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Subject:	Proposal for a Directive of the European Parliament and of the Council amending the Directive establishing a scheme for greenhouse gas emission allowance trading within the Community, in respect of the Kyoto Protocol's project mechanisms

I. INTRODUCTION

The Commission submitted its proposal to the Council on 29 July 2003. The proposal is based on Article 175(1) of the Treaty.

The objective of the draft Directive is to link the project-based mechanisms of the Kyoto Protocol, Joint Implementation (JI) and the Clean Development Mechanism (CDM), to the European Union emissions trading scheme (EU ETS) *, thereby enabling emission credits from the Kyoto mechanisms to be used by companies for compliance in the EU ETS.

The European Parliament is expected to deliver its opinion in first reading in April 2004.

The Working Party on the Environment examined the proposal at a number of meetings under the Italian Presidency. On 22 December 2003 the Council (Environment) held a policy debate on some of the main outstanding issues.

In order to facilitate further progress during the Irish Presidency, the Italian Presidency has prepared a consolidated text (in Annex), following the work done in the Working Party and the policy debate. The discussion is summarised in sections II and III of this note.

II. MAIN OUTSTANDING ISSUES

All delegations maintain a general scrutiny reservation. F/UK/DK maintain a Parliamentary scrutiny reservation.

The key outstanding issues described below relate to timing, supplementarity (setting of a quantitative limit to credit conversion), eligibility of credits and project activities (double counting, criteria for approval and national project activities). While this list is not exhaustive, it is likely that future work will continue to focus on these points, taking account of the ongoing discussions within the European Parliament, particularly in view of a possible first reading agreement on this proposal.

* Directive 2003/87/EC of the European Parliament and of the Council establishing a scheme for greenhouse gas emission allowance trading within the Community of 13 October 2003 and amending Council Directive 96/61/EC, OJ L 275, p. 32.

1. *Timing of the conversion of credits*

Article 11(bis), paragraphs 1 and 1bis

F/DK/NL/P/L request the deletion of the reference to the entry into force of the Kyoto Protocol.

E/F/P/IRL ask that conversion should not be limited to operators.

Most delegations (D/DK/E/UK/F/NL/S/P/L/I) have expressed that they wish to convert or could agree in principle (A/FIN/EL) to conversion of certified emission reductions (CERs) into allowances under the EU ETS already during the first trading period (2005-2007). B and Cion maintain their reservation on the early recognition of CERs.

Some delegations (S/A/D/EL/FIN) further emphasise that such conversion should happen only after the entry into force of the Kyoto Protocol.

2. *Supplementarity – setting a quantitative limit to credit conversion*

Article 11(bis), paragraph 2

According to the Marrakech Accords, the use of the market-based mechanisms shall be supplemental to domestic actions.

All delegations and the Commission have underlined the need to respect the supplementarity principle as established by the Marrakech Accords.

However, many delegations (DK/P/I/E/F/EL) are opposed to the setting of a maximum limit to conversion during the relevant period at Community level and would prefer to leave the responsibility for ensuring supplementarity to each Member State.

D/S/FIN/NL are in favour of monitoring/review by the Commission to ensure that complementarity is observed. NL could agree to the review to take place when conversion of credits reaches 6% .

D considers that JI projects in the enlarged community should be considered to be domestic action.

UK would prefer to fix a limit on retirement of CERs/ERUs at installation level, with flexibility as to whether such a limit would be fixed at EU or Member State level.

A/S/B are open to consider this proposal.

The Presidency text does not foresee a quantitative limit at Community level and gives to each Member State the responsibility to comply with the complementarity principle by establishing a limit on conversion of CERs and ERUs. A new recital is proposed to this end.

Cion has a reservation on the Presidency proposal.

3. *Eligibility of credits*

Land use, land use change and forestry (LULUCF): Article 11(bis) paragraph 3

Many delegations (I/UK/F/NL/E/L/P) consider that the EU ETS should not have more stringent provisions than those laid down in the Marrakesh Accords. DK/S have also reservations about additional restrictions. S would exclude credits from LULUCF projects making use of GMOs and invasive alien species.

Some delegations (D/A/FIN/B/Cion) consider that there is need to further examine the implications of decisions adopted at COP 9 and prefer to consider the possible inclusion of CDM credits from LULUCF at a later stage.

The Presidency text foresees that conversion of CERs from LULUCF projects would be allowed subject to relevant definitions and modalities agreed by the UNFCCC Conference of the Parties.

4. *Project activities*

a) *Double counting*

Article 11(ter) paragraphs 2 and 3

All delegations agree that the double counting of emissions and credits earned from emission reductions must be avoided. They consider that this should be ensured in a way that does not create a disincentive for renewable energy or energy efficiency/savings projects that indirectly reduce or limit emissions from installations covered by the EU ETS.

The Presidency compromise foresees (new paragraphs 2 and 3 in Article 11(ter)) that:

- hosting countries cannot allocate allowances in respect of emission reductions resulting from JI projects (rather than excluding JI projects that would result in emission reductions in sectors covered by the EU ETS as foreseen by the original proposal),
- when the host country issues JI credits for renewable energy or demand-side energy efficiency projects a corresponding amount of allowances is cancelled in a special reserve in the country's National Allocation Plan.

