Gaffney Cline

Carbon Monetisation Concepts for Companies in Developing Countries

Global Overview and Kyoto Protocol

To strengthen the global response to the threat of climate change, the Kyoto Protocol, adopted in December 1997, operationalizes the United Nations Framework Convention on Climate Change (UNFCC) by committing industrialized countries and economies in transition to limit and reduce greenhouse gases (GHG) emissions in accordance with agreed individual targets.

One important element of the Kyoto Protocol was the establishment of flexible market mechanisms, which are based on the trade of emissions permits. Under the Protocol, countries must meet their targets primarily through national measures. However, the Protocol also offers them additional means to meet their targets by way of market-based mechanisms:

- International Emissions Trading - Article 17 of the Kyoto Protocol allows countries that have spare emission units to sell this excess capacity to countries that are over their targets.
- Clean Development Mechanism (CDM) - Article 12 allows emission-reduction projects in developing countries to earn certified emission reduction (CER) credits which can be traded, sold and used by industrialized countries to a meet a part of their emission reduction targets.

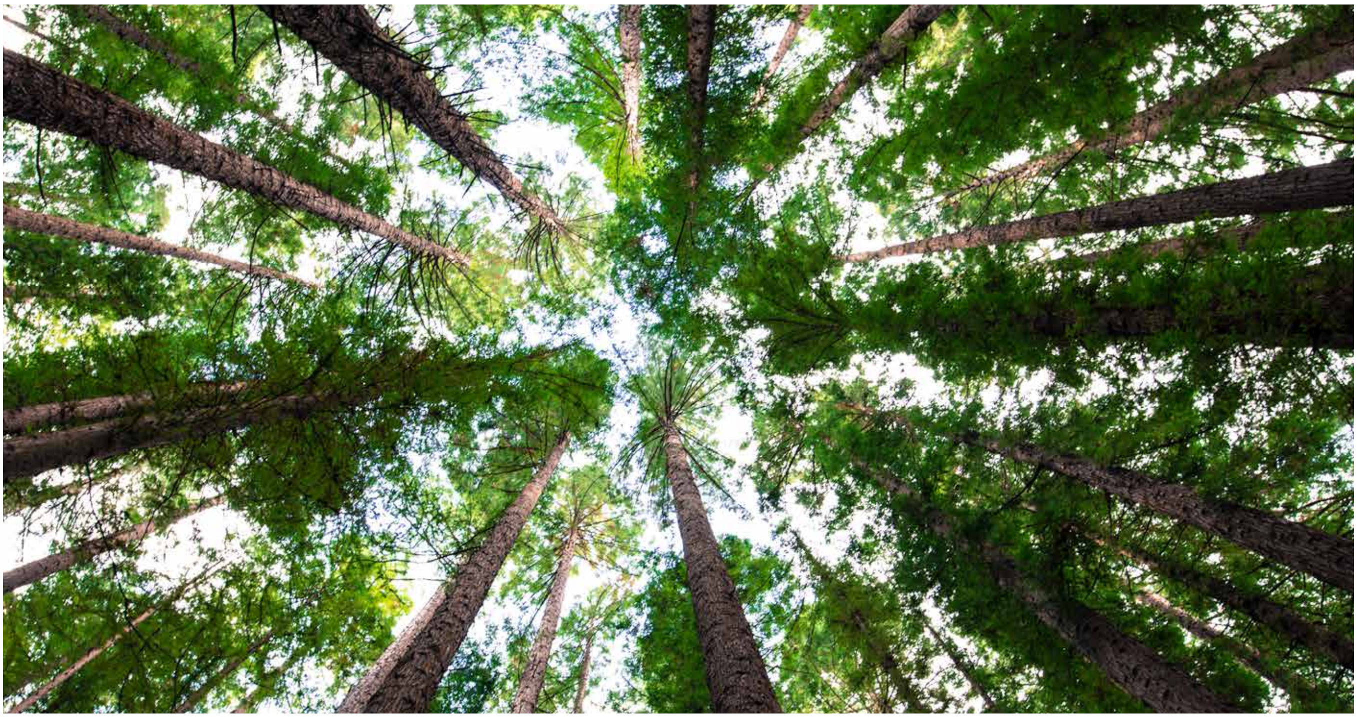
While there are several issues and criticisms with regards to the CDM process, the CER credits were traded in international markets, notably the EU Emissions Trading Scheme (ETS). The CDM process would have been the most relevant for companies in developing countries to monetize carbon reductions, however most major markets have stopped accepting international credits on their trading schemes (see Table 1). Subsequently, the Paris Agreement established a new market mechanism to replace the CDM and JI after 2020, however this has not been implemented yet.

