



Ministry for the
Environment
Manatū Mō Te Taiao

BAKER & MCKENZIE

A large, light blue stylized globe graphic on the left side of the slide, composed of a grid of squares and curved lines.

Participating in Carbon Markets Workshop
Auckland, 19 November 2007

Carbon markets & the CDM: a legal perspective

Martijn Wilder,
Head of Global Climate Change Practice Baker and McKenzie, Sydney

Baker & McKenzie International is a Swiss Verein with member law firms around the world. In accordance with the common terminology used in professional service organizations, reference to a “partner” means a person who is a partner, or equivalent, in such a law firm. Similarly, reference to an “office” means an office of any such law firm.



From legal frameworks to carbon markets



Introduction

- The global carbon markets are built upon legal and regulatory frameworks
- The shape of these frameworks will decide:
 - Who is liable to reduce greenhouse emissions
 - Who has permits and how they can be traded
 - The ability to create and trade offsets
 - How large and liquid the market will be
 - Linkage to other markets
- At present significant gap between agreed scientific targets and current legal targets so will require substantial increase in law and policy to further reduce emissions over time.



Key legal frameworks

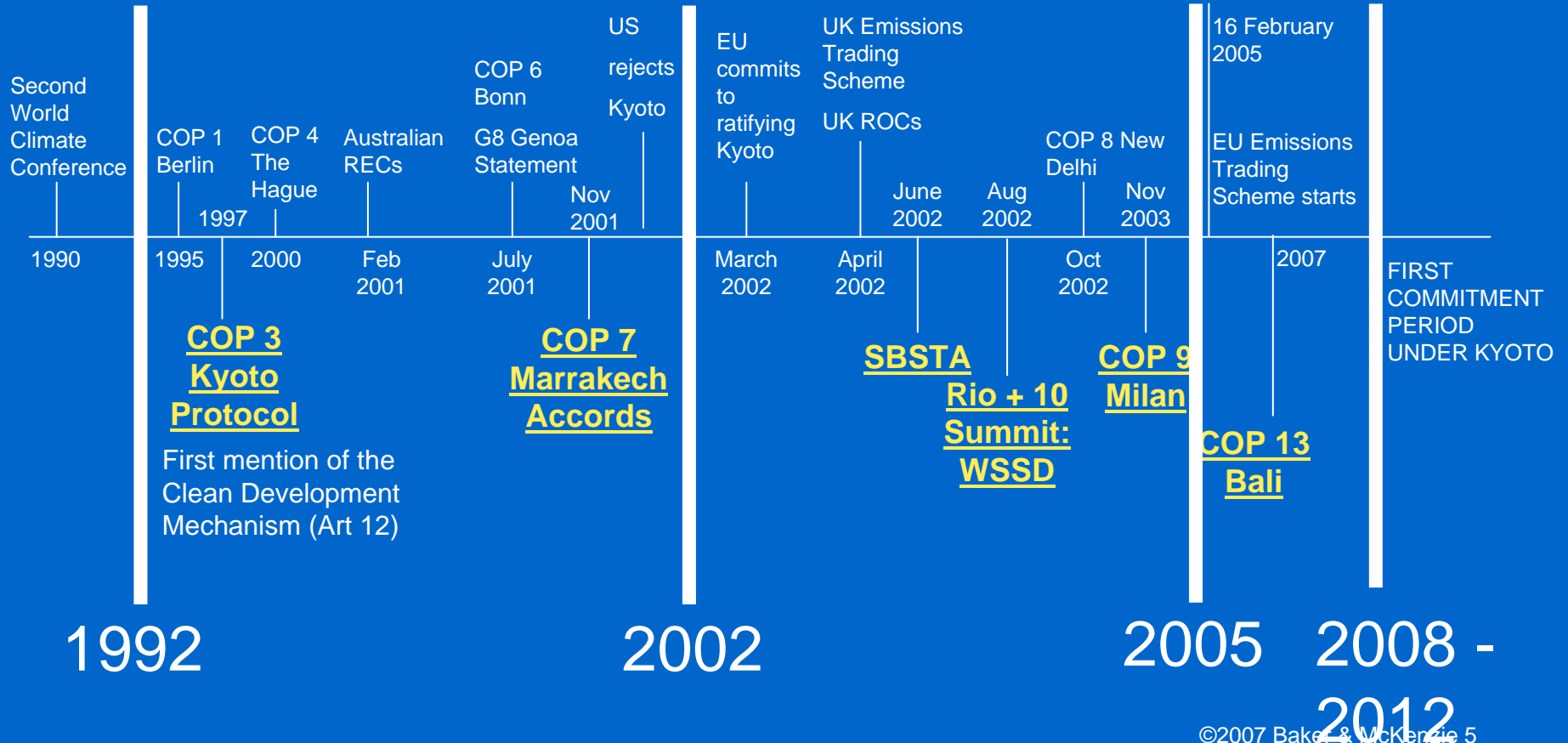
- The United Nations Framework Agreement on Climate Change (UNFCCC)
- The Kyoto Protocol
 - Cap and Trade market with international project based credits
 - No end date
- European Union Emissions Trading System
 - implements Kyoto and is cap and trade market with international project based credits
 - No end date
- Other compliance legal frameworks in UK, NSW and coming in US NZ and Australia.
- Voluntary markets such as formal markets like the Chicago Climate exchange.



