



The Business & Law Readers Digest

**Ukrainian Aspects
of Kyoto Protocol
Implementation**

Banking and Finance // Beverages Industry // Corporate // Corporate Dispute Resolution // Due Diligence // Employment // Financial Services // Insurance // Investments // **Kyoto Protocol Implementation** // Logistics // Mergers and Acquisitions // Natural Resources // Oil and Gas // Representative Office // Land // Ukraine and the WTO // Ukraine and Russia // Tourism



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The Agreed rules on Emission Trading in the Kyoto protokol

The regulations on Emissions Trading can be found in Article 17 and in paragraphs 3.10 and 3.11 of the Kyoto Protocol.

Article 17:

"The Conference of the Parties shall define the relevant principles, modalities, rules and guidelines, in particular for verification, reporting and accountability for emissions trading. The Parties included in Annex B may participate in emissions trading for the purposes of fulfilling the commitments under Article 3. Any such trading shall be supplemental to domestic actions for the purpose of meeting quantified emission limitation and reduction commitments under that article."

Article 3.10:

"Any emission reduction units, or any part of an assigned amount, which a Party acquires from another Party in accordance with the provisions of Article 6 or of Article 17 shall be added to the assigned amount for the acquiring Party."

Article 3.11:

"Any emission reduction units, or any part of an assigned amount, which a Party transfers to another Party in accordance with the provisions of Article 6 or of Article 17 shall be subtracted from the

assigned amount for the transferring Party."

This is not much text in view of the immensely complex task, but nevertheless there are several rules of the envisaged trading system that appear to be settled:

a) Primary participants in a trading regime will be the Parties to the Kyoto Protocol listed in its Annex B. These are the northern members of the OECD as well as most Central and Eastern European countries and some successor states of the former Soviet Union. Parties without legally binding emission reduction and limitation objectives under the Protocol are thus precluded from participating in trading. This concerns first of all the developing countries, but furthermore those industrialised countries that do not ratify the Protocol or that are not included in Annex B. Article 17 therefore provides an incentive to take on legally binding obligations in order to participate in trading. Restriction of participation to those Parties with legally binding targets should ensure that the overall amount of units circulating in the system are stable. If certified emission reductions generated by the Clean Development Mechanism were tradable, however, this princi-



ple would be violated. This "cap" on the overall amount of units circulating in the system is not only required by ecological considerations, but should furthermore provide stability and allow a dependable market to develop.

b) The basic mechanism for a trading regime has been defined in Article 3, paragraphs 10 and 11. Any emission reduction units, or any part of an assigned amount, which a Party acquires from another Party shall be added to the assigned amount for the acquiring Party and shall be subtracted from the assigned amount of the transferring Party.

c) The commodity that may be traded is called "any part of an assigned amount". This term refers to the "budget" (assigned amount) allocated to the Parties by Article 3.7 and Annex B of the Kyoto Protocol. The protocol thus does not follow the principle of per-capita distribution, as would be required according to ideas of equity. Instead, Article 3.7 stipulates that the "assigned amount" for the commitment period 2008-2012 for each Party is equal to the percentage inscribed for it in Annex B of its base-year emissions of the "basket" of gases listed in Annex A, multiplied by five.

The regulated gases in the so-called "basket" are first of all the three main

contributors to climate change: carbon dioxide (CO₂), methane (CH₄) and nitrous oxide (N₂O). The basket furthermore comprises sulphur hexafluoride (SF₆) and two groups of industrial gases, hydrofluorocarbons (HFCs) and perfluorocarbons (PFCs). The reduction targets must be achieved for the basket as a whole. Since the respective radiating force for each of those gases is different, the "Global Warming Potential" of each gas, as determined by the Intergovernmental Panel on Climate Change (IPCC), is used to calculate the overall obligation. The overall emissions of these gases has been restricted by the Kyoto Protocol for a first "commitment period" from 2008 to 2012.

A second commodity that might be traded according to Article 3 paragraphs 10 and 11 is called an "emission reduction unit". This term refers to Article 6, where "emission reduction units" may result from Joint Implementation projects and thus clarifies that the "credits" generated may not only be used by the acquiring Party to meet its own obligations, but that these credits are transferable to other Parties.

