



CARBON MARKET WATCH POLICY BRIEF

DOHA DECISIONS ON THE KYOTO SURPLUS EXPLAINED

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Anja Kollmuss

anjakollmuss@carbonmarketwatch.org

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INTRODUCTION

At COP 18 in Doha at the end of 2012, Parties decided how to deal with the large surplus of Assigned Amount Units (AAUs) from the first Kyoto commitment period (2008-2012: CP1) and how to prevent the accumulation of new surplus in the second commitment period of the Kyoto Protocol (2013-2020: CP2). This paper explains the decisions that were taken in Doha and examines their implications.

AAUs are tradable emission permits under the Kyoto Protocol. One AAU allows a country to emit 1 metric tonne of CO₂e. Kyoto Protocol rules allow countries to carry over all unused AAUs into the next commitment period. The other units that can be used for compliance under the Kyoto Protocol are offset credits generated under the Clean Development Mechanism (CDM), ERUs from Joint Implementation (JI) and RMUs from land use, land-use change and forestry activities.

The AAU surplus from CP1 is estimated to be over 13 billion tonnes of CO₂e. Russia (5.8), Ukraine (2.6) and Poland (0.8) are the largest surplus holders, followed by Romania (0.7), the UK (0.5) and Germany (0.5) ([Point Carbon, 2012](#)). Many of the former Economies in Transition had weak reduction targets under CP1. At the time when their targets were defined their emissions were already well below the level that they committed to CP1.¹ That meant that they received millions of excess AAUs. Meanwhile, many western European countries have seen their emissions fall dramatically since 1990 and particularly in the last few years due to the economic crisis.

If the 13 billion were used fully, countries with a CP2 reduction target would not need to engage in any further mitigation action until well beyond 2020 (assuming Kyoto style rules would continue) and would still meet their targets (for more on this see [analysis by Climate Analytics, 2012](#)).

At the international negotiations in Durban in December 2011 and Bonn in May 2012, proposals were made by the African Group, AOSIS and Brazil that would have significantly restricted the use of CP1 AAU surplus in CP2, to stop this surplus undermining CP2 targets. In August 2012, at UN negotiations in Bangkok, the three groups developed a joint proposal on behalf of the G-77 and China. The new proposal contained elements of all three proposals, see [Policy Brief: G-77 and China Proposal](#). Shortly before COP18 in Doha in November 2012, the Swiss presented their own proposal with the aim of protecting environmental integrity while enabling the negotiation to go forward (see [Swiss Proposal](#)).

Over the last three years, the EU was unable to reach an internal agreement on this issue because of Poland's staunch opposition to changing the rules on carrying CP1 AAUs forward. It was only in the second week of COP-18, that the EU finally agreed internally to a solution which was a compromise between those EU countries that had fought hard for strict limitations on the surplus (e.g. DE, UK, DK) on the one hand, and Poland and to a lesser extent some other new Member States on the other. The final decision that was passed in Doha is very similar to the EU's internal decision. In the following sections we explain what was decided in Doha.

SUMMARY OF THE AAU SURPLUS DECISIONS TAKEN AT COP 18

The compromise adopted in Doha has two main elements relating to surpluses from the first and second commitment period. The decision does not limit the carry-over of surplus AAUs from CP1 but puts limits on their use in CP2. It also makes it impossible for countries without a reduction target in CP2 to sell their surplus to countries with a reduction target. In other words, Russia and other countries with surplus that do not join CP2 will not be able to sell units to CP2 countries. To underline their climate commitments, several countries made political declarations that they will not buy AAU surplus from CP1 in CP2.

In Doha, countries also decided to restrict the initial assigned amount (the number of AAUs a country initially receives for CP2) in order to avoid the build-up of new surplus. This amendment makes it impossible for countries to accumulate new 'hot air', the term sometimes used for surplus AAUs that are the result of choosing

¹ In 1997, when the rules for the Kyoto protocol were negotiated, base year emission levels used for calculating Kyoto targets were set at 1990 levels. This is despite the fact that in Russia, Ukraine and most Central and Eastern European countries that are part of the EU, emissions had already dropped significantly after 1990.

a weak target and not the result of new and additional emission reduction efforts. This amendment may set an important precedent for future decisions on target setting.

See Appendix 1 for the full Doha decision text. In the following sections we will look at these decisions in more detail.

DECISIONS ON THE USE OF SURPLUS CP1 KYOTO UNITS

1. FULL CARRY-OVER OF AAUS

The Kyoto Protocol rules on AAU carry-over were not changed.² Countries with surplus AAUs from the first period of the Kyoto Protocol can still carry them over fully to the second commitment period.

2. CARRY OVER RULES FOR CERS, ERUS AND RMUS REMAIN

Kyoto Protocol rules on the other Kyoto units were also not changed.³ Units from the Clean Development Mechanism (Certified Emissions Reductions - CERS) and Joint Implementation (Emission Reduction Units - ERUs) can be carried over up to the value of 2.5% of the AAUs given to a country for **CP1**. Removal units (RMUs) from land use, land-use change and forestry (LULUCF) activities cannot be carried over.

3. CP1 AAU SURPLUS MOVED TO PREVIOUS PERIOD SURPLUS RESERVE

A country's CP1 AAU surplus carried over to CP2 is put in to a Previous Period Surplus Reserve (PPSR). Each country with a reduction commitment under CP2 will have a PPSR.

4. DOMESTIC USE OF CP1 AAU SURPLUS

The surplus in the PPSR can be used for a country's own compliance with its CP2 target during the true-up period of CP2. There is no limit on how much of its CP1 AAU surplus a country can use to comply with CP2.⁴ However a country cannot sell CP2 units to another country and then meet their own target with CP1 units.

5. CP1 AAU SURPLUS TRADING PROVISION

A country with a commitment in CP2 can buy CP1 AAUs from another country that has a commitment in CP2, up to a certain limit. The limit is set at 2% of the initial assigned amount (AA) a country received for **CP1**. In other words, the trading limitation is on the buyer, not the seller. The seller country can – hypothetically -- sell as much of its CP1 surplus as it likes, as long as it complies with its own target, see point 4 above. However sales will likely be limited, since demand is low. In other words, the number of traded CP1 AAUs is likely to be well below the 5-7 billion AAUs that are available from countries with a CP1 surplus that have a CP2 reduction commitment.