International Climate Change Negotiations

Rio Earth Summit UNFCCC

Kyoto Protocol enters into force





A short history...

- **1988** – United Nations General Assembly passes resolution “Protection of the global climate for present and future generations of mankind”
 - Sought report on science, possible mitigation measures and recommendations on a possible future international convention on climate
- **1990** – First IPCC Assessment Report
 - The IPCC’s 4th Assessment Report will be published this year
- **1992** – UN Conference on Environment and Development - The Rio Conventions
 - United Nations Framework Convention on Climate Change (UNFCCC)
 - Article 4(2)(a): Developed countries (Annex I) to adopt national policies to limit anthropogenic emissions of greenhouse gases and enhance greenhouse gas sinks and reservoirs. Developed countries to take the lead.
 - Share information, develop national policies and cooperate to adapt



A short history...

- **21 March 1994** –
 - UNFCCC entered into force
- **February 1995** – First Conference of the Parties (COP 1)
 - The Berlin Mandate established a process to get tangible commitments from Annex I parties
 - A COP has been held every year since 1995 – this year is COP 13
- **11 December 1997** – COP 3 – Kyoto Protocol adopted
 - Individual targets established for developed countries
 - Continued notion of “common but differentiated responsibility”
 - Established “flexibility mechanisms”



A short history...

- **November 2001** - COP 7 – The Marrakesh Accords
 - Modalities and Procedures for the Clean Development Mechanism
 - Guidelines for implementation of Joint Implementation
 - Modalities, rules and guidelines for emissions trading
 - Affirmed that domestic policies to ensure direct reductions are priority to these flexibility mechanisms
- **1 January 2005** - world's largest mandatory carbon trading scheme commences, the European Union Emissions Trading Scheme (EU ETS)
- **16 February 2005** – Kyoto Protocol entered into force



A short history...

- **November 2005** – COP 11 / Meeting of the Parties 1 (MOP 1)
 - Marrakesh Accords adopted as rules of the Kyoto Protocol
 - Procedures and mechanisms relating to compliance established
- **January 2006** – Asia-Pacific Partnership on Clean Development and Climate meets for the first time
 - Australia, China, India, Japan, Republic of Korea and the United States
 - Focus on technology as a solution to climate change
- **1 January 2008** – First commitment period of the Kyoto Protocol commences



Overview of the Kyoto Protocol

- Binding GHG reduction targets for 37 developed countries – participation of almost all countries
- Establishes international emissions trading
 - Trading between Kyoto parties to meet targets
 - Opportunities to create carbon credits in developing countries (Clean Development Mechanism) and economies in transition (Joint Implementation)
- Main documents:
 - UNFCCC/Kyoto Protocol
 - Marrakech Accords
 - Subsequent decisions of the Conference of Parties/Meeting of Parties
 - Executive Board “guidance”
 - UNFCCC Secretariat emails!



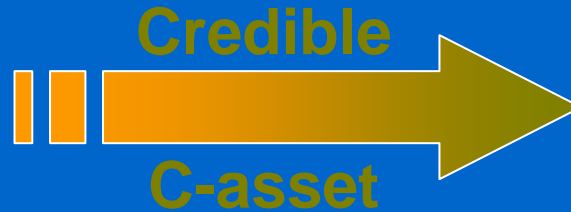
EU Emissions Trading Scheme

- 12,000 Installation in 28 EU Member States
- Linking to Kyoto Protocol market (“Linking Directive”) – but nuclear and forestry excluded and “large scale hydro” limitations
- EU Allowances granted under “National Allocation Plans” = around 20 Euro (for 2008-2012)
- Reconciliation of EU Allowances required every year (April)
- Substantial penalties for non-compliance (Penalties – 40 Euro/100 Euro)
- From 2008, each EU Allowance will be “stapled” to an EU Member State’s Assigned Amount Unit
- Variation from CERs: not “bankable” and allowance to emit (versus CER offset)