The emission trading in EU member states is regulated by EU Trading Scheme (EU ETS) established by Directive 2003/87/EC, as amended by Directive 2004/101/EC. EU ETS is the cornerstone of the EU's strategy for fighting climate change. It is the first international trading system for CO₂ emissions in the world. It covers over 10,000 installations



in the energy and industrial sectors which are collectively responsible for close to half of Europe's emissions of CO₂. The aim of the EU ETS is to help EU Member States achieve compliance with their commitments under the Kyoto Protocol in a cost-effective way. Letting participating companies buy or sell emission allowances means that emissions cuts can be achieved at the least cost.

At the heart of the ETS is the common trading 'currency' of emission allowances. One allowance gives the holder the right to emit one ton of CO₂. For each trading period under the scheme, Member States draw up national allocation plans which determine how many emission allowances each installation receives. The 'cap,' or limit, on the total number of allowances granted is what creates scarcity in the market. Companies that keep their emissions below the level of their allowances can sell their excess allowances. Those facing difficulty in keeping their emissions in line with their allowances have a choice between taking measures to reduce their own emissions, such as investing in more efficient technology or using less carbon-intensive energy sources, or buying the extra allowances they need on the market, or a combination of the two. Such choices are likely to be determined by relative costs. In this way,

emissions are reduced wherever it is most cost effective to do so.

In addition to domestic action by Member States to reduce their greenhouse gas emissions, the Kyoto Protocol allows Member States to invest in Joint Implementation (JI) and Clean Development Mechanism (CDM) projects in other countries and use credits from these for compliance purposes towards part of their emission reduction commitments. Member States are required to ensure that the use of Kyoto project credits is supplemental to domestic action. Since the EU ETS is the EU's central instrument for achieving the Kyoto Protocol targets, the Emissions Trading Directive allows operators of installations to use JI and CDM credits towards fulfilling a proportion of their emission reduction commitments under the scheme. This proportion must be consistent with Member State commitments to "supplementarity" and has to be fixed in the national allocation plan. The Commission considers that, as a general rule, installations should be allowed to use JI and CDM credits to supplement their allowance allocation by up to 10%. In assessing proposed limits that are greater than 10%, the Commission has taken into account the effort a Member State has to undertake to respect its Kyoto target.



Descriptor of general measures taken by Ukraine relating to implementation of commitments under the Kyoto Protocol

2.1. The regulatory and institutional basis for implementation of commitments under the Kyoto Protocol

The Kyoto Protocol was ratified by the Ukrainian Parliament in February 2004, and since then it has become an integral part of Ukrainian legislation. After the Protocol's coming into force in February 2005 Ukraine, as a Party to it, must fulfill certain commitments and has an opportunity to participate in the flexibility mechanisms envisioned in Articles 6, 12 and 17.

According to the Kyoto Protocol, within the period 2008-2012, total greenhouse gas (GHG) emissions in Ukraine should not exceed the 1990 level (assigned amount or quota for Ukraine). Results from the last GHG inventory showed that in 2004 the emissions made up 45% of the 1990 level. Basic forecasts indicate that in 2012 emissions will not exceed 1990 levels. Consequently, Ukraine may not need to undertake any specific measures to fulfill its commitments to the Kyoto Protocol.

At the same time, it should be noted that the existing emissions reduction compared to the base year occurred, mainly, due to deep economic recession of the 90s, the consequences of which the country has only started to overcome in recent years. The task is not only just to restore previous production outputs, but

also to bring new levels of quality, implying more efficient usage of energy resources. As a result, sustainable reduction of energy consumption and corresponding reduction of GHG emissions would be achieved.

Participation in the flexible mechanisms of the Kyoto Protocol may contribute to intensifying investment activities for the modernisation of the economy. This is particularly important for those sectors suffering from under-financing due to low financial returns, high risks and other factors. At the same time, it is necessary to ensure that transfer of a part of the national-assigned amount does not contradict the need for economic growth. Hence, the establishment of a regulatory, institutional and procedural basis for participation in Kyoto Protocol mechanisms, which should be accompanied by determination of the most expedient strategy for such participation.

Such an approach was adopted as a basis for the National Plan of Measures on Fulfillment of Provisions of the Kyoto Protocol to the UN Framework Convention on Climate Change by Resolution No. 346-p of the Cabinet of the Ministers of 18 August 2005. The plan envisages:

- Creating a national inventory system for greenhouse gas emissions and removals;



- Establishing a national GHG registry;
- Creating an infrastructure for joint implementation (JI) projects;
- Development of a national GHG emissions trading system;
- Regular preparation of National Communications;
- Development of national and regional plans on climate change mitigation;
- Development of a database of environmentally sound technologies.