6. STATUS UNCLEAR OF SURPLUS UNITS OF COUNTRIES NOT PARTICIPATING IN CP2

Some countries have surplus from CP1 but are not participating in CP2, most notably Russia which has close to 6 billion surplus AAUs. The Doha decision does not allow non CP2-participating countries to sell their surplus to a country with a target in CP2. But it is unclear what happens to that surplus during and after the end of CP2. Views differ on this and depend on the technical and legal interpretation of the Doha decision texts.⁵

7. STATUS UNCLEAR OF KYOTO SURPLUS AFTER 2020

The Doha agreement does not stipulate what will happen to any surplus at the end of CP2. In other words, there is no explicit cancellation of surplus in 2020 and it is unclear what will happen to the remaining surplus of Kyoto

² Established by Decision 13/CMP.1, paragraph 15

³ See footnote 2

⁴ For any emission that are above its initial assigned amount. See detailed explanation further down.

⁵ The Doha rules state that CP1 surplus AAUs will be added to the 2CP AA at the request of the Party. Since Parties that do not join CP2 will not have a CP2 AA, this cannot occur. The state and existence of these AAUs therefore depend on the legal conceptualization of AAUs: whether AAUs are seen as currency exclusively for meeting the emission reduction commitments under Kyoto or whether they constitute property. The former interpretation renders these units meaningless under 2CP without an AA. This is the view held by the majority of Parties. The latter would imply that AAUs have a function outside of the Kyoto Protocol.

emission permits⁶ at the end of CP2. This issue depends, among other things, on the legal interpretation of what constitutes an AAU (see footnote 5). Surplus-holding countries are likely to try to bring their permits into a new post-2020 agreement.

8. POLITICAL STATEMENTS ON SURPLUS USE

Australia, Japan, Liechtenstein, Monaco, Norway and Switzerland have made political statements that they will not purchase CP1 AAU surplus for compliance in CP2. The EU made a statement that CP1 AAUs cannot be used for compliance under their current EU climate legislation. The significance and impact of these political statements are discussed in more detail below.

DECISION TO LIMIT THE BUILDUP OF NEW SURPLUS AAUs IN CP2

Parties also passed new rules that will limit the amount of CP2 AAUs a country can use for compliance: Paragraph 3.7ter, an amendment to the Kyoto Protocol, states:

Any positive difference between the assigned amount of the second commitment period for a Party included in the Annex I and average annual emissions for the first three years of the preceding commitment period multiplied by eight shall be transferred to the cancellation account of that Party.

A country that makes a commitment under CP2 can only use the number of CP2 AAUs that is equivalent to the average of its emissions between 2008 and 2010 times 8 (the number of years in the commitment period). The remaining AAUs will be placed in a cancellation account and cannot be used for compliance (see examples and figures in the next section).

Paragraph 3.7ter in effect forces a country that decides to join CP2 to choose an emission reduction target that corresponds at least to a stabilization of its emissions at the level of 2008-2010. This will avoid or limit the creation of new surplus for most countries. Because of this, Ukraine, Belarus and Kazakhstan have threatened to withdraw from CP2. All of them submitted reduction targets (QELROS, see box *What is a QELRO?*) that are well above their average 2008-2010 emissions. This is discussed in more detail further below.

Table 1 shows the effect of 3.7ter on all countries that have a CP2 target using their submitted QELRO. The table was provided by Johannes Gütschow, Potsdam Institute for Climate Impact Research.⁷ The calculations show that

KYOTO AMENDMENT VERSUS DECISION

- The rules on how to deal with the **CP1 AAU surplus** were passed as Kyoto **decisions**.
- The rule on the **cap of AAUs for CP2**, was passed as an **amendment** to the Kyoto Protocol.

Legally decisions take effect immediately while amendments only come into effect once CP2 has been ratified.

WHAT IS A QELRO?

A country's QELRO (Quantified Emission Limitation and Reduction Objective) for CP2 is listed in [Annex B of the Kyoto Protocol Doha Amendment](#) (p.7). QELROs are the quantified commitments for GHG emissions expressed in percentages relative to a country's base year emissions (for most countries and most gases that's 1990). For example, the EU committed to reduce its emissions by 20% by 2020, lowering emission to 80% of what they were in 1990. The EU's QELRO is therefore 80.

The number of AAUs a country initially receives is calculated as follows:

Initial Assigned Amount = Baseline emissions (1990 for most countries) x QELRO x 8 (number of years in CP2)

⁶ These include AAUs, CERs, ERUs, and RMUs

⁷ See [Kyoto CP2 calculator, Feb 2013](#). All calculations are based on 2012 CRF data as reported by the Parties.

To calculate the Assigned Amount for CP2 the base year emissions were calculated from CRF 2012 data according to articles 3.7 bis and 3.8 of the Kyoto Protocol. Article 3.8 bis was not included, as Parties have still to fix a base year and provide data for NF3. The last sentence of Article 3.7 bis (deforestation rule for base year emissions) was accounted for in the way described in the KP reference manual. When Parties do not report emissions in CRF table 5 under "Forest land converted to other land-use categories" the sum of item 2.1 from tables 5.B through 5.F is used. If this data is also not present the sum of item 2 from tables 5.B and 5.C is used as a proxy.

The assigned amount for CP2 does not include LULUCF credit or any other type of units acquired during CP2 but only the initial assigned amount as calculated according to articles 3.7 bis and 3.8 KP.

3.7ter requires cancellation of a total of 3.6 billion AAUs. Without 3.7ter, the estimated CP2 surplus would be around 2.7 billion AAUs. Application of 3.7ter results in a shortage of CP2 AAUs of 2.2 billion.

