to meet agreed reduction targets beyond 2012.

2. **Continuation of the CDM in UN hands:**
   The CDM must remain available as a standardised UN mechanism for carbon offsetting independent of any option for CERs to be used to count towards legally binding or voluntary emission reductions. This would allow interested states or regions to use the CDM (as is now the case in the EU).

3. **CDM reform:**
   Acceptance of the CDM depends on its practicability and its environmental integrity. Both must be significantly improved following the 'trial and error' phase in the initial years. Timely reform of the CDM is thus called for to make it easier for the industrialised states to accept the mechanism and for the host countries to implement projects. Steps have already been taken in the right direction. The task now at hand is to ensure that these are implemented quickly and that additional steps follow. The problem of mass easy pickings with fruits that simply hang too low must be addressed. As recently decided by the EU,

Outlook into an uncertain future: the prospects of offset projects in many developing countries are in doubt.
Photo Yi Zhang / UNFCCC

JIKO Analysis

CERs from specific industrial gas projects should no longer be eligible for use from 2013.

4. **Promoting the programmatic approach to the CDM (PoA):**
   The programmatic CDM offers projects with sound environmental integrity, and often with social benefit. PoAs go beyond the individual projects in the original CDM and can be seen as a bridge to new, broader-based mechanisms. As yet there has been no bias towards easy pickings with the programmatic CDM. Its high acceptance can be used to promote consideration of new, yet-to-be designed offset schemes.

5. **Promoting the CDM as an offset mechanism:**
   An improved CDM can be an attractive asset in the use of emerging emissions trading schemes. Relying on an established mechanism can help save the time spent in designing a new one, and can also assist in establishing a more harmonised carbon market.

6. **Allow use of projects designed for other offset mechanisms:**
   With the CERs it generates, the CDM is the first global currency in the carbon market. In the mid term it is hoped that a global carbon market will emerge. Bilateral offset mechanisms and the yet to be created credited or supported NAMAs could provide the basis on which to market emission reductions – and projects originally developed for the CDM.

It cannot be ruled out that enough industrialised states will want to see the CDM as an offset mechanism even without a second commitment period. Nonetheless, given the long and drawn out climate change negotiation process, and the often long-winded national implementation of decisions, there is a risk that demand for CERs will be too low in the coming years.

In light of the international financing pledges for climate change mitigation, to which the carbon market is destined to contribute a significant amount, the question arises as to whether as an instrument the CDM will have outlived its stay after just one commitment period. While a few states use the CDM successfully on a disproportionately large scale, capacity building for the CDM has needed and still needs a longer timeframe in many countries. These countries could, however, get the impression that the industrialised nations are literally closing the door in their faces. They can rightly argue that most developing countries are neither among the emerging economies with high emissions nor the least developed countries (LDCs).

On the one hand, it is hoped that further progress can be achieved in Durban and that more industrialised nations outside the EU will want to use the CDM beyond 2012. On the other hand, there is a chance to combine international carbon financing and the carbon market for most developing countries. But in doing so, it would be wrong to simply take up slack in demand for CERs. With the programmatic approach to the CDM, an instrument is already available which, if embedded in NAMAs, is suited to increasing the emission reduction potential that the market and the state have failed to increase. Models on how to embed the (programmatic) CDM into NAMAs must be developed for this purpose.

In cooperation with the KfW Bank Group, the German Environment Ministry is working on workable models to make PoAs a stepping stone in NAMA development. We will address this issue at our side events at this year's CarbonExpo in Barcelona. Initial approaches are outlined in the KfW article elsewhere in this issue of JIKO Info.

Glossary / Abbreviations

All CDM/JI-specific terms and abbreviations are explained in detail in a glossary on the JIKO website at **www.jiko-bmu.de/459**

JIKO Interview

"A much simpler and more transparent CDM"

Five questions to Martin Hession, Chair of the CDM Executive Board

Continued from p. 1

Martin Hession, serves as Chair of the CDM Executive Board until the first meeting of the Board in 2012. He is Head of Global Carbon Markets, Department of Energy and Climate Change, United Kingdom.