Some delegations find this proposal constructive. F/UK/FIN/Cion maintain a reservation. Other delegations maintain a scrutiny reservation. B has proposed an alternative text, supported by A.

In general, it is considered that this complex question must be examined further to avoid any risk of double counting and the possible reduction in the effectiveness of the EU ETS it could entail.

- b) *Criteria for participation and approval of project activities*
Article 11(ter) paragraphs 4 and 6; Article 30 paragraph 2(l)

Regarding large hydroelectric power projects, D has suggested text ensuring that the criteria and principles of the World Commission on Dams are met in the preparation and implementation of projects. S/NL/B support this idea. E/F/A/P/FIN/EL are against.

Several delegations (E/EL/F/P/A) do not agree with the specific mention of large hydroelectric power projects in the review clause under Article 30 (2) (l).

As concerns the administrative procedures for the approval of projects (Article 11(ter) paragraphs 4-6), several delegations (E/DK/F/IRL/NL/P/UK/EL) consider that these overlap with UNFCCC procedures and might constitute an additional and unnecessary burden.

UK and F have proposed alternative wording.

- c) *National Project Activities*
Article 11(ter)

Some delegations (D/F/UK/E/P) would like to permit the issue of allowances within the EU ETS for emission reductions resulting from national projects, and concrete suggestions have recently been presented to this end. DK/B/A/Cion are against.

III. OTHER ISSUES

1. *Strategic Environmental Assessment (Article 17 bis)*

S/FIN/UK/E/A do not see the added value of the article.

2. *ODA (Article 21 bis)*

D has proposed a new paragraph on the use of ODA in CDM projects to cover specific country risks of a CDM project and therefore facilitate private engagement in the CDM in high risk countries.

DK maintains a reservation on the proposed text. E/F/FIN maintain a reservation given ongoing OECD negotiations.

3. *EMAS verifiers (Annex V, new point 13)*

E/EL/F/FIN/P/S/UK question why preference is given to EMAS verifiers. A supports the proposal.

4. *Implementation deadline (Article 2)*

A/B/E/EL/P/FIN/S/UK consider the timetable too strict.

Proposal for a
DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL
amending the Directive establishing a scheme for greenhouse gas emission allowance trading
within the Community, in respect of the Kyoto Protocol's project mechanisms

PREAMBLE: pm

Article 1
Amendments to Directive 2003/.../EC

Directive 2003/.../EC is hereby amended as follows:

1. In Article 3, the following points are added:
 - (k) "Annex I Party" means a Party listed in Annex I to the UNFCCC that has ratified the Kyoto Protocol as specified in Article 1(7) of the Kyoto Protocol;
 - (l) "project activity" means a project activity approved by one or more Annex I Parties in accordance with Article 6 or Article 12 of the Kyoto Protocol and the decisions adopted thereunder;
 - (m) "emission reduction unit" (ERU) means a unit issued pursuant to Article 6 of the Kyoto Protocol and the decisions adopted thereunder;
 - (n) "certified emission reduction" (CER) means a unit issued pursuant to Article 12 of the Kyoto Protocol and the decisions adopted thereunder.

2. The following Articles are inserted after Article 11:

"Article 11(bis)

Conversion of CERs and ERUs from project activities for use in the Community scheme

1. Following the entry into force of the Kyoto Protocol and subject to paragraphs 2 and 3 of this Article, Member States may convert CERs and ERUs from project activities into allowances for use in the Community scheme during each period referred to in Article 11(2) of this Directive, at the request of an operator. This shall take place through the issue of one allowance by the Member State in exchange for one CER or ERU held by that operator in its national registry.

- 1.bis During the period referred to in Article 11(1) of this Directive, Member States may convert CERs from project activities into allowances for use in the Community scheme at the request of an operator. This shall take place through the issue of one allowance by the Member State in exchange for one CER held by that operator in the CDM registry established by the Executive Board under decision 17/CP.7. Member States shall cancel CERs that have been exchanged for allowances valid for emissions during the period referred to in Article 11(1) of this Directive.

2. [...] *

3. All CERs and ERUs may be converted for use in the Community scheme except from nuclear facilities in accordance with the Kyoto Protocol and subsequent decisions adopted thereunder.

* Presidency proposal to add a new recital “Whereas the use of the mechanism should be supplemental to domestic action and domestic action will thus constitute a significant element of the effort made, each Member State will decide on the limit for conversion of CERs and ERUs:”.

In the case of land use, land-use change and forestry project activities, CERs may be converted subject to relevant definitions and modalities adopted by the Conference of the Parties to the UNFCCC.