TABLE 1: IMPACT OF 3.7TER ON CP2 COUNTRIES

	QELRO	2008-10 average emissions	CP2 AA /year	CP2 AA with 3.7 ter /year	BAU emissions CP2 /year	Total CP1 AAU surplus	Total CP1 AAU demand	Total CP2 AAU surplus without 3.7ter	Total AAU reduction with 3.7ter	Total demand CP2 with 3.7ter
Australia	99.5	546.7	556.2	546.7	602.9	158.9	-	-	75.7	449.1
Belarus	88	89.3	122.5	89.3	101.1	-	-	171.2	265.3	94.2
Croatia	80	29.6	25.2	25.2	32.5	-	-	-	-	59.0
European	80	4776.7	4621.9	4621.9	4709.6	2918.7	-	-	-	701.9
Iceland	80	4.7	3.0	3.0	4.4	-	4.6	-	-	11.2
Kazakhstan	95	255.3	342.1	255.3	291.6	-	-	404.1	694.5	290.4
Liechtenstein	84	0.3	0.2	0.2	0.3	-	0.2	-	-	0.4
Monaco	78	0.1	0.1	0.1	0.1	-	-	-	-	0.1
Norway	84	53.1	41.8	41.8	53.0	-	17.3	-	-	89.3
Switzerland	84.2	53.5	44.7	44.7	51.0	-	21.5	-	-	50.9
Ukraine	76	389.9	706.5	389.9	442.1	2614.2	-	2115.2	2532.4	417.2
Total		6199.2	6464.1	6018.1	6288.6	5691.8	43.6	2690.5	3568.0	2163.7

SURPLUS AT A GLANCE

- **CP1 surplus AAUs** are moved to a country's PPSR and can be used for compliance with the restrictions outlined in the Doha decisions.
- Carried over **CP1 surplus of other Kyoto units** (CDM and JI offsets) are added to a country's assigned amount and can be used for compliance or traded during CP2.
- The **amount of CP2 AAUs that is above a country's 2008-2010 emissions** are moved to a country's cancellation account and cannot be used for compliance.
- **CP2 surplus AAUs** potentially generated by a country's overachievement¹ during CP2 can be freely traded in CP2.

LOOKING AT THE COMBINED EFFECT OF THE DOHA DECISIONS

As explained above, Kyoto amendment 3.7ter limits the number of CP2 AAUs a country can use for compliance to an equivalent of their 2008-10 average emissions times 8. In combination with the Doha decisions on the use of CP1 surplus it raises the question under which conditions a country could use its CP1 surplus to comply with its CP2 target. The answer is a bit complicated. We use a hypothetical example of country A to illustrate three different scenarios. (Please also see box: *Initial Assigned Amount or Assigned Amount*).

Scenario 1: Country A has average emissions during CP2 that are higher than its 2008-10 average but lower than its initial CP2 AA (see Figure 1). Country A:

- Had **1990 emissions of 1500 tonnes**.
- Chose a **CP2 QELRO of 80, baseline 1990**. Therefore, its **yearly emissions in CP2** are limited to 1500 tonnes * 0.8 = **1200 tonnes**.
- Based on this QELRO, the country receives its **initial assigned amount** = 8 x 1500 x 0.8 = **9600 AAUs** (box framed in blue containing both link and green area).
- **2008-2010 emission average: 1000 tonnes per year**.

The surplus and demand for CP1 are calculated from the initial Assigned Amount issued for CP1 (as defined by articles 3.7 and 3.8 KP, using the indicative base year emissions from the Parties initial reports) and a projection on emissions during CP1, the PRIMAP4BIS baseline (www.primap.org).

- **3.7ter** defines that country A has available 1000 tonnes * 8 years = **8000 CP2 AAUs for compliance with its CP2 target** (green area).
- **3.7ter** defines that the remaining 9600 – 8000 = **1600 AAUs are transferred to the cancellation account** (pink area).
- Country A also has a considerable surplus from CP1 (hatched turquoise area) but it cannot use it for compliance in CP2. If a **country's CP2 emission are higher than its 2008-10 average but lower than its QELRO it cannot use its own CP1 surplus for compliance in CP2**. Country A would have to buy units elsewhere to cover any emissions above their 2008-10 level (pink area under the orange emissions line).
- Country A may still be able to sell its CP1 AAU surplus that is in its PPSR. In theory, a country affected by 3.7ter could 'swap' AAUs with a county that is not affected by 3.7ter: County A, unable to use its own CP1 AAU surplus for CP2 compliance because of 3.7ter sells CP1 surplus AAUs to country B, which has a more stringent QELRO and is therefore not affected by 3.7ter. Country B in turn sells county A CP2 AAUs. If rules of supply and demand apply in this situation, we'd likely see the CP1 units from country A sell at a lower price than AAUs from country B, since country A is restricted by both 3.7ter and the 2% buyer limit whereas country B has AAUs that are fully fungible and have no trading limits.

INITIAL ASSIGNED AMOUNT OR ASSIGNED AMOUNT?

There is a lack of clarity how para 3.7ter and the CP1 surplus decisions will be implemented. One of the main issues is how the term "assigned amount" is interpreted. There are two relevant options:

- **Initial assigned amount** (initial AA) refers to the number of AAUs a country receives based on the QELRO it submitted. The initial assigned amount is fixed and does not change.
- **Assigned amount** (AA) refers to all Kyoto units a country owns, including trades between AAUs, CERs, ERUs and RMUs. For example, if a country purchases CERs, its total AA will be its initial AA and the purchased CERs. The AA therefore changes depending on the transactions a country engages in.

Paragraph 3.7ter states that: *Any positive difference between the assigned amount of the second commitment period for a Party. [...]*

