Carbon Trading Under the Clean Development Mechanism

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I. Summary

Because of the Clean Development Mechanism (CDM) under the Kyoto Protocol that was extended in 2012 until 2020, private investors in projects in developing countries that are Kyoto Protocol (CER) signatories can obtain Certified Emissions Reduction credits, which can be sold to companies in developed countries that fail to meet their emission targets. This mechanism would apply to any energy, infrastructure, or waste management projects when the technology implemented cuts carbon emissions[1].

II. Background on Climate Change & Kyoto Protocol

The United Nations Framework Convention on Climate Change (UNFCCC) entered into force on March 21, 1994. The treaty is aimed at stabilizing greenhouse gas (GHG) concentrations in the atmosphere at a level that would prevent dangerous anthropogenic interference with the climate system. Under the Convention, governments gather and share information on GHG emissions, national policies, and best practices, launch national strategies for addressing GHG emissions and adapting to expected impacts, including the provision for financial and technological support to the developing countries, and cooperate in preparing for adaptation to the impacts of climate change.

The Kyoto Protocol, signed December 11, 1997, and entered into force February 16, 2005, is linked to the UNFCCC by setting binding emissions targets for 37 industrialized countries and the European community at an average of 5% against 1990 levels by 2012. Kyoto's three market-based mechanisms are: (1) emissions trading, (2) the CDM, and (3) joint implementation (JI). There are 83 signatory countries to the Kyoto Protocol and key developing countries include: India, China, the Philippines, Vietnam, Indonesia, Malaysia, Jordan, Saudi Arabia, Brazil, Mexico, and Argentina.

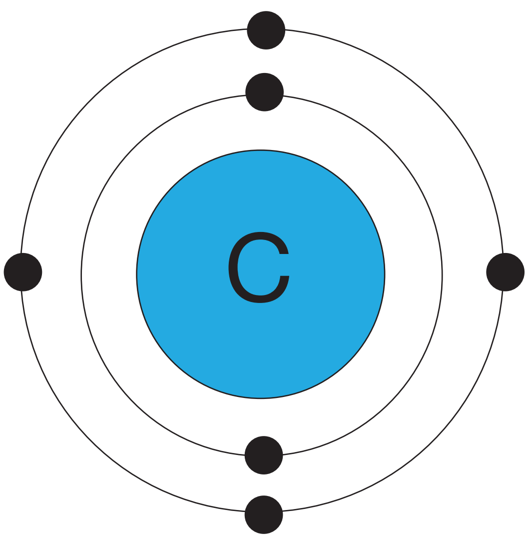
The 18th Conference of the Parties in Doha, Qatar held November 26 - December 8, 2012 resulted in agreement to a second commitment period under the Kyoto Protocol that will start January 1, 2013, avoiding a gap between the first commitment period which expired December 31, 2012, and runs until the end of 2020. Governments have agreed to form a binding treaty by 2015 that will include all countries.

III. Clean Development Mechanism

CDM is the first global environmental investment and credit scheme of its kind, providing a standardized emissions offset instrument, CERs. By transferring new and green technologies from the developed countries to the developing countries under the CDM, emissions can be reduced substantially. The transferring country or company can be given due credit for the reduction in GHGs. The mechanism stimulates sustainable development and emission reductions, while giving industrialized countries some flexibility in how they meet their emission eduction or limitation targets.

[1] Although the United States is not a signatory to the Kyoto Protocol, certain projects qualify for carbon credits under voluntary offset schemes. These credits are worth less than those under the CDM.

The CDM, defined in Article 12 of the Protocol, allows a country with an emission-reduction or emission limitation commitment under the Kyoto Protocol (Annex B Party) to implement an emission-reduction project in developing countries. Such projects can earn saleable CER credits, each equivalent to one tonne of CO_2, which can be counted towards meeting Kyoto targets. These saleable credits can be used by industrialized countries to meet a part of their emission reduction targets under the Kyoto Protocol.



Specifically, under the CDM, developed countries, or companies in those countries, fund GHG abatement projects in the developing countries where abatement costs are much lower. A CDM project activity might involve, for example, a rural electrification project using solar panels or the installation of more energy-efficient boilers. In turn, the developed countries receive credits, or CERs, that can be used to offset their emission reduction obligations.

IV. Designated National Authority

In accordance with the CDM modalities and procedures, Parties participating in the CDM shall utilize a Designated National Authority (DNA) for the CDM. The registration of a proposed CDM project activity can only take place once approval letters are obtained from the designated national authority of each Party involved, including confirmation by the host Party that the project activity assists it in achieving sustainable development.

STEPS:

To participate in Kyoto's mechanisms, countries:

1. Must have ratified the Kyoto Protocol.

2. Must have calculated their assigned amount, as referred to in Articles 3.7 and 3.8 and Annex B of the Protocol in terms of tonnes of CO_2-equivalent emissions.

3. Must have in place a national system for estimating emissions and removals of greenhouse gases within their territory.

4. Must have in place a national registry to record and track the creation and movement of Emission Reduction Units, Certified Emission Reductions, Assigned amount units and Removal Units (RMU)s and must annually report such information to the secretariat. They must annually report information on emissions and removals to the secretariat.

In addition, for CDM, countries must:

1. Establish a national authority (Designated National Authority or DNA) capable of approving proposed CDM projects.

2. Develop CDM project approval criteria.

3. Issue written approvals (Letters of Approval or LoAs) for projects which have been approved as CDM projects by the DNA.

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