To ensure coordinated implementation of these tasks, by the Decree of the President of Ukraine of 12 September 2005 No. 1239/2005 "On coordinator of activities for implementation of Ukraine's commitments under the United Nations Framework Convention on Climate and Kyoto Protocol to the United Nations Framework Convention on Climate Change" the Ministry of Environmental Protection of Ukraine was appointed as a national coordinator of actions for the fulfillment of the Kyoto Protocol and UNFCCC commitments.

2.1.1. The national inventory system

Ukraine regularly prepares and submits within required timeframes annual national inventories of GHG emissions

and removals. A common and compulsory order for performing such activity was introduced by the Cabinet of Ministers of Ukraine Decree of 21 April 2006 No. 554 "On confirming the Order of system operation for the estimation of anthropogenic emissions and removals of greenhouse gases not controlled by the Montreal Protocol". The inventory rules introduced in this way are mandatory for all government bodies and all economic entities, and include the following main points:

- Appointment of the National Agency on Ecological Investments as a single national entity with overall responsibility for preparation and submission of inventory in accordance with Kyoto Protocol requirements;
- Determination of the scope and objectives of the national GHG inventory system;
- Development and approval of an annual inventory plan;
- Collection of information on GHG emissions and removals from ministries and agencies, central and local government bodies and economic entities;
- Conducting necessary studies to update emission factors;
- Carrying out preparation of annual GHG inventory reports;



- Archiving information from national inventory and related materials;
- Publishing annual inventory reports on the Ministry of Environmental Protection's website and submitting them to the UNFCCC Secretariat.

The national inventory system in Ukraine enables the country not only to fulfill its commitments under Article 5.1 of the Kyoto Protocol, but also to optimise domestic measures on GHG emissions mitigation. From this viewpoint, the important results of the inventory are identification of key emission sources and sinks, determination of existing trends, and provision of data for adjustment of future forecasts. This provides an opportunity to determine priority sectors for implementation of measures, in account of returns on invested funds and achievable absolute reduction figures.

2.1.2. The national registry

To guarantee participation in the flexible mechanisms from the beginning of the commitment period, Ukraine is going to put into operation the national GHG registry in accordance with the decision 19/CP.7. A detailed description of the registry is to be included in the report on calculation of Ukraine's assigned amount.

In October 2005 the Ministry of Environmental Protection conducted a ten-

der to determine a registry supplier and allocated budgetary financing for the implementation of necessary works. Technical specifications for the tender were developed with respect to the requirements formulated in relevant decisions of the Parties' Conferences, and foresaw registry software compatibility with technical specifications of the international transaction log (ITL) being established by the UNFCCC Secretariat. European experience of registry systems operation (GRETA, SERINGAS, and ECRA) was also taken into account, as well as requirements of the national legislation of Ukraine. Additionally, the registry's functionality will support potential needs of the domestic emissions trading system, the possibility of creating which is now elaborated in conformity with the National Plan of Measures on Fulfillment of the Kyoto Protocol and UNFCCC.

Basic software for the registry has been developed and passed a required expert review in accordance with national procedures. However, the software is yet to be tested for compatibility with the ITL, when possible adjustments may have to be made. Necessary hardware has been purchased and installed, and instructions for system users have been prepared. Presently, the registry system for practical operation is being tested. The National Agency on Ecological Investments under the Ministry of Environmental Protection has been appointed as registry administrator.



2.1.3. The joint implementation mechanism

Participation in the JI mechanism is additional to emission mitigation efforts taken by Ukraine on its own, under existing domestic programmes like the Comprehensive National Programme on Energy Conservation adopted by the Cabinet of Ministers of Ukraine Decree of 10 April 2006 No. 248. Large-scale activity within the framework of JI mechanism implies realisation of hundreds of projects. Given available experience in the clean development mechanism, the capacity of the Track 2 JI mechanism (which is similar to it) may prove to be inadequate for realisation of such a number of projects. That is why the strategic priority for Ukraine is to fulfill, as soon as possible, conditions for participation in the Track 1 of the JI mechanism in accordance with decision 16/CP.7.