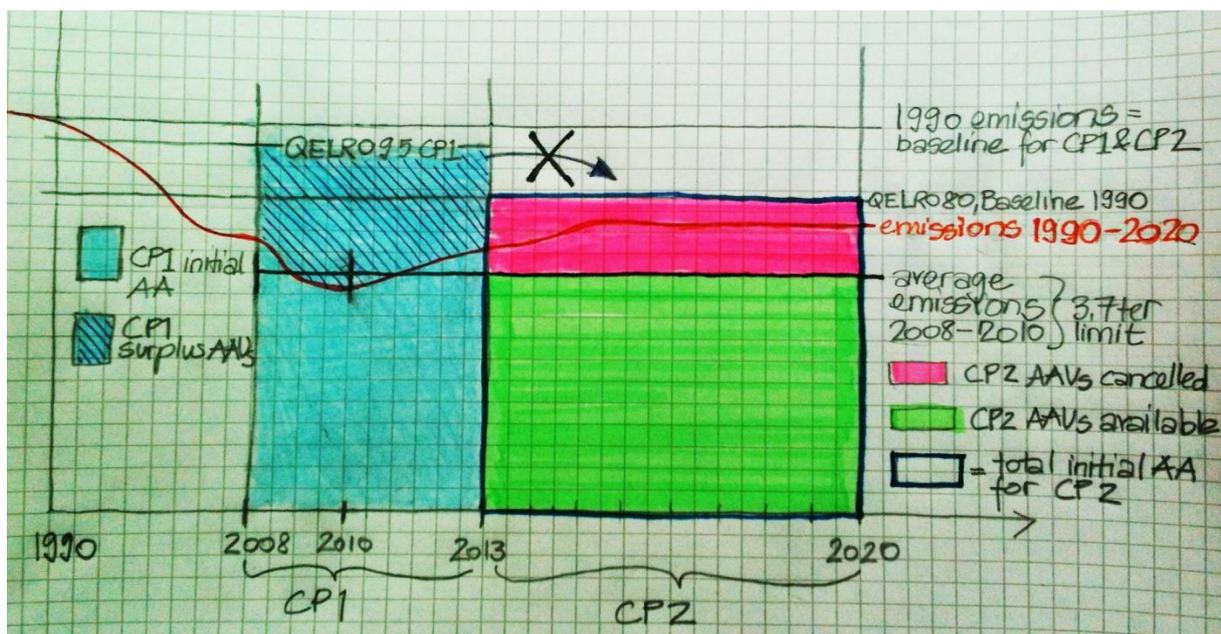
If this is interpreted to apply to the AA and not *initial AA* it could mean that 3.7ter also cancels everything that has been added to the initial AA and is over 2008-2010 average, including the surplus from CP1. This could mean that any purchase of Kyoto units could not be added to a countries available AA.

Furthermore, the timing of when units will be moved to the PPSR and to the cancellation account is unclear.

It is possible that Parties will have to take further implementing decisions to clarify the implications for the rules.

In this paper we assume that 3.7ter is applied to the initial AA.

FIGURE 1: THE IMPACT OF 3.7TER ON A COUNTRY A WITH A QELRO THAT IS ABOVE THEIR 2008-2010 EMISSIONS



Scenario 2: Country A lowers its QELRO to be the same as their 2008-10 average emissions. Its average emissions during CP2 will therefore be higher than its 2008-10 average and higher than its initial CP2 AA. In this scenario, country A can use their CP1 surplus for compliance in CP2 because the surplus rule says [bold added]:

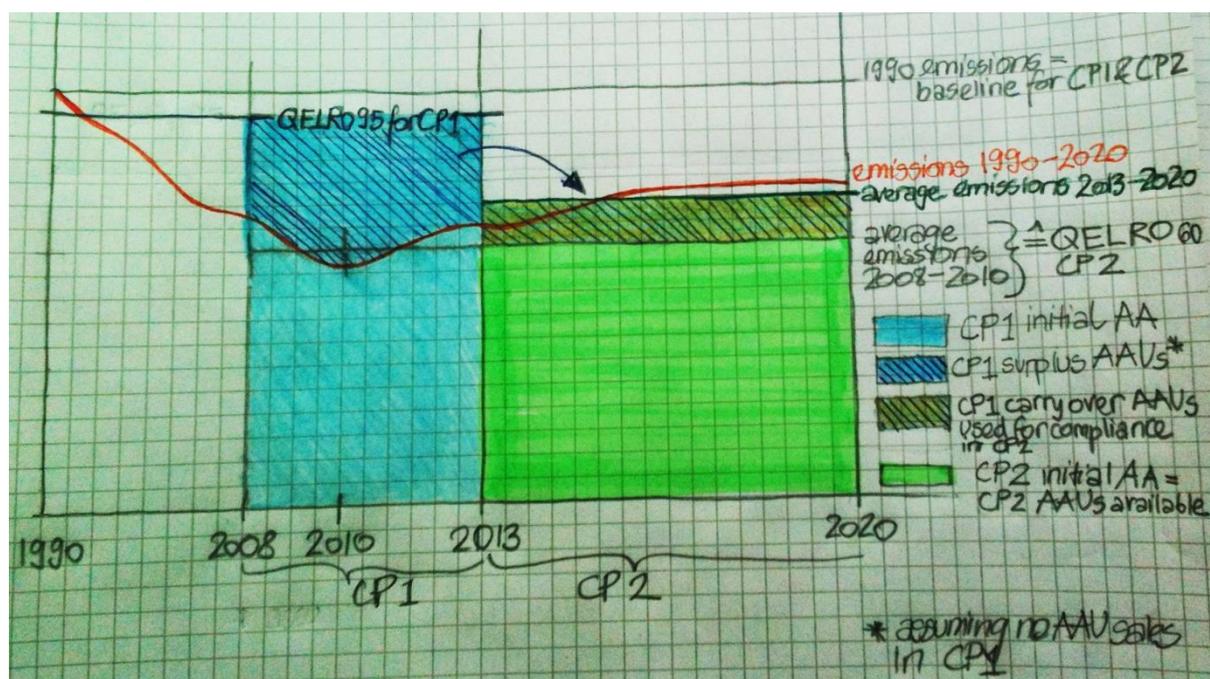
25. *Decides further* that units in a Party's previous period surplus reserve account may be used for retirement during the additional period for fulfilling commitments of the second commitment period **up to the extent by which emissions during the second commitment period exceed the assigned amount** for that commitment period, as defined in Article 3, paragraphs 7 bis, 8 and 8 bis, of the Kyoto Protocol;

Figure 2 below illustrates this second scenario:

- Country A sets its QELRO to the level of its 2008-10 average emissions
- Its initial assigned amount is 8000 AAUs and corresponds with the 3.7ter limit.
- Actual emissions from 2013-2020 will be higher than its QELRO (dark green line in figure 2).
- Country A can use its CP1 surplus (hatched turquoise area) to meet their CP2 target (hatched ochre area).

This scenario may be of particular relevance for Ukraine who has a significant CP1 AAU surplus which it cannot use with its current QELRO which is well above the limit set by 3.7ter. If the Ukraine was to lower its QELRO it would have its CP1 surplus available for compliance in CP2. (see further discussion below).

