PROJECT DEVELOPER FORUM

Project Developer Forum Ltd.
100 New Bridge Street
UK London EC4V 6JA

Europe: +44 20 7121 6100
Asia: +65 6578 9286
office@pd-forum.net
www.pd-forum.net

CHAIRPERSON:
Gareth Phillips
gareth.phillips@pd-forum.net

CO VICE CHAIRPERSONS:
Rachel Child
rachel.child@pd-forum.net
Sven Kolmetz
sven.kolmetz@pd-forum.net

To	European Commission
From	gareth.phillips@pd-forum.net
Date	28th February 2012
Page	1/6
Subject	**Consultation on the state of the EU ETS**

Dear European Commission,

Thank you for the opportunity to comment on the Report from the Commission to the European Parliament and the Council on The state of the European carbon market in 2012.

The PD Forum is strongly supportive of market-based mechanisms as the most cost effective and efficient means of reducing GHG emissions. Our members are involved in the development and implementation of GHG emission reduction projects, largely under the CDM, and we are also engaged in the development and financing of low carbon technologies such as renewable energy, distributed energy efficiency technologies and non-CO2 GHG abatement.

We believe that to be effective, the carbon price in the EU ETS must be high enough to trigger a switch to cleaner fuels and investment in new technology and today's price is not having this impact. As a result, although the mechanisms of the EU ETS are functioning, it is not having the desired impact on GHG emissions and hence is not effective as Europe's flagship climate change policy. We note that as of today, the prospects for the implementation of the backloading proposal are significantly improved and we consider that this is a vital first step for recovery of the EU ETS

Regarding the options for structural measures, we are supportive of a wide range of measures including Options a, b, c, d and f but we are not supportive of option e.

Options a b and c are all related to increased ambition. The PD Forum calls upon the EC to lead the way in increasing ambition. We are frustrated by the lack of ambition amongst Parties who negotiate from a short term perspective. We expect emission reduction policies to impact decision making processes for decades to come and as a consequence, short term political and commercial interests must be put aside to address the long term implications facing our planet. The European Union is one of the few Parties, if not the only Party, which can lead this process and if the EU fails to show leadership, no other Party will take the lead:

Option a: Increasing the EU reduction target to -30%
We urge the EU to move to -30% at the UNFCCC orchestrated ministerial roundtable in 2014. The EU is already close to -20% and studies have shown that the cost of moving to -30% are marginal. In exchange for a tougher target, the EU will develop more energy efficient industries and an energy efficient economy which will be more competitive in the long term. Low energy and low resource lifestyles are becoming increasingly essential as the world's population increases and resources become increasingly stretched. The EU can lead the way and create economic opportunities, whilst securing our own future at the same time.

Option b: Retiring a number of allowances in phase 3

As a first step, we urge the EC to retire the 900 million EUAs which we anticipate will be removed from the auction schedule under the backloading proposal. We would also urge the EC to consider limitations on the banking and carry-over of un-used allowances such that the carry-over from one phase to another cannot exceed individual entities' targets. Excess units should be retired. It may also be possible to limit carry-over of emission reduction units and we urge the EC to undertake further consultations and analyses in these areas.

Option c: Early revision of the annual linear reduction factor
We urge the EC to revise the annual linear reduction factor to ensure that Europe is on track to meet its long term target of 80 – 95% reduction in GHG emissions relative to 1990 by 2050. Failure to do so will result in the lock-in of inefficient technologies, making eventual achievement of the target more expensive. We would also like to highlight the environmental benefits of emission reductions sooner rather than later. Although there is no social time preference (i.e. interest rate) applied to emission reductions, the fact is that emission reductions today have a greater environmental benefit than emission reductions in the future. Relying on accelerated emission reductions in the future runs the risk of higher environmental impacts and places a greater burden on future generations to compensate for the failure of our actions today.