Significant changes have already occurred, and we have seen a marked improvement in the CDM in terms of business planning, and the quality and efficiency of assessment. I think we have both the mandate and some concrete proposals that will build such a system, but the accent for the moment must be on delivery, and on implementation and consolidation rather than radical change.

JIKO Info: The issues of first of its kind and common practice have been debated in the EB for a very long time. What do you think are the chances for finally coming to an agreement this year and what it could it look like?

Martin Hession: This is potentially one of those proposals. I am hopeful that we can have some sort of decision, as this could deliver something simpler and more transparent if done correctly. I know that there are skeptics as to the value of these approaches, and given the difficulties perhaps this isn't surprising. I understand the constraints of data and the upfront investment that might need to be made for these approaches to be possible in practice. Nevertheless, I think they offer the potential of a much more standardised and transparent approach to assessment of additionality and for this reason alone it's worth pursuing them. I think if they are to progress we will be taking a stepwise approach, testing them in particular sectors and project types rather than revising guidance wholesale from the beginning.

JIKO Info: In the Business Plan adopted at EB 59 the Board agreed to develop ten Standardised Baselines (SBL) until mid-2012. What are going to be the first areas for developing standardised baselines developed by the EB and what are the major challenges in SBL development?

Martin Hession: Most importantly for me the recent decision of the CMP provides a window for external stakeholders to put forward standardised baselines and baselines via DNA's on a national basis. The decision also asks for a focus on methodologies that are applicable in underrepresented countries and regions. I think this provides an opportunity for countries and regions to define their priorities themselves. This has to be a welcome development. It remains to be seen what comes forward and I have heard many different ideas, but I think the best I can say is that different countries will focus on different things. Of course the standardised baselines approach actually covers a range of ideas and approaches to setting baselines and there are lot of ideas under discussion. For some it is about setting performance benchmarks, for others it is about providing more in terms of standards and default factors in particular methodologies. I do think that providing for default factors for use in technical assessments, though controversial, could more than anything level the playing field for less developed hosts.

JIKO Info: The demand for CERs stemming from projects in Least Developed Countries (LDCs) is steadily increasing, partly due to regulations by the European Union. However, the CDM is a market-based mechanism and LDCs generally don't attract much foreign investment. Against this background, what do you think is the scope for improving the geographical distribution of CDM projects and what are the means for doing so?

Martin Hession: It is true the CDM is a market mechanism and investment will be distributed accordingly. I think there is much the CDM can do to promote equal access to the mechanism, but little it can do in terms of equality of outcome in terms of investment. By this I mean we need to make sure that our rules are tailored to the situation of different countries and do not unintentionally discriminate against sectors and project types; but, we cannot enter into the business of project promotion or positive discrimination. We do a lot to promote understanding of the mechanism internationally, but could do more. As I already mentioned, standardised approaches could offer a route to having more tailored requirements that are more appropriate to specific national circumstances. But a lot is outside our direct control and dependant on the investment climate and policies and positions of host and buyer countries. Hopefully the proposed loan scheme to cover preparation costs can make a contribution, and the renewed consultative exercise broadened to include public and private sector experts

JIKO Interview

can assist us in focusing our efforts more effectively.

JIKO Info: Many regard Programmes of Activities (PoAs) as an interim step on the way to new market-based mechanisms, such as sectoral approaches or credited NAMAs. What role can PoAs play on the road to sectoral mechanisms and which steps should the EB take in order to foster PoA development?

Martin Hession: Programmes of Activities certainly offer the potential for CDM to operate at broader scale and present the opportunity to learn a lot about framing and assessing of emission reductions activities at the programme level. One issue is institutional framing. PoAs provide umbrella authority under which individual activities can be approved for crediting by DOEs without further direct scrutiny by the Board. As a result there is a lot of controversy around defining eligibility requirements for inclusion of activities in a PoA and the potential liability of DOEs for wrongful inclusion of such activities. This is part of a bigger question we need to resolve this year – liability of auditors. But I think the biggest challenge here is the question of the contribution of PoAs to overall emission reductions. Proposals on NAMAs and sectoral approaches all include the concept of some contribution to emission reduction which is not credited. I think it's possible for Programmatic CDM to work in this way but in the end how this would work and the nature of the contribution would be a question of national policy and discretion. Whatever happens it seems clear to me that PoA requires a strong institutional backing to work at scale.