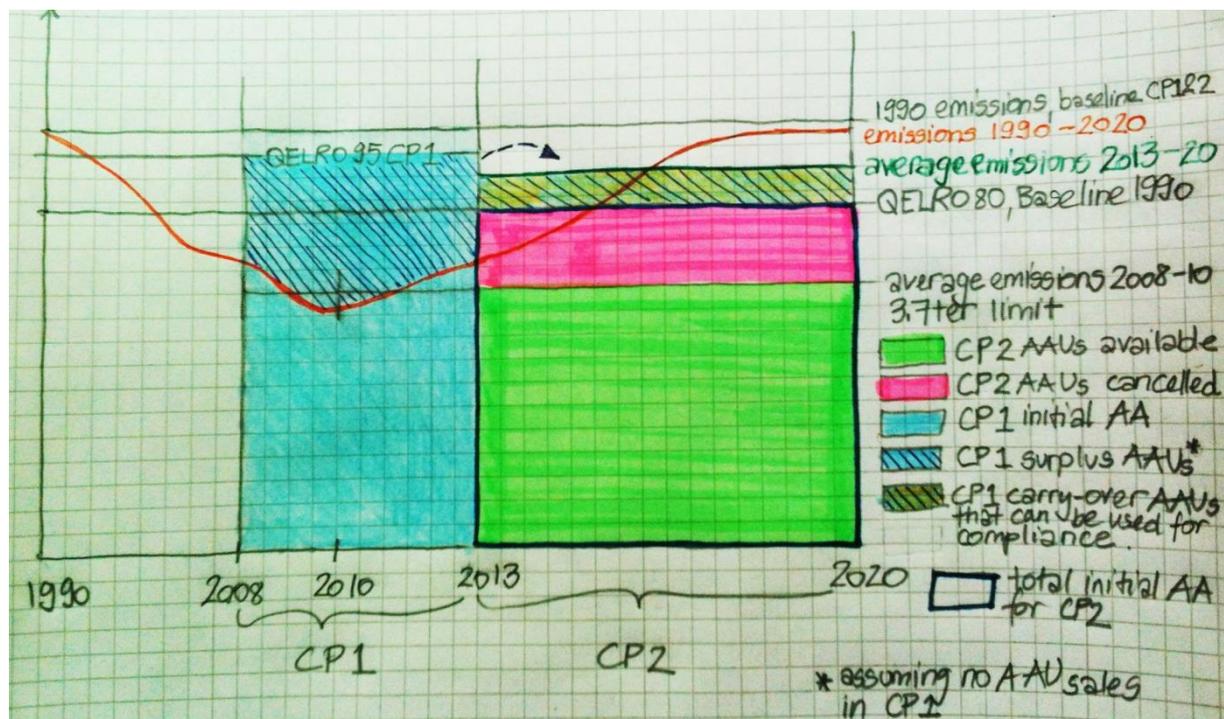
FIGURE 2: THE IMPACT OF 3.7TER ON A COUNTRY WITH A QELRO EQUAL TO THEIR 2008-2010 EMISSIONS



Scenario 3: Country A has the same CP2 QELRO as under scenario 1 but its 2013-2020 emissions are above its CP2 QELRO. In other words, country A's emissions are higher than under scenario 1.

Figure 3 illustrates the third scenario. In this case country A could use its own CP1 AAU surplus to compensate for emissions that are above its initial AA (hatched ochre area in figure 3). It would have to use other units (e.g. buy AAUs from other countries) to cover for the amount of emissions difference between the limit set by 3.7ter and its initial AA (pink area).

FIGURE 3: THE IMPACT OF 3.7TER ON A COUNTRY WITH A QELRO ABOVE THEIR 2008-2010 EMISSIONS AND AVERAGE CP2 EMISSIONS ABOVE THEIR QELRO



HOW THE DOHA DECISIONS WILL AFFECT THE EU

THE IMPACT OF 3.7TER ON THE EU AS A BUBBLE

Under the Kyoto Protocol the EU is treated as a bubble.⁸ This means that the reduction target (QELRO) of the EU as a whole is considered key not the QELROs of individual EU countries. In Doha, the EU issued a statement that paragraph 3.7ter will also apply to the EU as a bubble (see Appendix III). This gives the EU more flexibility: an individual EU country can have a weaker target than their average 2008-2010 emissions as long as the EU as a whole has a reduction target in line with 3.7ter.

Table 2 below⁹ compares the projected impact of 3.7ter on the EU as a bubble and if all EU countries were treated separately ("EU27 sum"). The impact of 3.7ter would be considerably greater if 3.7ter applied to EU countries individually. If applied to each individual member state, 3.7ter would require cancellation of a total of over 2.7 billion AAUs from EU member states. If 3.7ter is applied to the EU as a bubble, 3.7ter has no effect. The resulting demand for AAUs in CP2 is only 0.7 billion under the bubble approach as compared to 3.5 billion if the rule were to be applied to each EU member state individually.

⁸ "The European Community and its Member States will fulfil their respective commitments under article 3, paragraph 1, of the Protocol jointly in accordance with the provisions of article 4." (see [EU Declaration](#) and article 4.2 of the [Kyoto Protocol](#))

⁹ The table was provided by Johannes Gütschow, Potsdam Institute for Climate Impact Research. See footnote 7 for details