In addition to these options, we invite the Commission to undertake further investigations in a number of additional areas:

In order to solve the mismatch between emission reduction needs and allocations, we suggest three possible (non-exclusive) options:

a) the EC develops a transparent algorithm of dynamic allocation of EUAs in which the free allocations are calculated ex-post based on real production and not on historical averages and a benchmark. This would enable the system to adjust overall supply by reducing the allowances created in downturns and prevent the industry from loosing competitiveness in periods of growth. The transparent algorithm would allow industry to compute their allocations in the future and it would address the current unacceptable situation whereby protected industries make substantial windfall profits.
b) As suggested under option b above, we urge the Commission to consider limitations on banking and carry-over of allowances and emission reduction units.
c) Instead of a fixed linear reduction factor, the EC should consider a rolling allocation such that the number of allowances is fixed [five] years ahead whilst not exceeding the long term linear reduction target, providing industry with sufficient advance notice but also enabling adjustments to be made to take macro-economic circumstances into account.

We also urge greater engagement in international negotiations with trading partners to address the issue of competitiveness: If our trading partners would place emission limitations on the relevant sectors of their economies, then both Parties could move to auctioning of allowances in preference to free allocation. The PD Forum proposes that to facilitate this process, current Annex 1 emissions are decoupled from historic emissions allowing all Parties to negotiate targets on the basis of current technologies and current economic activities, whilst Annex 1 Parties take on additional long term obligations to acquire and cancel UN recognised allowances and emission reduction units in recognition of Annex 1 Parties' historic emissions.

Option d and f offer significant opportunities for expansion of the scope of the EU ETS and we support both of these proposals, subject to further elaboration:

Option d: Extension of the scope of the EU ETS to other sectors.
Our experience in the development and implementation of a wide range of emission reduction projects (many of which use similar technologies to projects implemented within EU ETS participants) is that fossil fuel consumption in large point sources or aggregated sources (e.g. fleets of vehicles) are well suited to the principles of emissions trading whilst dispersed or small

sources are harder and less efficient to monitor. Non-CO2 GHGs can be accurately monitored however the potential disparity that can be introduced via the combination of global warming potentials and highly efficient abatement means that any free allocation must be very carefully handled and a high proportion of purchasing of allowances would be favoured. That said, the risks of adverse impacts through, for example, accidents or failure of monitoring systems are much greater and it may be better to address non-CO_2 GHG emissions through existing pollution prevention legislation.
We support the extension of ETS to aviation and shipping without a further increase in the number of allowances to be issued but we do not necessarily support the extension of ETS to non-CO_2 GHG sources without further impact studies.

Option f: Discretionary price management mechanism
PD Forum is supportive of the creation of a discretionary price management mechanism which creates a fund to purchase allowances and emission reductions under a defined policy. Such a fund would then either cancel some or all of the allowances (in which case it would simply act to increase the price and enhance the environmental integrity of the EU ETS) and / or hold them to sell back into the market at times of shortage (in which case it would act as a stabilization mechanism). Such a volume regulation mechanism could work as a central bank for carbon and would facilitate the management of supply to suit the economic cycle whilst also tackling the EU's Energy / Climate Change policy overlap.

PD Forum notes that the Parties already created flexibility mechanisms for the supply of additional units in the form of the CDM and Joint Implementation (as well as international emissions trading) but neglected to create a mechanism to address over-supply. This oversight has been replicated in the design of the EU ETS, hence the current challenges facing the EU ETS.

We would also like to highlight the fact that using the CDM as the additional supply mechanism (as opposed to selling excess allowances back into the market) has a number of other advantages, including the promotion of sustainable development in developing countries, and helping developing countries to build capacity to evolve into low carbon economies in the future. Whilst the CDM has been criticised as a means of subsidizing European competitors, opportunities exist to revise and reshape the CDM (see more details on this point below).

We urge the Commission further explore the benefits of creating a price management mechanism.