JIKO Analysis

Can PoAs serve as a stepping stone for NAMAs?

by Carolyn Neufeld, KfW

Carolyn S. Neufeld
an economist by profession, is a Senior Project Manager at KfW's Carbon Fund. She is responsible for the PoA Support Centre.

In international negotiations on the UN Framework Convention on Climate Change, various strategies to mitigate greenhouse gas emissions have been discussed both for the existing framework and for potential future frameworks. Consensus exists that climate change mitigation has to see substantial up-scaling in order to be effective. Among the many approaches hotly being discussed are National Appropriate Mitigation Actions (NAMAs). This article assesses the potential for CDM Programmes of Activities to serve as a first stepping stone on the road towards NAMA development.

The Programmes of Activities (PoAs) model has been developed and operationalised in the past few years. The aim is to register as CDM or JI projects large numbers of small-scale measures, which aggregate substantial emission reductions but cannot carry the CDM/JI transaction costs by themselves. Depending on the institutional and sectoral set-up they can be used to implement and support national policies. As PoAs share several elements with a potential NAMA, they can be useful in providing a starting point for NAMA development: they can support sector-wide and national approaches to implement mitigation activities in households, enterprises and the public sector. PoAs can provide important insights to determine baselines and monitoring models, and to provide financing for the implementation of NAMA-related policies.

Goal of the conceptual work

Bearing this in mind we believe this bottom-up approach can serve as a pillar of NAMA development. Thus, as part of the work conducted in the BMU-funded PoA Support Centre, KfW commissioned the consultancy South Pole to conduct a study with the aim of analysing the relationship between PoAs and potential NAMAs, and to identify the 'stepping stones' and requirements needed to develop a strategy for low carbon development for use with NAMAs. The work builds on existing PoA activities prepared by the PoA Support Centre. The following outlines the study's design and some of its preliminary findings.

JIKO Analysis

Four modules will do

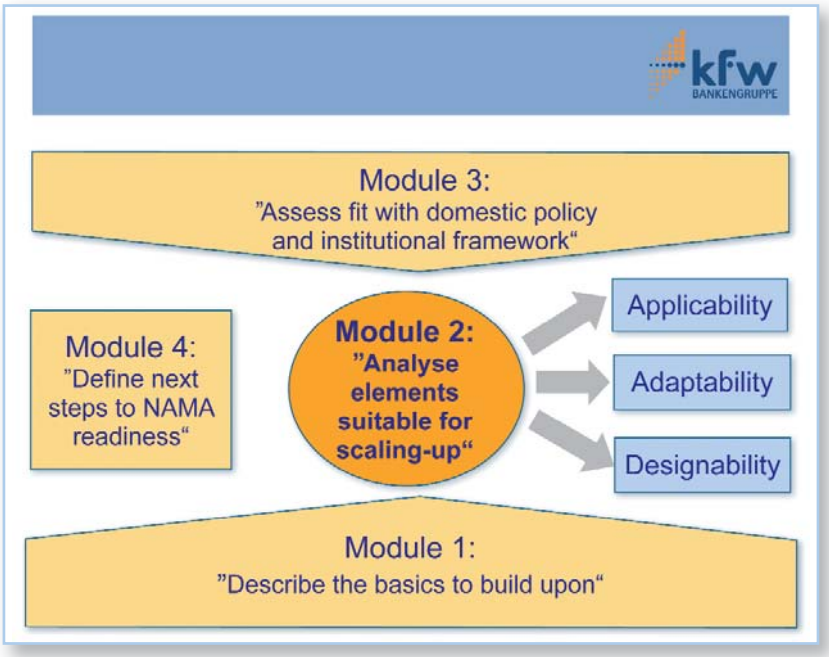
The idea of the study on the bottom-up approach currently comprises four basic modules which define the NAMA work programme:

Module 1 serves as the groundwork that needs to be undertaken: It describes the PoA, its scope, the eligibility criteria, implementation arrangements, and the sources of greenhouse gases.

