Reducing the cost of compliance - Use of International Credits in the EU ETS

On 8th November 2013 the European Parliament and the Council adopted new rules, which at last clarified how many international credits from global carbon reduction projects can be used for compliance under the EU Emissions Trading Scheme (EU ETS), ending months of uncertainty in the European market.

“North Sea oil companies that do not act on these new rules will be leaving money on the table when it comes to compliance with the EU ETS. Taking advantage of the clarification to cut compliance costs and release instant cash involves a simple switch, not a risky or complicated trading strategy,” says Liz Bossley, the CEO of the Consilience Energy Advisory Group Ltd.

EU ETS legislation, governed by Directive 2003/87/EC, allows so-called “installations” to use international credits created under the Kyoto Protocol's project based mechanisms towards fulfilling part of their EU ETS obligations. The Kyoto Protocol created two project based mechanisms that generate international credits:

- The Clean Development Mechanism (CDM), which generates credits known as Certified Emission Reductions or CERs from projects in developing countries; and
- The Joint Implementation (JI) mechanism, which generates credits known as Emission Reduction Units or ERUs from projects in developed countries with an emissions cap under the Kyoto Protocol.

Existing installations had an entitlement in Phase 2 (2008-2012) of the EU ETS to use international credits up a limit set by each individual Member State (the UK allowed each installation a limit of 8% of total Phase 2 allocation). However, for Phase 3 (2013-2020) the European Commission (EC) has harmonized the rules and set EU-wide limits on the amount of international credits that can be used.

“In the current carbon market, installations can purchase eligible international credits (CERs or ERUs) at much lower cost than the standard instrument - EU Allowances. By exchanging the CERs or ERUs for EU Allowances up to the limit, this simple trade allows companies to significantly reduce compliance costs or generate revenue” says Tim Atkinson, Senior Associate of the Consilience Energy Advisory Group Ltd.

Consilience’s analysis suggests that across some 72 installations in the UK Oil & Gas Sector covered under the EU ETS, there is now the opportunity to use approximately 9,680,000 international credits in replacement of EUAs in Phase 3.

At current market prices the spread between the commonly used EU allowances and international credits (in this case CERs) is around €4 per tonne of carbon dioxide equivalent. This means that the unused international credit limits across the UK Oil & Gas sector currently represents an opportunity to release €38.7 million.

In order to cost effectively manage compliance under the EU ETS, installations should look closely at the CER/ERU limit that applies to their installation and identify the most appropriate trade for their specific needs..

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