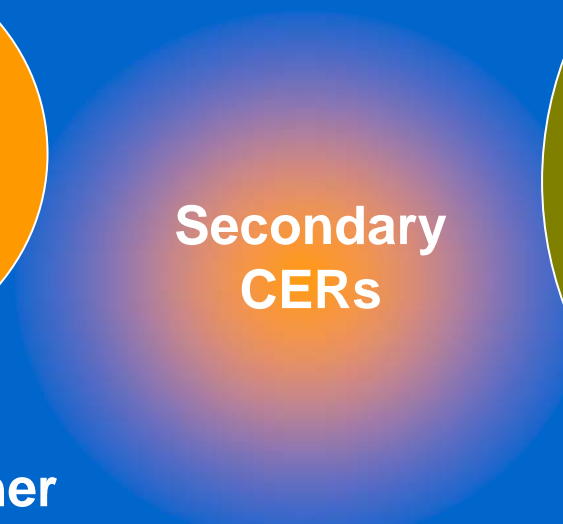


Structure of the Market

Project-Based Transactions



Allowance Markets



Voluntary & Retail
10 MtCO₂e

Other Compliance
17 MtCO₂e

New South Wales Certificates
20 MtCO₂e

Chicago Climate Exchange
10 MtCO₂e

UK ETS
2 MtCO₂e





The Clean Development Mechanism



Introduction

- The proposed NZ ETS
 - Framework document released September 2007
 - Cap-and-trade scheme covering all sectors
 - International linkage with inclusion of Certified Emission Reductions (CERs) under the CDM for compliance, but not from nuclear or forestry projects (and possibly not HFC-23)
- NZ entities can acquire CERs through:
 - The direct participation in the development of or purchase from CDM projects
 - Investment in carbon funds
 - From market players, trading platforms, brokers, auctions
 - Secondary trades OTC Spot and Forward trades

What is the CDM?

- A mechanism to create cost efficient offset project based credits.
- Under Article 12 of the Kyoto Protocol (“the Protocol”), the CDM is defined as having the purpose of:
 - Assisting Parties not included in Annex I (essentially developing countries) in achieving sustainable development and in contributing to the ultimate objective of the Convention, and
 - Assisting Parties included in Annex I (industrialised countries) in achieving compliance with their quantified emission limitation and reduction commitments.
- Annex I entities can purchase credits from emission reduction projects in non-Annex I Parties (developing countries) which are eligible to host emission reduction projects
- The credits – Certified Emission Reductions or CERs – are then able to be used by the Annex I entity to meet a Kyoto target or compliance under a domestic emissions trading scheme
- Domestic law overlay



CDM Project Examples

Carbon offset
projects in non-Annex 1
countries :

- renewable energy
- landfill
- fuel switching
- modification of production process e.g. HFCs, N₂O, flaring etc
- Agricultural (e.g. methane reduction)
- fuel/energy efficiency
- Afforestation/Reforestation



Seller

- Chinese Plant



Buyer

- (Private Fund, World Bank)
- Resell through IM process
- World Bank raised U\$1.2 billion in 23 mins



CER re-purchase on EU market

- compliance buyers
- traders

CERs

(ERPA/ SERPA)



- Revenue to plant
- Potential technology funding unless paid for upfront or netted off
 - 65% tax to NDRC



Euro payments



Restrictions on CDM Project Types

- Annex I Parties to refrain from use of CERs generated from nuclear projects
- Permanence requirements on Forestry Projects
 - tCERs and ICERs which must be verified every 5 years and ultimately replaced by a permanent credit
- EUETS: No dams over 20MW unless they comply with the guidelines of the World Commission on Dams. Further guidance has been requested on this by EU states since countries have interpreted this differently
- HFC23?



CDM project eligibility criteria

- Must be undertaken in a non-Annex I country (i.e. a developing country) that is a Party to the Kyoto Protocol;
- The participation of all participants must be voluntary and approved by the party authorising their participation (the Host Country or any Annex I Party involved in the project);
- The project activity must contribute to the goal of national "sustainable development" for the Host Country;
- The project activity must result in "real, measurable and long-term benefits" related to the mitigation of climate change; and
- The emission reductions must be "additional" to any emission reductions that would have occurred in the absence of the certified project activity.