Article 11(ter)

Project activities

1. Member States shall take all necessary measures to ensure that baselines for project activities, as defined by subsequent decisions adopted under the Kyoto Protocol, undertaken in countries having signed a Treaty of Accession with the Union fully comply with the *acquis communautaire*, including the temporary derogations set out in the Treaty of Accession.
2. For JI emission reductions from project activities which fall under the scope of this Directive, ERUs may be issued if an equal number of allowances is cancelled from corresponding operators accounts in the registry.
3. For emission reductions resulting from project activities undertaken in installations generating power from renewable sources or project activities aimed at demand-side energy efficiency measures, ERUs may be issued if the hosting Member State has foreseen compensation for such ERUs in the national allocation plan for the respective period through the cancellation of an equal number of allowances.
4. Member States shall take all necessary measures to ensure that the preparation and implementation of project activities in which they participate or authorise private or public entities to participate that are undertaken outside the territory of the Community take into account the environmental and social impacts of those projects. They shall also ensure that these projects are developed and implemented in such a manner to contribute to sustainable development, and to the specific development needs and objectives of the host countries.

5. In considering approval of project activities in accordance with Articles 6 and 12 of the Kyoto Protocol and decisions adopted thereunder, Member States shall ensure that project activities result in:
 - (a) real, measurable and long term benefits related to the mitigation of climate change;
 - (b) reductions in emissions that are additional to any that would occur in the absence of the proposed project activity; and
 - (c) the transfer of environmentally safe and sound technology and know-how.
6. Provisions for the implementation of paragraphs 1 to 5 shall be adopted in accordance with Article 23(2)."

3. In Article 17 the following paragraph is added:

"Information on project activities in which a Member State participates or authorises private or public entities to participate, held by the competent authority, shall be made available to the public by that authority subject to the restrictions laid down in Article 3(3), Article 4 and Article 5 of Directive 2003/4/EC."

4. The following article is inserted after Article 17:

"Article 17(bis)

Assessment of national JI and CDM implementation plans or programmes

Member States shall assess the environmental effects that may result from their national plans or programmes for the implementation of projects and consult the public prior to their adoption, taking into account Directive 2001/42/EC * of the European Parliament and of the Council and Directive 2003/4/EC, as appropriate."

* Directive 2001/42/EC of 27 June 2001 on the assessment of the effects of certain plans and programmes on the environment.

5. In Article 18 the following paragraph is added:

"Member States shall in particular ensure coordination between their designated focal point for approving projects pursuant to Article 6, paragraph 1(a) of the Kyoto Protocol and their designated national authority for the implementation of Article 12 of the Kyoto Protocol respectively designated in accordance with subsequent decisions adopted under the Kyoto Protocol."

6. In paragraph 3 of Article 19 the following sentence is added:

"That Regulation shall also include provisions concerning the conversion of CERs and ERUs for use in the Community scheme and on monitoring of the level of such conversion."

7. Article 21 is amended as follows:

(a) In paragraph 1 the second sentence is replaced by the following:

"This report shall pay particular attention to the arrangements for the allocation of allowances, the conversion of ERUs and CERs for use in the Community scheme, the operation of registries, the application of the monitoring and reporting guidelines, verification and issues relating to compliance with the Directive and on the fiscal treatment of allowances, if any."

(b) Paragraph 3 is replaced by the following:

"3. The Commission shall organise an exchange of information between the competent authorities of the Member States concerning developments relating to issues of allocation, the conversion of ERUs and CERs for use in the Community scheme, the operation of registries, monitoring, reporting, verification and compliance."

8. The following article is inserted after Article 21:

"Article 21(bis)

In accordance with the UNFCCC, the Kyoto Protocol and any subsequent decision adopted for their implementation, the Commission and the Member States shall endeavour to support capacity building activities in developing countries and countries with economies in transition in order to help them take full advantage of JI and the CDM in a supportive manner with their sustainable development strategies and to facilitate the engagement of entities in JI and CDM project development and implementation."

9. Article 30 is amended as follows:

- (a) in paragraph 2 the following point is added

"(l) the impact of project mechanisms on host countries, particularly on their development objectives, including whether JI and CDM large hydro-electric power production projects have been established which have negative environmental and social impacts;"

- (b) paragraph 3 is deleted.

10. In Annex V the following point is added:

"(13) Verifiers accredited in accordance with the procedure and criteria laid down in Regulation (EC) No 761/2001 of the European Parliament and of the Council allowing voluntary participation by organisations in a Community Eco-Management and Audit Scheme (EMAS) which have the necessary expertise and experience in greenhouse gas mitigation activities can be verifiers for project activities eligible under Joint Implementation undertaken within the Community."

Article 2
Implementation

1. Member States shall bring into force the laws, regulations and administrative provisions necessary to comply with this Directive by 30 September 2004 at the latest. They shall forthwith inform the Commission thereof.

When Member States adopt these measures, they shall contain a reference to this Directive or be accompanied by such a reference on the occasion of their official publication. The methods of making such reference shall be laid down by the Member States.

2. Member States shall communicate to the Commission the text of the provision of national law, which they adopt in the field covered by this Directive. The Commission shall inform the other Member States thereof.

Article 3

This Directive shall enter into force on the day of its publication in the *Official Journal of the European Union*.

Article 4
Addressees

This Directive is addressed to the Member States.

Done at Brussels,

For the European Parliament
The President

For the Council
The President

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