Module 2 digs in deeper by analysing the main design elements of a PoA and the potential for up-scaling that PoA to a NAMA, but differentiating between identifying (i) activities that are fully applicable to a NAMA, (ii) design elements that need to be adapted, and (iii) elements that need to be developed from scratch.

Module 3 introduces the regulatory and institutional domestic policy framework that is needed for successful NAMA implementation and assesses the potential linkages between the PoA set-up and the NAMA framework.

Module 4 of the conceptual framework identifies the scope of work or the NAMA 'readiness' of the case studies and the need for adaptation and adjustments as described in Module 2.



From PoA to NAMA in four steps

Source: KfW / South Pole

These modules serve as steps in PoA to NAMA development.

Initial Conclusions

The report indicates that PoAs are particularly suitable in supporting NAMA development, as PoAs use and test concepts relevant to NAMAs. This is especially true when NAMA design is at an early stage in the country in question. Nonetheless, careful analysis of the applicability and adaptability of the components is vital.

The report also shows that the more the existing PoA is integrated into national policies and strategies, the better the chances are for scaling up the PoA to a NAMA. Although this is not very surprising, it shows the limitation of the approach: A PoA that is not well integrated into a sector-wide policy might not be usable at all in efforts to develop a NAMA.

Another important finding is that the co-existence of NAMAs (including a future 'credited NAMA') and PoAs in the same sector is possible if a robust approach is taken to prevent double counting. In the short term, the best solution might be to deduct CERs issued for the PoA from a NAMA cap or from the NAMA's achievement as regards GHG emissions. In the medium and long-term, more work must be carried out to design models for co-existence between the CDM and NAMAs.

Finally, although PoAs were introduced some time ago and were operationalised in 2007, experience in implementing and developing them remains limited. The CDM Reform Agenda and the PoA Reform Agenda need to perform and produce results which facilitate PoA implementation and deliver insights into NAMA design.

The study will be presented at this year's CarbonExpo in June, 2011. It will also be published on the BMU's CDM/JI website, www.jiko-bmu.de.

JIKO Report

As the market matures, much help still needed to tap full potential

CDM Programmes of Activities gain a boost from PoA Support Centre

By Carolyn Neufeld, KfW

KfW operates the PoA Support Centre on behalf of the German Environment Ministry (BMU). This involves the development of a portfolio of eligible Programmes of Activities (PoAs), capacity building activities and dissemination of information. An experienced project partner, KfW offers advisory, structuring and assessment services for programme proposals as well as financing and grants to cover the preparation of programme models, project design documents (PDDs) and monitoring plans. JIKO Info presents an overview of current developments and results.

The BMU-funded PoA Support Centre has supported well over 30 PoA PINs, and a great number of interested parties from developing countries have been advised on the feasibility and structuring of their PoAs. The PoA Support Centre's current PoA pipeline covers a broad range of sectors and regions, see Figure 1.

Twenty percent of the programmes supported by KfW are located in least developed countries (LDCs). This illustrates the efforts of the PoA Support Centre to concentrate on supporting PoAs in challenging countries and regions, namely in Africa and LDCs.

Specialised PoA workshops held in developing countries – an important service provided by the PoA Support Centre –- have been met with great interest and positive feedback. In 2010, workshops were held in Cambodia and Tanzania, and in 2011 in Nepal, India, Kenya and Laos. From the experience gathered so far, these capacity building workshops continue to be a key element in enabling participants who have had very little contact with the PoA approach.

In the past two years the UNFCCC PoA Pipeline has grown to almost 90 PoAs. This seems to indicate a relative market maturity for PoAs. However, this is still a very small number of PoAs in the CDM compared to the overall CDM project pipeline. What is more, only eight PoAs have been registered to date and even fewer have successfully added CDM programme activities (CPAs) and issued credits. This clearly shows that there is still much work to do to help PoAs reach their full potential.

