To: European Commission
DG Climate Action, DG Enterprise, DG Energy, DG ECFIN and the Secretariat General

Introduction

Norsk Hydro wishes to set out its views on the proposed Commission plan to restrict the access to credits generated from Kyoto flexible mechanisms (CDM and JI).
First of all we would like to emphasize that the use of offset mechanisms within the EU ETS is an important tool in enabling companies to comply with their reduction obligations in the most economic manner. In addition we would like to highlight the role of flexible mechanisms in general in establishing a global carbon market and in promoting investments.

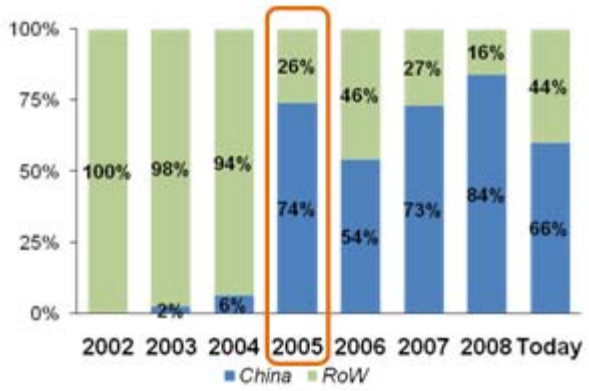
Norsk Hydro was one of the early movers when investing in the PCF, the Prototype Carbon Fund, in 2000. The PCF was the first fund in the world with a strategy objective to show how project based emission reductions could be created for compliance use under the Kyoto framework. The fund was a private-public partnership, totally 23 investors, and had a clear strategy to purchase credits promoting sustainable development in its host country. One of the PCF's primary strategies was to demonstrate the potential for mobilizing new resources for addressing global environmental problems through market-based mechanisms. Therefore, the PCF's aim was to build a credit portfolio that was balanced both with regards to technologies and countries.
Since the fund was established, China was geographically one of PCF's targeted areas. However, by the end of 2005 there were very few CDM registered in China and the PCF's project portfolio reflected this situation. It was also very early in the Chinese projects CDM development process as, prior to the World Bank UCF, just 17 projects (all sectors combined) had started the CDM regulatory approval process. As the PCF was one of many credit purchaser form the World Bank Umbrella Carbon Facility (UCF) – Tranche 1, and the PCF was the architect behind the structure of the projects, we would like to assert why we absolutely think these HFC projects satisfy the UNFCCC supremacy both with regards to additionality and sustainability. Further the two projects in the UCF represented a more geographical sound distribution of offset credits at that time the projects were registered.

Based on information we have received from the World Bank, we would like to give you a better understanding of our views as to why we feel there should be no restrictions in the EU ETS beyond the Kyoto period with regards to compliance use of these credits. Further, we think it is unreasonable to punish early movers who have followed the UNFCCC procedures and even acted beyond them with regards to setting additional sustainable criteria. Last but not least, the early movers were also those who were one of the catalysts behind bringing China more awareness and willingness to take on climate reduction actions.

Overview

In December 2005 the World Bank signed two ERPAs for HFC-23 projects in China – contracting for the purchase of a combined total of 129 Mt CO2e -- helping to expand the primary carbon market, deepening liquidity, and solidifying China's emergence in the carbon market. The two projects (i.e., "Jiangsu Meilan" and "Changshu 3F")[1] were developed at existing HCFC-22 production facilities. At that time, there was no national or local regulation requiring the facilities to contain emissions of HFC-23; as a result, this potent greenhouse gas (GHG) (equivalent to 11,700 tCO_2e per ton of HFC-23 emitted) was being released into the atmosphere. Indeed, in the absence of the CDM (or any regulation), there was no incentive for the elimination of this gas, making these projects the closest to "black-and-white" cases of additionality[2]. Today there are more than 2,400 projects that have reached this milestone. The graph below (Figure 1) shows the growth of China's role in the CDM market (data compiled up to April 2010).

Figure 1: Growth of the China CDM market



The approved CDM methodology for the "Incineration of HFC23 Waste Streams" (AM0001) required the projects to be at already existing facilities with historical production, capping production levels and removing any perverse incentive to build new plants or produce more HCFC just to capture the carbon revenues, thereby providing appropriate safeguards to ensure environmental integrity. The two projects developed under the World Bank UCF's first tranche are also clear examples of technology transfer that helped Chinese chemical enterprises establish the best practice of end-of-pipe waste gas management systems, including incinerator, waste water treatment system, and worker safety trainings.

As the projects were developed, the World Bank marketed them to potential fund participants and established the Umbrella Carbon Facility. The 1st tranche has participants that include several World Bank Carbon Funds as well as individual private and public sector entities. The total capitalization is close to US$1 billion.