TABLE 2: COMPARISON OF IMPACT OF 3.7TER ON EU AS BUBBLE AND EU MEMBER STATES SEPARATELY

	QELRO	2008-10 average emissions	CP2 AA /year	CP2 AA with 3.7 ter /year	BAU emissions CP2 /year	Total CP1 AAU surplus	Total CP1 AAU demand	Total CP2 AAU surplus without 3.7ter	Total AAU reduction with 3.7ter	Total demand CP2 with 3.7ter
AUT	80	83.8	63.2	63.2	79.4	-	70.1	-	-	129.2
BEL	80	132.4	116.6	116.6	124.1	21.9	-	-	-	60.4
BGR	80	63.2	106.1	63.2	69.1	282.9	-	296.0	342.9	46.9
CZE	80	139.6	155.4	139.6	155.0	189.0	-	3.1	126.7	123.6
DEU	80	941.4	985.9	941.4	922.2	226.9	-	509.7	356.0	-153.7
DNK	80	63.2	56.0	56.0	56.5	-	29.4	-	-	4.2
ESP	80	375.3	231.8	231.8	350.6	-	178.6	-	-	949.9
EST	80	18.9	34.1	18.9	19.7	98.7	-	115.2	121.6	6.4
FIN	80	70.3	56.8	56.8	67.8	5.0	-	-	-	88.3
FRA	80	530.1	451.1	451.1	511.5	218.8	-	-	-	482.7
GBR	80	605.0	623.9	605.0	575.2	463.1	-	389.4	151.3	-238.1
GRC	80	124.7	85.6	85.6	112.1	64.6	-	-	-	211.8
HUN	80	69.4	92.3	69.4	72.7	200.1	-	157.3	183.4	26.1
IRL	80	63.5	44.5	44.5	56.3	8.6	-	-	-	94.7
ITA	80	511.5	413.5	413.5	498.7	-	100.3	-	-	681.7
LTU	80	22.4	39.5	22.4	22.8	115.3	-	134.1	136.8	2.7
LUX	80	11.9	10.5	10.5	11.4	-	11.7	-	-	6.9
LVA	80	11.6	20.7	11.6	12.2	60.1	-	68.1	73.0	4.9
NLD	80	204.5	170.4	170.4	196.3	-	15.5	-	-	206.8
POL	80	396.1	450.8	396.1	455.2	623.3	-	-	437.2	473.2
PRT	80	75.4	48.1	48.1	70.3	12.3	-	-	-	177.3
ROU	80	132.2	222.6	132.2	130.5	624.7	-	736.3	723.3	-13.0
SVK	80	46.8	57.6	46.8	50.9	97.0	-	53.9	86.7	32.8
SVN	80	20.1	16.3	16.3	19.5	-	5.8	-	-	25.4
SWE	80	63.2	57.7	57.7	61.3	59.8	-	-	-	29.0
EU sum	NA	4'776.7	4'611.2	4'268.8	4'701.3	3'372.1	411.5	2'463.1	2'739.0	3'460.0
EU Bubble	80	4'776.7	4'621.9	4'621.9	4'709.6	2'918.7	-	-	-	701.9

THE EU'S POLITICAL STATEMENT

The EU, Japan, Australia, Norway, Switzerland, Lichtenstein, Monaco all issued political statements in Doha that that they will not purchase CP1 AAUs for compliance under CP2 (see Appendix II). The EU stated:

European Union legislation on Climate-Energy Package for the implementation of its emission reduction objectives for the period 2013-2020 does not allow the use of surplus AAUs carried over from the first commitment period to meet these objectives.

Below background information that sets the EU declaration in context:

1. The EU's the Climate & Energy (C&E) package, containing the EU's domestic climate targets and policies including the EU-Emissions Trading Scheme (EU-ETS) and the Effort Sharing Decision (ESD), was adopted in 2008 at a time when it was still uncertain if there would be a CP2. Therefore the C&E policies do not include any linking to the Kyoto Protocol. EU countries will have to meet both targets: those under the C&E and those under the Kyoto Protocol. The two systems will work in parallel but it is not yet fully clear how this will work in practice.
2. The EU's statement does not mention that CP1 surplus AAUs may indirectly be used in CP2 through the carry-over of EU-ETS allowances: Despite the fact that the C&E package is not linked to CP2, there is a link between the EU-ETS and surplus AAUs. EU-ETS allowances (EUAs) from the second ETS trading period (2008-2012, coinciding with CP1) are shadowed by CP1 AAUs. The EU-ETS is currently oversupplied by about 2 billion EUAs.¹⁰ The total CP1 AAU surplus owned by EU member states is around 4 billion. The EU allows for full carry-over of EUAs units. Because of the shadowing, the EU as a whole¹¹ may need up to 2 billion CP1 AAUs to carry the surplus EUAs into the third EU-ETS trading period (2013-2020).

¹⁰ European Commission (2012). [The state of the European carbon market in 2012.](#)

¹¹ It is still unclear which country will need how many AAUs, since EUAs are held privately by companies covered under the EU-ETS and can be traded freely across the EU.

- It is unclear whether the EU declaration still stands if the EU increases ambition to 30%. If the EU were to move to 30%, the C&E package would have to be reopened at which point the relationship of AAUs to the C&E targets could be renegotiated.

To summarize, the EU's declaration states the fact that AAUs cannot be used as compliance units under its C&E package. The statement does not mention CP1 units that may be used for shadowing carry-over EUAs. Furthermore, it is unclear what would happen if the EU moved to a higher target. Most importantly, 3.7ter applied to the EU as a bubble does not require the cancellation of any CP2 AAUs. If 3.7ter was applied to each individual EU member state, 3.7ter would require cancellation of over 2.7 billion AAUs from EU member states. In other words, application of 3.7ter to the EU as a bubble reduces the EU's projected CP2 demand almost five-fold (from 3.5 billion to 700 million). Therefore the EU's need for additional AAUs is likely quite limited and can be satisfied by the CP1 AAU surplus held by EU countries.