Sector	Region	Coordinating Entity
Energy Efficiency in Buildings	Poland, Estonia, Israel	Banks + Public Supply Company
Energy Efficiency in SMEs	Poland, India	Banks
Household Stoves/ Biogas	Nepal , Nigeria, Mexico China, India, West Africa	NGO, Banks Public Institutions
Renewable Energy (Solar Water Heater/ Mini Hydro)	South Africa, Central America, Philippines, Nepal, Vietnam, East Africa, Mexico	Banks Private companies

Fig. 1: The current PoA Centre pipeline;
Source KfW

JIKO Report

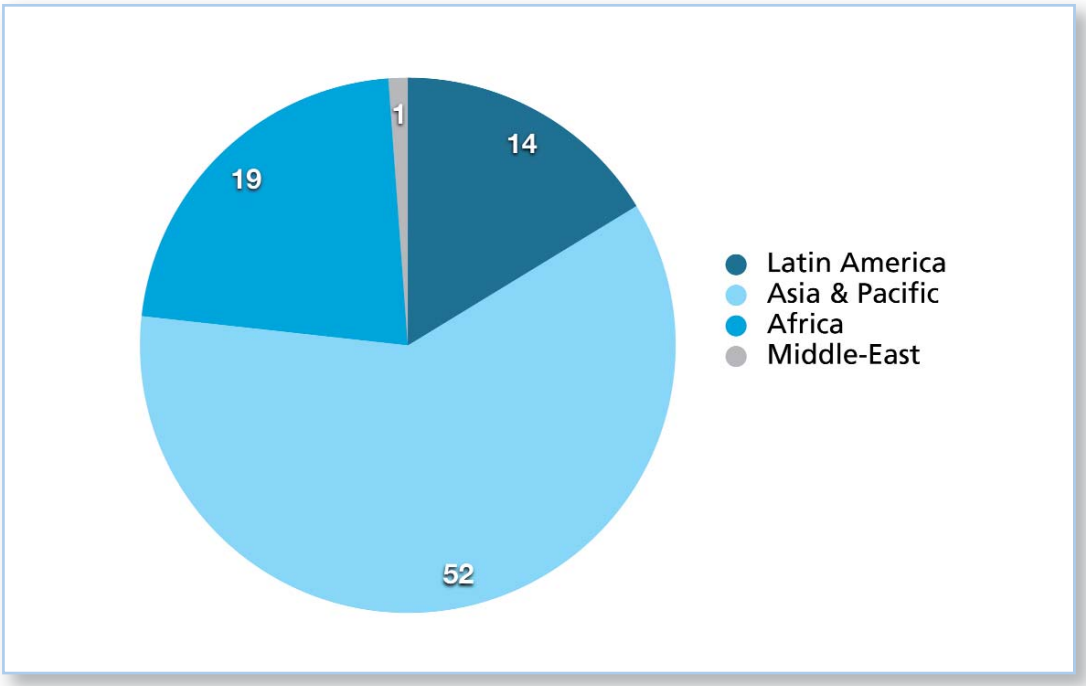


Fig. 2: Geographic distribution of the current PoAs pipeline.
Source: UNEP Risoe

The market for consulting services has seen a very positive development in the past three years. It is now possible to involve a wide range of consultants who are active in PoA development. Also, consultancy firms have begun to specialise more and more on PoAs. Many companies have at least one contact person for PoAs, others have even shifted their strategic focus towards PoA development. PoA Coordinating and Managing Entities (CME) are also benefiting from this knowledge, showing that considerable learning effects have taken place in the past two years. Nevertheless we see that one of the main hindrances for PoA development is the complex nature of the concept and the still very limited knowledge and capacities of project developers in the host countries.

In terms of regulation, there is still much to be done. Crucial issues here include reducing complexity in the regulatory CDM framework and rethinking the liability issue for Designated Operational Entities.

Another important contribution to the development of PoAs by the PoA Support Centre has been the development of the PoA Blueprint book in cooperation with perspectives, a specialist consulting firm, as a lead author. This book has been updated and expanded to include case studies and is now available in Spanish and French.