Ukraine has already met some of the conditions for participation in JI Track 1 and intends to meet the rest of them. Ukraine is a Party to the Kyoto Protocol and has appointed the National Agency on Ecological Investments as a national coordinator for activities associated with the Protocol. The formation of the national inventory system is in process and the submission of the annual emission inventory has been achieved. Creation of the national GHG registry is being completed. Main national procedures regulating activity on JI projects in Ukraine have been developed and adopted.

Existing regulatory documents on the JI mechanism include, first of all, a Decree of the Cabinet of Ministers of Ukraine of 22 February 2006 No. 206 "On confirming the Rules for review, approval and implementation of the projects aimed at reducing the amount of anthropogenic emissions or increasing removals of greenhouse gases in accordance with the Kyoto Protocol to the United Nations Framework Convention on Climate Change". The procedure sets out two stages of JI project approval - receiving a letter of endorsement and a letter of approval for the project, and also subsequent monitoring and verification of its results.

Provisions of this Cabinet of Ministers' decree were elaborated in more detail in the following orders of the Ministry of Environmental Protection:

1. Order of 17 July 2006 No. 341 "On confirming the requirements to the documents substantiating the amounts of anthropogenic emissions and removals of greenhouse gases, necessary for obtaining a letter of endorsement by the owner of emissions source where a joint implementation project is planned to be implemented", which adopted the requirements to the documents submitted in support of the application for the letter of endorsement. The order establishes the list of relevant documents and requirements to their format and content. The letter of endorsement provides grounds for an owner of a potential JI project to proceed with development of full project documentation.



2. Order of 17 July 2006 No. 342 "On confirming the requirements to preparation of Joint Implementation projects", which adopted the requirements to full project documentation submitted in support of the application for the letter of approval. The order establishes the list of relevant documents and their format and content requirements. The structure of the project documentation corresponds to the requirements established by the JI Supervisory Committee under the UNFCCC Secretariat.

Adopted regulations are already being actively applied. Their practical efficiency is testified by the fact that the Ministry of Environmental Protection has already issued 43 letters of endorsement and 4 letters of approval for JI projects. To intensify and facilitate cooperation with potential investors in JI projects, inter-government memoranda of understanding are being concluded. To date, such memoranda are already signed with Canada, Denmark, the Netherlands and the World Bank, and are being prepared for signing with France, Austria, Italy and Portugal.

2.1.4. Emissions trading

A domestic emissions trading system does not yet exist in Ukraine. Ukraine has no formal international commitments to introduce it, and considering the forecasted surplus amount compared to actual emissions over the period of the Kyoto commitments, the development of such system is not an economic necessity. At

the same time, implementation of such a system in Ukraine is not excluded currently in connection with the following main factors:

- Necessity to stimulate improvement of energy efficiency to reduce dependence on external supplies of energy resources;
- Appearance of real constraints as a result of possible sale of a considerable portion of the national assigned amount surplus; and
- Possibility to increase economic return from participation in the JI mechanism.

To consider options for a domestic emissions trading system, Ukraine initiated a study on development of the national plan for allocation of emission allowances among enterprises and industrial sectors. The study is considering how the allowance allocation could be accommodated to the plan for the social and economic development of the country, with account of peculiarities of the national economy and other important aspects.

The decision about participation in international emission trading under Article 17 of the Kyoto Protocol and its possible volumes will be made on the basis of detailed economic forecasts for 2008-2012 and following periods. Development of such forecasts is prescribed to relevant ministries by special instruction of the prime minister of Ukraine, and



is also envisioned as a part of development of the national emission allowances allocation plan.

2.1.5. Institutional issues

The key state body on all issues related to the Kyoto Protocol is the Ministry of Environmental Protection in accordance with the Decree of the President of Ukraine of 12 September 2005 No. 1239/2005 "On coordination of activities for implementation of Ukraine's commitments under the United Nations Framework Convention on Climate and the Kyoto Protocol to the United Nations Framework Convention on Climate Change". First of all, this relates to the inventory issues and JI mechanism. Thus, according to the Decree of the Cabinet of Ministers of Ukraine of 22 February 2006 No. 206 "On confirming the Rules for review, approval and implementation of the projects aimed at reducing the amount of anthropogenic emissions or increasing removals of greenhouse gases in accordance with the Kyoto Protocol to the United Nations Framework Convention on Climate Change", the National Agency on Ecological Investments under the Ministry of Environmental Protection is authorised to issue the letters of endorsement and approval for JI projects, determine requirements to project documentation and procedures, and supervise the process of project implementation. The National Agency on Ecological Investments is responsible for preparation and submission of annual inventories.