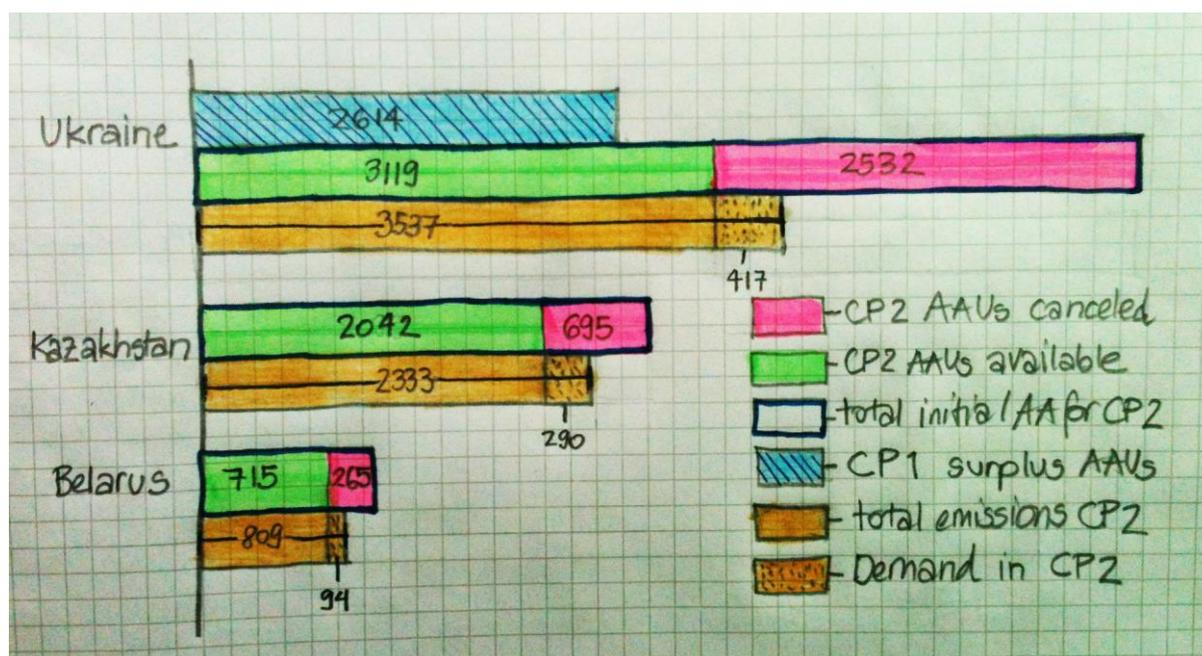
HOW THE DOHA DECISIONS WILL AFFECT BELARUS, KAZAKHSTAN AND UKRAINE

In Doha, Ukraine, Kazakhstan and Belarus gave their written consent to join CP2. They also voiced clear opposition to cancellation or limitation of any surplus units. Ukraine for example explicitly stated with their QELRO submission: *Should be full carry-over and there is no acceptance of any cancellation or any limitation on use of this legitimately acquired sovereign property.* All three countries submitted QELROS that are well above their average 2008-10 emissions. After the Doha package was passed, all three countries indicated that they may not ratify CP2. Paragraph 3.7ter would greatly reduce the CP2 AAUs they would have available for compliance and would in fact leave the countries in a demand situation under BAU, unless they implement adequate measures. Table 3¹² and Figure 4 below illustrate the impact of 3.7ter on these three countries.

TABLE 3 IMPACT OF 3.7TER ON BELARUS, KAZAKHSTAN AND UKRAINE

	QELRO	average 2008-2010 emissions	CP2 AA /year	CP2 AA w 3.7 ter/year	BAU emissions CP2 /year	CP1 AAU surplus	CP2 AAU surplus w/o 3.7 ter	AA reduction w 3.7 ter	Demand CP2 w 3.7 ter
Belarus	88	89	122	89	101	0	171	265	94
Kazakhstan	95	255	342	255	292	0	404	695	290
Ukraine	76	390	706	390	442	2'614	2'115	2'532	417
Total		735	1'171	735	835	2'614	2'690	3'492	802

FIGURE 4: IMPACT OF 3.7TER ON BELARUS, KAZAKHSTAN AND UKRAINE



¹² The table was provided by Johannes Gütschow, Potsdam Institute for Climate Impact Research. See footnote 7 for details

Belarus and Kazakhstan had no commitment under CP1. They therefore have no surplus from CP1. All three countries would have a significant CP2 surplus without 3.7ter. All of them also have rising BAU (business-as-usual) emissions. This means that with the application of 3.7ter, they will be short of AAUs – Belarus by 94 million, Kazakhstan by 290 million. Because of 3.7ter these countries will have to reduce emissions below their projected BAU emissions or purchase Kyoto units from other countries.

The Ukraine on the other hand has a CP1 surplus over 2.6 billion. For Ukraine, the situation would change dramatically if it lowered its QELRO to correspond to its 2008-10 emissions, see Figure 2. Under this scenario, Ukraine is projected to have a demand in CP2 of 417 million. Its CP1 surplus would more than suffice to cover that demand and Ukraine may also be able sell part of its CP1 AAUs surplus. If on the other hand, Ukraine withdraws from CP2, it will not be able to sell any of its CP1 surplus and the legal status of its CP1 surplus will be unclear (see footnote 5).

HOW THE DOHA AAU AND 3.7TER RULES WILL AFFECT JOINT IMPLEMENTATION

3.7ter may have a positive effect on JI's environmental integrity. JI credits (ERUs) are issued by a host country through the conversion of its AAUs into an equivalent number of ERUs. This ensures that there is no double counting of emission reductions.

A country with a weak reduction target and therefore a significant AAU surplus has an incentive to maximize the issuance of JI credits. Weak additionality rules and non-conservative baselines can maximize credit issuance but undermine the environmental and economic integrity of carbon markets. Since all CP2 countries have to have a somewhat stringent target under 3.7ter, this may lead to an improved environmental quality of JI.

However, this will not be the case if Parties decide to allow for the use of CP1 surplus to generate JI credits. Under current rules no ERUs can be issued for the reductions achieved in CP2 until countries receive their CP2 AAUs. This is unlikely to happen before 2015. However, if the rules are changed and host countries are allowed to use their CP1 surplus AAUs to convert into ERUs they will have no incentive to limit issuance of ERUs to only those projects that are truly additional. This issue will likely be a controversial. The reform of JI will be further discussed under the Subsidiary Body for Implementation (SBI).

CONCLUSION

The decisions on use restrictions of AAU surplus that were taken in Doha are complex. Legal clarifications are needed and it is possible that countries will have to take further implementing decisions to clarify the operationalization of the rules.

Although countries in Doha did agree to rules on how Kyoto surplus units are to be used during CP2, Parties did not address what will happen to any surplus Kyoto units after the end of CP2 in 2020. Surplus holding countries will likely push this issue again under ADP advocating for recognition of their "past efforts" in the post 2020 agreement. They may be in a weaker bargaining position though, since most Parties seem to agree that AAUs are the currency of the Kyoto Protocol and do not hold intrinsic value.