Vision for future market development

Creating a vision for future market developments such as Nationally Appropriate Mitigation Actions (NAMAs) is crucial for the carbon market as a whole. In a situation where central features are still unclear, it is essential not to 're-invent the wheel' but to draw on experience gained with the CDM and PoAs when designing the new instruments. A recent study conducted by the PoA Support Centre analyses how experience with PoAs can spur and support the design of NAMAs. Highlights of this work can be found on page x. One key conclusion is that PoAs can be an important instrument for scaling up greenhouse gas reduction activities, but reforms are needed to unlock their potential and their ability to support NAMA development. In light of the CDM reform agenda we are confident that this year could be a very important one for PoAs.

Further Information:

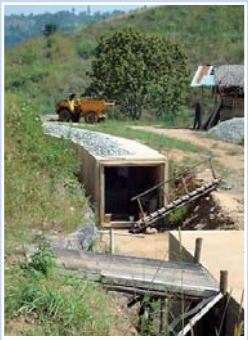
The PoA Blueprint Book can be downloaded here:
www.kfw.de/carbonfund

JIKO Report

SPEAR: A promising new multi-country PoA

By Bill Farmer, Uganda Carbon Bureau

This appealing multi-country CDM Programme of Activities (PoA) will be launched in late 2011 to provide quick and cheap access to the international carbon market for East African project developers of small-scale, grid-connected, renewable energy projects of up to 15MW each. Developed by the Uganda Carbon Bureau (UCB), SPEAR Ltd (Small-Scale Programme of Activities in East Africa covering Renewable Energies) covers the five countries of the East African Community (Kenya, Uganda, Tanzania, Rwanda and Burundi), plus Sudan. This pioneering PoA is supported by BMU via the KfW PoA Support Centre. South Pole Carbon Asset Management Ltd has received funding to work with UCB's staff to design the project and to complete the CDM registration documents. GIZ has also provided a long-term technical expert at UCB to plan the SPEAR PoA and its launch.



SPEAR is the Coordinating/Managing Entity of the PoA and will be able to support numerous clean energy projects across the region. East Africa has common historical links, and the revived East African Community has plans for deepening economic and political integration backed by the recent launch of an East African Common Market. Hence, SPEAR is seen as a useful instrument to support regional development, and the East African Development Bank has been invited to become a shareholder.

Clean energy projects that SPEAR supports are part of the solution to reducing greenhouse gas (GHG) emissions, and mitigating climate change. The individual projects will provide reliable power to villages, businesses and industries to spur local development and replace energy sources with high GHG emissions. Projects joining the SPEAR 'umbrella' will benefit by using template documents for their inclusion and support throughout the carbon registration process. All monitoring and verification administration will be handled by SPEAR, and advice will be provided on project financing options.

All photos (c) Jan Martin Witte, KfW

JIKO Analysis

Challenges for JI project developers and investors in the event of a post 2012 gap

by Thomas Forth (BMU) and Michael Ruffing (KfW)

"The difficulties faced in international negotiations on finalizing an agreed framework for post-2012 international greenhouse gas (GHG) emission regulation have left the rules relating to carbon offsetting in limbo. Though neither the Kyoto Protocol nor its component structures and mechanisms will cease to exist after 2012, in the absence of a further agreement a gap in which no quantified emission reduction commitments are in force would create significant uncertainty regarding the continuity of various activities relating to the flexible mechanisms under the Protocol." This is the introduction to a recently published Climate Focus study on carbon offsetting in Europe post 2012 (see box). Even if, from a negotiating standpoint, a gap could be avoided, for project developers and investors the gap after 31 December 2012 appears very likely. In any case, the uncertainties and the risks are so high that no one could ignore them and go back to normal JI activities.

Boiler rehabilitation as one activity of the Polish PoA.
Photo: BOS Bank

The gap influences JI activities in different types of JI host countries dramatically. It is necessary to distinguish between the different legal framework conditions in Russia and Ukraine, and in the EU member states . The EU member states with obligations under the Effort Sharing Decision (ESD) have some advantages in trading and cooperation opportunities. On the basis of existing caps within the non-ETS sectors of the EU the member states get an annual emission allocation (AEA) on which they could trade in a limited number of AEA.