[1] The Jiangsu Meilan project is referenced by the CDM as project 0011; it was registered on June 4, 2006. The Changshu 3F is referenced by the CDM as project 0306; it was registered on August 8, 2006. Both projects have a 7-year renewable crediting period under the CDM, with the first crediting period running from December 1, 2006 through November 30, 2013 for Jiangsu Meilan, and from December 22, 2006 through December 21, 2013 for Changshu 3F.

[2] See World Bank 2010 "10 Years of Experience in Carbon Finance – Insights from working with the Kyoto Mechanisms", available at www.carbonfinance.org.

The key sustainable development benefits from the UCF include the establishment of the Chinese Clean Development Mechanism Fund (CDMF), partly funded by the proceeds of a levy equivalent to 65% of all revenues accruing from the sale of HFC-23 emission reductions[3].

1. The China CDM Fund

The objective of the CDMF is to support domestic climate change related activities by providing technical assistance, research and development, capacity building, as well as supporting climate change mitigation investment projects in the area of climate change. The size of the China CDM Fund is reported to be currently about US$900 million. On an annual bases the CDMF reports on the previous year financial supported activities.

The China CDM Fund Management Guidelines are published on the Government of China's website (http://www.gov.cn/flfg/2010-10/21/content_1727534.htm)[4]. These guidelines have just been published after approval, and the Fund can now begin operations.

1.1 Administration and management

As designed, the China CDM Fund's management structure has two components:

- The Supervisory Board, consisting of representatives from the Ministry of Finance (MoF), the National Development and Reform Commission (NDRC), the Ministry of Foreign Affairs, the Ministry of Science and Technology, the Ministry of Environment Protection, the Ministry of Agriculture, and the Meteorological Administration Services Council. The Supervisory Council is the inter-ministerial body responsible for the approval of the following: (i) Fund management procedures; (ii) the Fund's strategic plan, including annual use of funds; (iii) grant projects and investment projects; (iv) annual budgets and financial statements. The Supervisory Council has a chairperson (from NDRC) and a vice chairperson (from the MoF).

- The Fund Management Center is responsible for the day-to-day operation of the Fund, including receiving revenues from the CDM levy and managing the use of funds. MOF provides direct oversight.

1.2 Sources of funding

The major sources of funding can come from:

- Transfer through the state-owned portion of the CDM emission reductions revenue (all the state-owned portion of revenue from CDM projects should go to the CDM Fund)
- Fund operating revenues;
- Contributions from domestic and foreign institutions, organizations and individual donors; and
- Other sources.

The Fund Management Center is responsible for collecting the state-owned portion of CDM revenue from either the Project Entity or the credit purchaser according to the ERPA.

[3] Decree 37 introduced a levy on the CER revenues generated by various CDM projects in China funded from a levy on CERs: 65% from HFC/PFC projects; 30% from nitrous oxide projects; and 2% from other projects (EE, RE, CMM/CBM, small scale reforestation).

[4] The statutes of the CDM Fund were approved by the State Council of China in October 2010. At the time of drafting this note, the official English translation had not yet been made available.

1.3 Uses of funds

Funds from the CDM Fund can be applied: (i) to extend capacity building grants; and (ii) support climate change investment projects.

(i) Capacity building grants
Grants can be provided to support capacity building for climate change adaptation and to enhance public awareness of climate change.
(ii) Investments in climate change mitigation and adaptation projects

The Fund can provide funding for adaptation and mitigation projects through equity investment, loans, guarantees, and other products approved by the Supervisory Board. The Fund Management Center is in charge of identifying, screening, and evaluating investment proposals. Large-scale projects (defined as requiring CDM Fund support of more than RMB70 million) are subject to review and approval by the Supervisory Board.

2.1 World Bank support

In addition to the activities related to the ERPAs, the World Bank has provided technical assistance to support the CDM Fund management to build their capacity. The World Bank organized 2 three-day training programs for the CDM Fund staff team in Washington DC, in 2008 and 2009 respectively. Through these training programs, the World Bank shared knowledge and insights on the World Bank's priority areas for climate change mitigation and adaptation, as well as provided technical training on fund and project management related activities to members of the CDMF and members of the Ministry of Finance that deal with and approve CDMF related activities. The World Bank will continue to provide assistance as needed.

Summary

As described above, the CDM mechanism has been important for creating awareness and for driving national actions for reducing greenhouse gas emissions in China. We believe that it is crucial to maintain China’s focus in these matters by not abandoning agreed UN procedures for accepting projects as eligible under the CDM mechanism. The CDM mechanism is a widely respected system with a well established control system under the UN. It provides transparent and predictable framework for project owners, investors and for those acquiring credits, and needs to be preserved and respected as such.

Yours faithfully,
for Norsk Hydro ASA

Liv Rathe
Director Greenhouse Gases