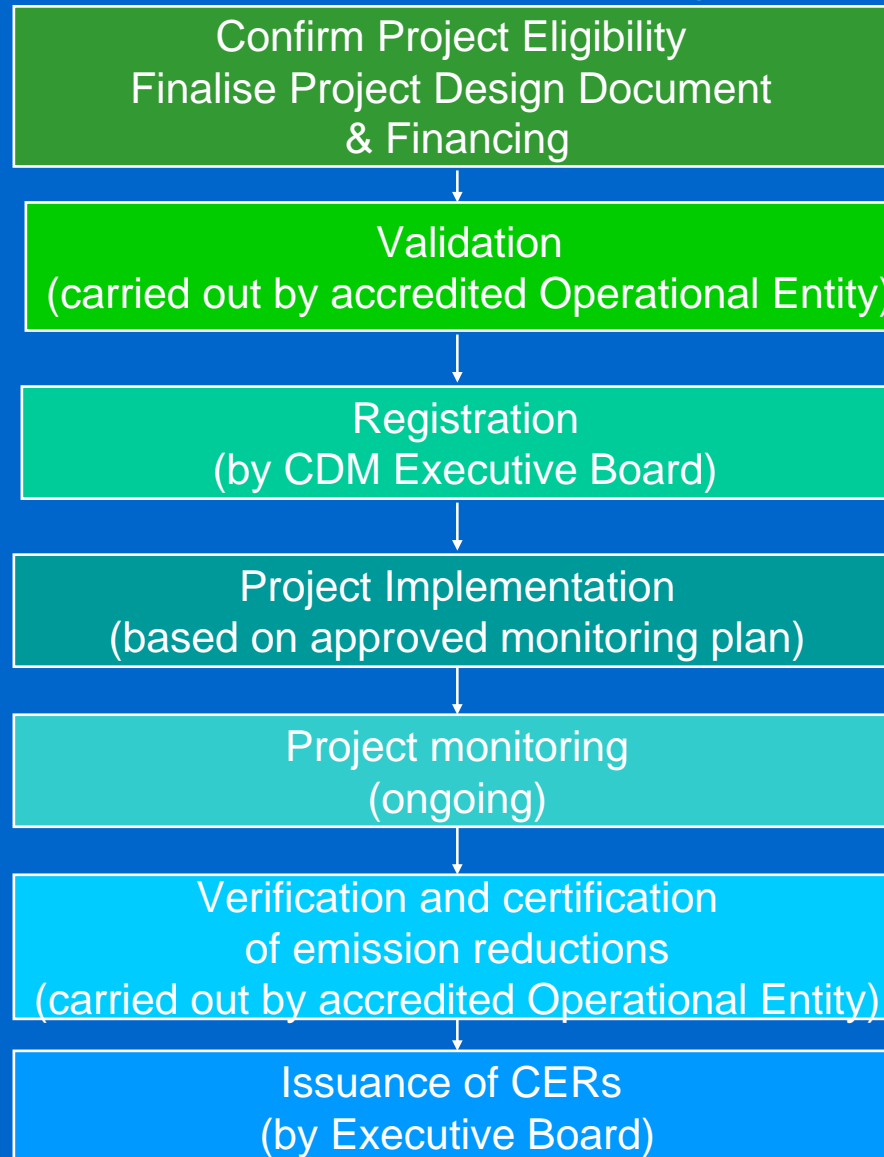


CDM project eligibility criteria

- Reductions based upon methodologies- many existing and approved.
- Need to develop baseline and monitoring methodologies for new project types
 - Can be costly and time consuming
 - No guarantee of approval by Executive Board
 - Many methodologies when first submitted are not easily applied beyond the specific project for which they were developed



CDM Project Cycle





CDM project participation

- Must fulfil project approval and obtain all Country approvals to get project registered and generate CERs
- Requirement to be a Project Participant to receive CERs directly from the Project.
- Nomination of Focal Point to communicate with UN Executive Board regarding distribution of CERs (provides additional legal protection)
- Additional domestic approval criteria:
 - Declaration of compliance with CDM rules (UK)
 - CER floor price (China) among other issues



Some key issues

- Programmatic CDM
- Two new forestry methodologies released at EB 35 and increasing momentum to allow avoided deforestation
- Delays in project registration
- Increasing number of projects being subjected to review
- Concern over quality of DOE work
 - Increased scrutiny of DOE work, with more spot-checks