In the Joint Statement of the 17th Meeting of the Environment Ministers of the Visegrad Group Countries dated 8 March 2011, the Czech Republic, Hungary, Poland and Slovakia underlined the positive outcomes of the international climate negotiations in Cancún while addressing their concerns on the future of the project-based mechanisms in the period post 2012, not least as regards Joint Implementation. In the Joint Statement's point 8 the Visegrad Group endorses the necessity to work on solutions within the EU: "The Ministers agreed that the domestic offsetting mechanisms are useful and cost-effective tools to reduce GHG emissions within the EU. They agreed to invite the Commission to elaborate on the rules for projects which would reduce emissions in the non-ETS sector, as stated in article 24a of the revised emission trading directive." For the time being there is no such solution within the EU and the ESD may well provide a practical option through project-based trading deals at EU member state level. Further deliberations are needed.

Under two programmatic JI projects (boiler rehabilitation with primarily small and medium-sized enterprises, and thermomodernisation in public and private buildings) agreed between Poland's BOS Bank and Germany's KfW and developed with funds from BMU, 23 investment projects (JPAs) have been identified since the programme was launched in July 2010. The projects are open for inclusion of individual investment projects until the end of 2012 and should generate emission reduction units over 10 to 12 years. A global loan of €30 million granted by KfW to BOS Bank is available to finance the individual investment projects. Without the ERUs or other revenue from carbon offsetting/trading after 2012, BOS Bank will not be able to continue the programmes. In a workshop held by KfW and BOS Bank in Berlin on 10 March 2011, four scenarios were outlined for the two programmatic JI projects, all of which see a need for action from EU member states.

Scenario 1: No gap

- A new international agreement will be signed prior to 2013.
- This agreement enters into force directly after the expiration of the first commitment period under the Kyoto Protocol (KP)(AWG KP: "provisional application"), i.e. the second commitment period starts directly after the expiration of the first.
- JI will remain unchanged as part of the new agreement.
  - ⇨ The programmatic JI projects conducted by BOS Bank can be continued unchanged – there may be a need to issue new letters of approval at the beginning of 2013 (because of the new commitment period).

The future of JI in Europe and Article 24a EU ETS

The difficulties faced by the international negotiations in finding a regulation for the time after 2012 – the conclusion of the first commitment period of the Kyoto Protocol – have left the rules for the use of the flexible mechanisms in limbo. Even if the negotiations for a new treaty prove successful in the run up to 2012, the ratification process of such a treaty will probably not be concluded by the end of 2012, making a regulatory gap for CDM and JI very likely. Due to its stronger connection to emission targets and assigned amounts under the Kyoto Protocol, the uncertainties for JI seem slightly more worrying. The KfW Bankengruppe has recently published a report on the implications these uncertainties could have for the future of carbon offsetting and the use of JI in the European Union after 2012. In the following, the report is briefly summarized.

The unclear future of JI in the European Union

The EU legislation seeks to avoid these uncertainties by providing specific provisions for the use of the project-based mechanisms for the time after 2012. In addition, the newly amended EU Emissions Trading (ETS) Directive extending and renewing the system as well as the new framework to govern emissions from sources not covered by the EU ETS (the Effort Sharing Decision – ESD) have also introduced the option to establish a new EU-wide offsetting instrument (Article 24a of the EU ETS Directive). While there is no certainty yet on its implementation, such an instrument would be distinct from and independent of the Kyoto framework and therefore stay intact with or without the continuation of the Kyoto Protocol commitments periods. While these regulations aim at providing more planning reliability for the period after 2012, they also contain ambiguities of their own:

1. The use of post-2012 ERUs from existing or new projects outside Europe

Neither the EU ETS Directive nor the Effort Sharing Decision provide certainty on how JI projects and credits will be treated in the absence of a new international agreement. While both documents state that JI cannot continue after 2012 without an international agreement, both texts also seem to indicate that if ERUs were available for post-2012 emissions, they would be accepted in both EU schemes.

2. The future of intra-Member-State JI projects registered before 2013

Further uncertainty concerns the treatment of projects within the EU which were registered before 2013 and which are being implemented in installations now falling under the ESD. While there is a provision that regulates the hosting of JI projects in installations covered by the EU ETS, there is no such regulation for installations under the ESD. With no further amendments, this could lead to double counting as a Member State hosting a JI project in an installation affected by the ESD would issue ERUs without having his national quota in the ESD (the so called Assigned Emission Amount – AEUs) adjusted accordingly. Therefore, the reductions achieved by the project would be counted twice.