Table 1: Major International Emission Trading Schemes

EU ETS	The EU-issued Directive (EU) 2018/410 deleted paragraph 7 of Article 11b of Directive 2003/87/EC which prevents the trading of international credits in the EU ETS from 1 January 2021. Consequently, no international credits may be held on ETS accounts and international credit entitlements will cease to exist.
UK ETS	The UK's post-Brexit carbon trading scheme will launch in 2Q2021. BEIS has confirmed that international credits will not be permitted in the UK ETS at this time. However, this will be under review, as well as the use of offsets.
Swiss ETS	International offsets were allowed up to 2020, subject to certain criteria. Most categories of credits from CDM projects in least-developed countries were allowed. Credits from CDM and JI projects from other countries were eligible only if registered and implemented before 31 December 2012. Since 2021, offsets can no longer be used to meet compliance obligations.
New Zealand ETS	Units from Kyoto Protocol flexible mechanisms were eligible for use in the system with no restrictions until 2015. As of 1 June 2015, international units are not eligible for surrender in the NZ ETS. The Government can decide to allow international units as part of the annual unit supply-setting process. However, only units from Government-approved sources and those meeting environmental integrity standards would be eligible and would be subject to quantitative limits.
Korean ETS	Domestic offsets, i.e., Korean Offset Credits (KOCs) were allowed in Phase 1. KOCs and international credits (subject to qualitative criteria) have been allowed since Phase 2 (2018-2020) however, CDM projects must be operated by Korean companies.

Article 6

While the Paris Agreement does not directly reference the use of carbon markets, Article 6 establishes a mechanism that may serve as the foundation for a market mechanism to allow for greenhouse gas emissions or carbon trading activities, either between Parties to the Paris Agreement or with the involvement of the private sector (for example, through the sale, purchase or creation of credits). However, negotiations around Article 6 have been contentious, and it is the only article on which the Parties to the Paris Agreement have not yet reached agreement. It is on the agenda for upcoming COP26 meeting in November 2021 in Glasgow.



Voluntary Carbon Markets

Since the international carbon markets appear to be closed off for CER credits for the time being, companies in developing countries may want to consider voluntary carbon markets.

Voluntary markets are not "organised", i.e. not constrained by regulations or Kyoto Protocol mechanisms. Allowances and targets are freely defined and allow any actor to offset their emissions through the purchase of carbon credits. All the different mechanisms can coexist in voluntary markets, including Verified Emissions Reductions (VER) credits and Tailor-made products on OTC (over the counter) markets. Voluntary markets involve credits used for voluntary purposes, as opposed to credits used to meet compliance obligations in jurisdictions with regulated carbon market schemes.

There is no centralized voluntary greenhouse gas or carbon credit market. Project developers can sell their credits directly to buyers or sell through a broker, an exchange or a retailer, who then resells the credits to a buyer. The majority of voluntary credits are purchased by the private sector, where corporate social responsibility goals and industry leadership are typically the key drivers of credit purchases. Currently, some of the leading schemes for credit certification are shown in Table 2.

Table 2: Major International Voluntary Emission Trading Schemes

Scheme	Credits	
Verra	VCU	Voluntary Credit Unit
The Gold Standard	VERs	Voluntary Emission Reductions
Plan Vivo	PVC	Plan Vivo Certificates
Climate Action Reserve	CRT	Climate Reserve Tonne
American Carbon Registry	ERT	Emission Reduction Ton

Each scheme involves different methodologies for measuring and verifying emissions' reductions and GaffneyCline can advise on identifying suitable option(s) for companies.

The voluntary carbon market suffers from low liquidity and other issues and as a result, a 'Taskforce on Scaling Voluntary Carbon Markets' was launched by Mark Carney, UN Special Envoy for Climate Action and Finance Advisor to UK Prime Minister Boris Johnson for COP26.

Taskforce on Scaling Voluntary Carbon Markets

The Taskforce itself is comprised of more than 40 leaders from six continents with backgrounds across the carbon market value chain. Participants bring expertise from the financial sector, market infrastructure providers, plus buyers and suppliers of carbon offsets.

The purpose of the Taskforce is to significantly scale-up voluntary carbon markets and ensure they are transparent, verifiable and robust. Hence, as first step, the Taskforce developed a blueprint for a voluntary carbon market.

To support the scaling-up of voluntary carbon markets, the Taskforce identified recommendations under six major topics across the value chain (including supply, market mechanisms and demand) requiring action as well as an implementation plan and potentially setting up a pilot market. Monitoring of further developments in this area of voluntary carbon markets will certainly be of interest for companies in developing countries.

EU Fuel Quality Directive (EU-FQD) Alternative

Another potential option for companies in developing countries may be to consider “credits” that may become part of the EU-FQD requirements. Under the Renewable Energy Directive (RED II), the EU is increasing the required renewable fuel content of transportation and other fuels up to 2030 by mandate.

The FQD has been in place since 2009 but the push for higher renewable targets has re-focused a number of European refiners as they have reached existing practical limits on fuel mixing constraints. The European refiners are therefore looking into the inclusion of upstream carbon reduction “credits” in the processed crude oil as part of the refined end-product.

There may be options for companies in developing countries in the near future to commence discussions with European refiners, with whom they trade and provide oil to obtain some form of upstream “credit” associated with sales of crude oil into the European market.

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bd@gaffneycline.com | www.gaffneycline.com | Follow us on LinkedIn

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