Issuance and Trading of CERs



The CER

Tradeable compliance instrument transferable between Parties and between private entities under private contract

Based on 1 verified/certified tonne of CO₂-e reduced below established baseline

Once Project generates a verified tonne of reduced/abated greenhouse gas documentation submitted to CDM Executive Board by Focal Point and a formal requests for the issuance and distribution of CERs made

Once issued tracked and recorded through national and CDM registries

Free trading between National Registries (subject to systems being effective and eligibility criteria met)



Taxing CERs and Registration Fee

- “Share of proceeds” deductions:
 - SOP Administration = US\$0.20 per CER (US\$0.10 discount for first 15,000 CERs) upon issuance for “administration”
 - SOP Adaptation = 2% CER deduction for “adaptation”
- Registration fee = First year of SOP Admin based on average annual CERs estimated in PDD over the crediting period (up to a maximum of US\$350,000)



Issuance and Trading in CERs

- Traded within an international registry system comprising of:
 - the CDM Executive Board registry
 - Annex I national registry accounts
- International Transaction Log
 - Now operative – Japan linked 14 November 2007
 - CERs can be forwarded to national registry account
 - Switzerland and New Zealand to come on line in November or December
- Not yet able to trade between countries

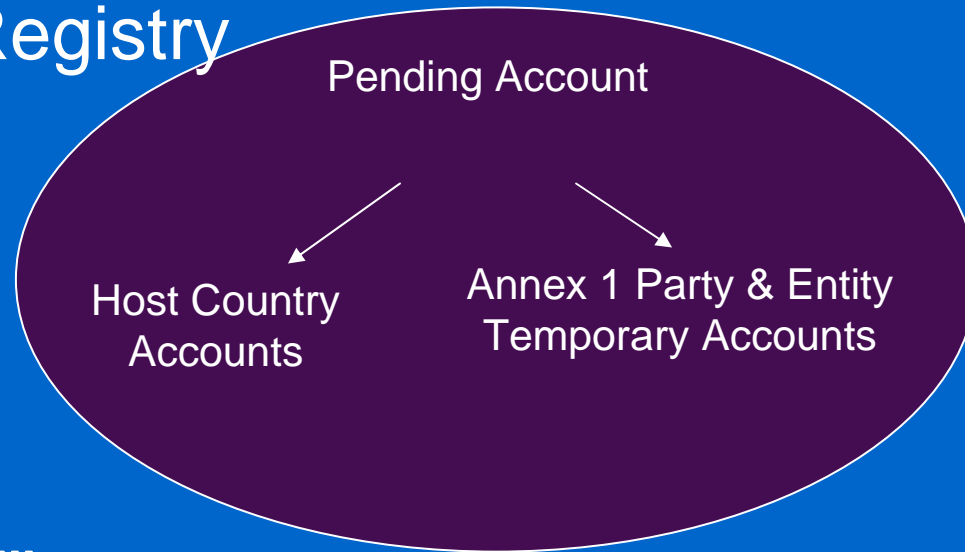


Issuance and Trading in CERs

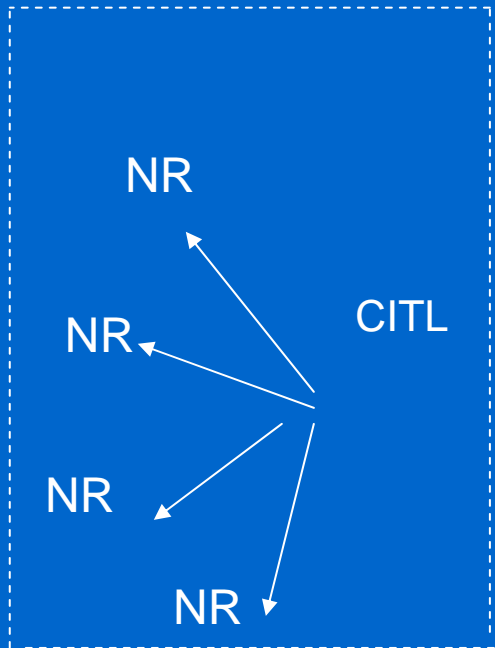
- For countries not linked to ITL
 - Annex I party temporary holding accounts
 - Automatic forwarding from temporary accounts – but only to national registry account of same Annex I party
- EU Delays
 - Delays in ITL linking to CITL
 - Plan B now in progress – EU member states will be linked directly to ITL, then through CITL once ITL/CITL connection established

International Registry Infrastructure

CDM Registry



EU



(17/CP.7)
Forward or Transfer

ITL

NR

NR

NR



Emissions Trading Eligibility Requirements

- Requirements include
 - national system for estimating emissions and removals of greenhouse gases within their territory
 - national registry to record and track the creation and movement of ERUs, CERs, AAUs and RMUs
 - Must maintain enough Kyoto credits in national registry to stay above Commitment Period Reserve (90% of Assigned Amount).