3. The future of European JI projects in the light of Article 24a projects

Independent from an international agreement allowing the continuation of JI after 2012, it is not clear whether the EU ETS would tolerate JI project activities hosted in EU Member States. This ambiguity is caused by the option contained in Article 24a to create a genuine EU-wide offsetting mechanism not linked to the Kyoto Protocol. It remains unclear if this instrument, if ever adopted, would replace or simply supplement JI.

The need for regulation

These uncertainties leave JI projects in limbo and call for specific regulations. Such regulations should answer the question how double counting in pre-2012-registered projects under the ESD could be avoided and provide clarity on the future relationship between JI projects and projects under the 24a instrument, in case this mechanism will ever be adopted.

You can download the report at:
http://www.kfw.de/kfw/de/KfW-Konzern/Klimaschutz/PDF/Carbon_Offsetting_in_Europe_Post_2012__04.04.2011.pdf

Scenario 2: ERU generation during true-up period of first KP commitment period

- A new international agreement will not be signed prior to 2013.
- However, the JISC proposal (see next bullet point) submitted in Cancun is finally approved by the KP Parties in Durban end of 2011. This approved proposal is not only applicable to Track 2, but also to Track 1. At the moment the proposal applies to Track 2 only; i.e. it would not be applicable to the BOS Bank projects.
- In line with the JISC proposal, ERUs could also be generated for emission reductions during the Kyoto Protocol's true-up period (until mid April 2015) provided Poland still has AAUs from the first commitment period for conversion into ERUs.
- During this true-up period a new international agreement will be signed which enters directly into force as in Scenario 1.
  - ⇨ Even in Scenario 2, the programmatic JI projects conducted by BOS Bank can be continued unchanged.

Thermomodernization of a school building as JPA
Photo: BOS Bank

Scenario 3: Green Investment Scheme (GIS) based on AAUs

- A new international agreement will not be signed prior to 2013 and the JISC proposal will not be approved by the KP Parties in Durban at the end of 2011.
- Poland would include the BOS Bank projects into its on-going GIS (proceeds from AAU sales are used primarily for the financing of energy efficiency measures in the building sector) by extending the present priority programmes which at present only cover energy efficiency in public buildings. The Polish GIS Act itself would not have to be changed.
- Poland would sell AAUs (e.g. to Japan or Japanese firms) in the amount of the estimated post-Kyoto ERUs under the two BOS Bank projects (prior to 2013 or during the true-up period of the first commitment period), and would use the revenue from the sale to fund the two BOS Bank programmes.
  - ⇨ The programmatic JI projects could in principle be continued, but perhaps in a more simplified way (e.g. verification in line with JI rules not necessary).

Scenario 4: AEA GIS

- A new international agreement will not be signed prior to 2013 and the JISC proposal will not be approved by the KP Parties in Durban at the end of 2011. Poland would not use an AAU GIS to support the BOS Bank projects.
- Starting from 2013, AAUs will be replaced by Annual Emission Allocations (AEA) within the EU, AEAs like AAUs can be traded between EU member states (see Article 3, para 4 of the Effort Sharing Decision).
- Poland could set up an AEA GIS and sell AEAs to other EU member states with an AEA deficit in the same way as in Scenario 3. The difference to Scenario 3 is timing and the constitution of the market (it could be that the AEA market is more liquid than the AAU market).
  - ⇨ Like in Scenario 3, the programmatic JI projects could be continued in principle, even in a more simplified way.

There are also possible combinations between Scenario 2 and Scenario 3 as well as between Scenario 2 and Scenario 4 in the event there is no international agreement during the true-up period of the first KP commitment period. In Scenario 3, a possible buyer of the AAUs should be identified and negotiations started by Poland as early as in the first half of 2012. Regarding Scenario 4, the same activities should be started as soon as the implementing legislation for the AEA market has been finalized and adopted by the EU.

As can be seen in the sample case, there are still options ('back door options') even if the international negotiation process fails. Nonetheless, the EU member states have an obligation to act.

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