Option e: limit access to international credits
The PD Forum does NOT support any further limits on access to international credits and, in conjunction with measures to increase demand for credits (i.e. options a, b and c), we support a relaxation of the existing limits on the import of CERs (which restricts imports from projects registered after 2012 to those hosted in Least Developed Countries) on the basis that these countries are not sources of significant amounts of emissions and hence their scope to create emission reductions is limited. In the opinion of our members, different sustainable development mechanisms would be more effective in these countries compared to the CDM[1]. In times when the demand for additional emission reductions increases and prices rise, LDC based CDM projects may struggle to meet the demand for CERs resulting in the failure of the CDM to fulfil its role as a flexibility mechanism.

Furthermore, access of international credits to the EU ETS and other ETS has played an essential role in the establishment of a credible CO_2 price signal in developing countries and has helped to build the capacity to support the development of new emission trading schemes in countries such

[1] For example, the CDM additionality test makes certain assumptions about the functioning of capital markets which are not necessarily justified in least developed economies

as China, Korea, Kazakhstan, Chile and Mexico. Introducing arbitrary import limits for international credits creates artificial barriers and unexpected arbitrage opportunities whilst making future linkage between ETS more and more complicated. Rather than implementing unilateral access limits, the PD Forum believes that the EC should use the existing and currently on-going review of the CDM Modalities and Procedures to turn the CDM into an instrument which delivers high quality emission reductions which all Parties can use for offsetting purposes without the need for further unilateral qualitative restrictions. The PD Forum has a number of proposals for the current review which we believe can deliver on such an objective.

The importance of the CDM

A source of additional emission reductions is an essential component of a capped regime because in times of shortage of allowances, prices would spike or more likely, there would be significant non-compliance with caps. Potentially saddling the EU economy with an absolute and immovable cap is NOT a good competitive strategy. The CDM and JI provide a safety valve to the EU ETS, potentially supplying additional emission reduction units at times when the cap is too small. At the same time, the CDM has been an enormously successful mechanism, triggering investment into new technology in developing countries, bringing wide ranging benefits. Since its inception, the CDM has lead to more than USD215bn of such investment (CDM Policy Dialogue, http://www.cdmpolicydialogue.org/report/rpt110912.pdf).

Mitigation in fast growing developing countries today is paramount to avoid their technological lock-in and to redirect their economic growth towards a more sustainable trajectory. It is well known that GHG abatement potential in Europe and the OECD as a whole is insufficient to limit global climate change to 2°C and therefore supporting developing countries in avoiding the build up of GHG intensive infrastructure is a key priority for the international community. The question is why should EU industry be burdened with this responsibility? The answer is at least five-fold:

a) For too long we have been polluting the environment for free and the negative impacts are going to affect all of us; Europeans now pay for waste disposal services whilst 20 years ago this was considered to be a free good. Disposal of our GHG emissions is just the same except the impacts are longer term, global and less visible;
b) Consumers should ultimately pay for the pollution caused by the products and services they buy and industry rather than Government is best placed to recover those costs – alternatively, Governments can take tougher caps and provide greater bilateral development assistance, and or purchase Certified Emission Reductions and Emission Reduction Units as envisioned under the Kyoto Protocol whilst taxing their subjects to pay for it;
c) Industry, not Government, possesses the technology and ability to invest in emission reduction projects in other countries, so EU ETS entities do not need to buy CERs – they can also create them by investing in their own projects and benefit host countries through technology transfer in the process;
d) Giving EU ETS entities the choice between buying allowances at auction and generating or buying emission reductions from project based activities provides flexibility and efficiency in emission trading markets; it specifically enables entities to hedge their future risks;
e) Including project-based emission reductions in the EU ETS provides the most efficient means of promoting linkage between developing ETS and the EU ETS.

Therefore, it is vital that any structural reforms enacted send a signal to the market that the EU continues to take seriously its leading international role in project based emission reductions.

We acknowledge that the CDM is seen by some as a means of supporting competition rather than promoting sustainable development and we have a number of proposals designed to both safeguard the future of the mechanism and reduce its impact upon competitiveness. These are detailed here http://www.pd-forum.net/files/95ad91353ea4b144240534afb46a5ffb.pdf and will be further refined and submitted to the Subsidiary Body for Implementation by 25th March 2013.