NZ entities seeking to trade CERs

- Open account in NZ registry (although other options are UK, Netherlands).
- Trade governed by contract or some other legal arrangement under which parties agree to CER volume, price, delivery and payment terms (including responsibility for CDM taxes) and compensation arrangements for non-delivery.
- For purchases direct from projects usually conduct project due diligence and there is always the developing country risk



Introduction to the CDM Rulebook



CDM Rulebook

- Definitive online database of the CDM rules – a single, comprehensive resource for all participants in the CDM process
- Online textbook similar to legal research tools – users can:
 - **search** commentary on certain aspects of the CDM rules; and
 - **browse** various categories of rules, including the project cycle, bodies, small-scale, forestry, programmatic CDM, etc.

CDM Rulebook

Clean Development Mechanism Rules, Practice & Procedures

SEARCH

Topic, phrase or chapter

Go

Advanced Search

Home

Project cycle

Bodies

A-Z index

Small-scale projects

Forestry Projects

NAVIGATION

Project Design Document

Bundling

Validation

Registration

Review of registration

Registration FAQs

SDP (Admin)

Verification

Verification

Issuance

Registration

Lorem ipsum dolor sit amet, consectetur adipiscing elit. Sed eleifend. Donec at augue. Praesent sodales placerat

Eligibility

Lorem ipsum dolor sit amet, consectetur adipiscing elit. Sed eleifend. Donec at augue. Praesent sodales placerat sapien. Vivamus tempor massa ac velit. Nullam diam est, lacinia at, ornare at, euismod sit amet, nisl. Maecenas suscipit cursus nulla. Etiam venenatis tortor in ante nonummy scelerisque. Cras mauris. Morbi ornare luctus lorem. Nunc sollicitudin justo vel odio congue scelerisque.

Additionality

Lorem ipsum dolor sit amet, consectetur adipiscing elit. Sed eleifend. Donec at augue. Praesent sodales placerat sapien. Vivamus tempor massa ac velit. Nullam diam est, lacinia at, ornare at, euismod sit amet, nisl. Maecenas suscipit cursus nulla. Etiam venenatis tortor in ante nonummy scelerisque. Cras mauris.

Latest updates

Topics recently updated

Bodies

- CDM Registry
- Administrator
- Executive Board
- Project Participants

Project Cycle

- Eligibility
- Validation
- Certification





What does it cover?

- Rules and practice covered
 - UNFCCC and Kyoto Protocol
 - COP and COP/MOP Decisions
 - Decisions of CDM Executive Board
 - Market and project experience
 - Informal clarifications by UNFCCC Secretariat
- Also draw on prominent secondary sources



Integrity and Reliability

- Internal Review Process
 - Draw on Baker & McKenzie network of climate lawyers across the globe
- Advisory Panel Review
 - Panel includes DNAs, DOEs, IETA, and a range of leading CDM lawyers
 - Range of Annex I and non-Annex I representatives
- Regular updates to be undertaken by Baker & McKenzie team



Donors

- CDM Rulebook is funded by:
 - New Zealand Ministry for the Environment
 - United Kingdom Foreign & Commonwealth Office
 - Swedish Energy Agency
 - World Bank
 - Asian Development Bank
 - United Nations Development Program
 - UNEP Risoe Center



Important Dates

- Pilot version of the Rulebook to be launched at COP/MOP 3 in Bali
 - Wednesday 5 December at 3.00pm at the Bali Grand Hyatt Hotel, Nusa Dua
 - The launch event is part of the International Emissions Trading Association's programme of side events for COP/MOP 3
 - Open for comments
- Formal internal and Advisory Board review during early 2008
- Target Date for Completion of Version 1 of the CDM Rulebook March or April 2008



www.cdmrulebook.org/



Participating in Carbon Markets Workshop Auckland, 19 November 2007



Ministry for the
Environment
Manatū Mō Te Taiao

Martijn Wilder,
martijn.wilder@bakernet.com
Head of Global Climate Change Practice
Baker and McKenzie, Sydney