The Doha decision on the CP2 AAU use restrictions are important. 3.7ter requires cancellation of a total of 3.6 billion CP2 AAUs. Without 3.7ter, the estimated CP2 surplus would be around 2.7 billion AAUs. Application of 3.7ter results in a shortage of CP2 AAUs of 2.2 billion. Although the impact of 3.7ter changes if Ukraine, Belarus and Kazakhstan decide not to ratify CP2 it sets a politically important signal that countries who want to join an international climate agreement need to set targets that do not create surplus. The Doha decision on the CP2 AAU use restrictions sets a precedent and may also affect the negotiations for a future climate agreement under ADP.

APPENDIX I: COP18 DECISION AND AMENDMENT CONCERNING AAU SURPLUS

<http://unfccc.int/resource/docs/2012/cmp8/eng/l09.pdf>

VI.

23. *Decides* that each Party included in Annex I with a commitment inscribed in the third column of Annex B as contained in annex I to this decision shall establish a previous period surplus reserve in its national registry;

24. *Decides also* that where the emissions of a Party referred to in paragraph 23 above in a commitment period are less than its assigned amount under Article 3, the difference shall, on request of that Party, be carried over to the subsequent commitment period, as follows:

(a) Any ERUs or CERs held in that Party's national registry that have not been retired for that commitment period or cancelled may be carried over to the subsequent commitment period, up to a maximum for each unit type of 2.5 per cent of the assigned amount calculated pursuant to Article 3, paragraphs 7, and 8;

(b) Any assigned amount units held in that Party's national registry that have not been retired for that commitment period or cancelled shall be added to the assigned amount for that Party for the second commitment period. That part of a Party's assigned amount consisting of AAUs held in that Party's national registry that have not been retired for that commitment period or cancelled shall be transferred to its previous period surplus reserve account of the subsequent commitment period, to be established in its national registry;

25. *Decides further* that units in a Party's previous period surplus reserve account may be used for retirement during the additional period for fulfilling commitments of the second commitment period up to the extent by which emissions during the second commitment period exceed the assigned amount for that commitment period, as defined in Article 3, paragraphs 7 bis, 8 and 8 bis, of the Kyoto Protocol;

26. *Decides* that units may be transferred and acquired between previous period surplus reserve accounts. A Party referred to in paragraph 23 above may acquire units from other Parties' previous period surplus reserve accounts into its previous period surplus reserve account up to 2 per cent of its assigned amount for the first commitment period pursuant to Article 3, paragraph 7 and 8;

F. Article 3, paragraph 7 bis

The following paragraphs shall be inserted after paragraph 7 of Article 3 of the Protocol:

7 bis. In the second quantified emission limitation and reduction commitment period, from 2013 to 2020, the assigned amount for each Party included in Annex I shall be equal to the percentage inscribed for it in the third column of the table contained in Annex B of its aggregate anthropogenic carbon dioxide equivalent emissions of the greenhouse gases listed in Annex A in 1990, or the base year or period determined in accordance with paragraph 5 above, multiplied by eight. Those Parties included in Annex I for whom land-use change and forestry constituted a net source of greenhouse gas emissions in 1990 shall include in their 1990 emissions base year or period the aggregate anthropogenic carbon dioxide equivalent emissions by sources minus removals by sinks in 1990 from land-use change for the purposes of calculating their assigned amount.

G. Article 3, paragraph 7 ter

The following paragraph shall be inserted after paragraph 7 bis of Article 3 of the Protocol:

7 ter. Any positive difference between the assigned amount of the second commitment period for a Party included in the Annex I and average annual emissions for the first three years of the preceding commitment period multiplied by eight shall be transferred to the cancellation account of that Party.

APPENDIX II: POLITICAL DECLARATIONS RELATING TO CP1 AAU CARRY OVER

Australia

1. Australia will not purchase AAUs carried over from the first commitment period. Australia will adhere to arrangements in other countries relating to the transfer of AAUs under any arrangement that Australia may have linking our emissions trading scheme with any other scheme including the European Union emissions trading scheme. Imported AAUs will continue to be ineligible for surrender for compliance by liable entities in Australia's emissions trading scheme.

European Union and its 27 member States

2. European Union legislation on Climate-Energy Package for the implementation of its emission reduction objectives for the period 2013-2020 does not allow the use of surplus AAUs carried over from the first commitment period to meet these objectives.

Japan

3. The Government of Japan will not purchase AAUs carried over from the first commitment period.

Liechtenstein

4. Liechtenstein will not acquire and use surplus assigned amount units carried over from the first commitment period to comply with its commitments in the second commitment period except for any units that are associated with carry over in the European Emissions Trading Scheme.

Monaco

5. Monaco will not purchase carried over AAUs from the first commitment period under the Kyoto Protocol.

Norway

6. Norway will not purchase carried over AAUs from the first commitment period under the Kyoto Protocol.

Switzerland

7. Under the Swiss domestic legislation applicable during the second commitment period, Switzerland will not use carried-over AAUs transferred from other Parties for compliance under Article 3 of the Kyoto Protocol for the second commitment period. Switzerland will adhere to arrangements in other countries relating to the transfer of AAUs under any arrangement that Switzerland may have linking our emissions trading scheme with any other scheme including the European Union emissions trading system.

APPENDIX III: STATEMENT BY THE EU AND ITS MEMBER STATES AND CROATIA AND ICELAND

Doha, 8 December 2012

Article 4 of the Kyoto Protocol foresees the possibility for Parties to fulfil their commitments under Article 3 of the Kyoto Protocol jointly. As reflected in the new text of Annex B to the Kyoto Protocol, the quantified emission limitation and reduction commitments for the European Union, its Member States, Croatia and Iceland for the second commitment period under the Kyoto Protocol are based on the understanding that these will be fulfilled jointly in accordance with Article 4 of the Kyoto Protocol.

The European Union, its Member States, Croatia and Iceland hereby state that Article 3, paragraph 7 ter will be applied to the joint assigned amount pursuant to the agreement on joint fulfilment by the European Union, its Member States, Croatia and Iceland and will not be applied to Member States, Croatia or Iceland individually. Moreover, the EU and its Member States will also submit the information required by paragraph 9 of Decision - /CMP.8 in Document L.9 jointly.

We will deposit our instruments of acceptance at the same time, as was the case for the Kyoto Protocol itself, to ensure its simultaneous entry into force for the European Union, its 27 Member States, Croatia and Iceland.