We also wish to express our concern about the mis-match between the supply of CERs and ERUs and the demand, both now and in the future. There are formal and informal proposals circulating in both UNFCCC and EU ETS circles aimed at addressing the current supply of additional emission reductions through individually, or a combination of:

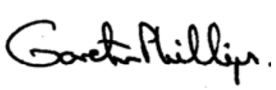
a) technology and/or geography specific limitation of the crediting period for registered project activities;
b) discounting of emission reductions on the basis of geographic and / or technological origin; and/or
c) raising the benchmark or crediting baselines for certain technologies.

Each of these approaches has advantages and disadvantages but in principle they have the potential to address the surplus of supply, reduce the impact of the CDM on competitiveness, contribute to host country mitigation and encourage an improvement in price of emission reductions in the medium term. We believe that each of these options should be investigated further by the European Commission, in conjunction with the existing review of the CDM Modalities and Procedures and on-going Guidance to the CDM Executive Board and Joint Implementation Supervisory Committee, to ensure that CDM and JI remain useful and valuable components in the EU ETS and other developing emission trading schemes in the future.

In addition to these, the PD Forum has proposed the creation of a Host Country Mitigation Share of Proceeds (SOP), detailed in the link above. Briefly, this instrument would give Host Countries the authority to specify the proportion of CERs from each issuance to be transparently transferred into their mitigation account and surrendered against targets or pledges. Host Countries, through their DNAs, would set the SOP at varying levels in order to encourage CDM driven investment into specific technologies and regions and also limit the crediting period consistent with their own policies and measures. So for example, an advanced developing country might call for a 30% SOP on technology A in Region X for a 7 year crediting period with the facility being integrated into an ETS or other policy thereafter, whilst a least developed country may call for a 2% SOP on the same technology implemented anywhere in the country, with a 21 year crediting period. This approach is flexible and devolves important aspects of the CDM to host countries whilst retaining the centralized control functions.

The PD Forum would be pleased to engage further in these discussions and consultations, particularly around the use of CERs within the EU ETS.

Yours faithfully,



Gareth Phillips
Chairman, Project Developer Forum
www.pd-forum.net

PD Forum members have created and sustain **thousands of European jobs** in a new industry embracing environment, technology, finance, trading, audit and verification. We are companies which initiate low carbon and clean technology projects around the world and **21 of our 50 members are European companies**.

AES Climate Solutions, Agrinergy, Arauco Biomass, Blue World Carbon and Climate Change Global Services, Camco, Carbon Resource Management,Climate Bridge Ltd, Climate Change Capital, Climate

Corporation Emissions Trading GmbH, CVDT Consulting, EcoSecurities , Electrabel S.A./N.V. (GDF Suez), Emergent Ventures India, Enecore Carbon, Energy Changes Projektentwicklung GmbH, Energy Systems International, EQAO, FirstClimate, Gazprom Marketing & Trading Ltd, Green Gas International, GreenStream Network Plc, MGM International, Mitsubishi Corporation, N.serve Environmental services, Orbeo, Sindicatum Sustainable Resources, South Pole Carbon Asset Management, Tricorona, UPM Umwelt-Projekt-Management GmbH, Atmosfair GmbH, CarbonSoft Corporation Ltd, Center for Environment and Economy, C-Quest Capital, Do-inc Business B.V., FS Carbon Consulting, Green Resources Limited, Inspiring Sustainability, Mabanaft Carbon B.V., Managing Emissions, Mavi Consultants, Mehr Renewable Energies Co. Ltd., Millenium Development Goals Carbon Facility , Nexus, Carbon for Development, Promethium Carbon (Pty) Ltd, Dr. Ralph Westermann, R&J International Ltd, Rough Climate, The Paradigm Project, Uganda Carbon Bureau.