The National Agency on Ecological Investments also plays a key role in providing for the operation of the national GHG registry.

To ensure inter-agency coordination and supervision of the measures relating to the UNFCCC, the Cabinet of Ministers of Ukraine adopted Decree of 14 April 1999 No. 583 "On Inter-agency commission on ensuring implementation of the United Nations Framework Convention on Climate Change" and created a special interagency commission. Apart from the Ministry of Environmental Protection, the commission is composed of the representatives of the Ministry of Economy, Ministry of Finance, Ministry of Fuel and Energy, Ministry of Industrial Policy, Ministry of Agrarian Policy, Ministry of Construction, Architecture and Housing and Communal Services, Ministry of Transport and Communication, Ministry of Foreign Affairs, Ministry of Justice, Ministry of Education and Science, State Committee on Statistics, State Committee on Forestry, State Committee on Land Resources, Council of National Security and Defence, National Academy of Sciences, parliamentary commission on environment. The commission is chaired by a Vice-Prime Minister, and the commission's first deputy chairman is the Ukrainian Minister of Environmental Protection of Ukraine. The Inter-agency Commission is a high-level political body, meeting as necessary to resolve strategic issues related to the Kyoto Protocol and UNFCCC, coordinate the state bodies, consider materials received from for-



eign governments and international financial institutions, prepare proposals and supervise implementation of commit-

ments under the Kyoto Protocol and UNFCCC.

Ukraine's perspectives on Emission trading and it's practical implementation

Ukraine has the right to sell the unused part of the quotas (allowed emission) as a result of signing the Kyoto Protocol. In accordance with this agreement Ukraine is allowed to emit into the atmosphere up to 925 million tons of greenhouse gases. However, such a level of industrial emissions has not been recorded since 1990 and after the collapse of the Soviet Union it was reduced by more than half.

All the Kyoto Protocol signatories are oriented towards the 1990 level. Because of that, Ukraine now has the opportunity to sell the unused part of the quotas. The Ministry of Economy of Ukraine has predicted that the unused quotas in 2008-2015 will equate to 2.2 billion tons.

The purchase of the unused part of the quotas is profitable for those countries that have no plans to trim down power consuming industries, which are responsible for the lion's share of emissions (metallurgy, auto-making industry, cement production, etc.)

The Ukrainian government is willing to sell the unused part of the quotas. More

precisely, greenhouse gas quotas unused by Ukraine will be sold by auction, which shall attract 12 billion dollars within 5 years. The Cabinet of Ministers has plans to conduct a test sale. The equivalent to 10-20 million tons of carbonic gas will be sold initially.

The first sale should be made as soon as possible. It is necessary for Ukraine to move ahead of Russia, with whom Ukraine occupies 80% of the market. The counteragents should see that Ukraine is a market leader.

Kyiv city plans to sell only half of the unused quotas (2.2 billion tones from 2008-2015). The rest will be set aside. Thus, approximately 1 billion tons will be available for sale, but only after some pertinent legislative norms are regulated.

The National Agency of Ecological Investments is finishing the development of the methodology, which will regulate the minimum price of the CO₂ equivalent.

Ukraine's quotas are in demand by those countries that exceed their own limits. It is



more convenient for them to pay millions to Ukraine than to minimise their emissions. Austria, Spain, France, the Netherlands and Belgium have demonstrated interest in CO2 quotas, but Japan is the most interested party.

The Cabinet of Ministers empowered state officials to sign a Memorandum of Understanding with the governments of the Netherlands, France and Japan on mutual implementation of Article 6 of the Kyoto protocol.

There are drafts and plans regarding sale of the quotas, but the actual purchase is likely to take place in the second half of this year and only if an amount of legislative and organisational work is carried out by the Ukrainian government.

The National Agency of Ecological Investments is inclined to believe that the market price of conditional emissions will not exceed 10 euros per ton. Therefore, Ukraine will be able to make EUR 2-2.5 billion annually by selling its quotas. In other words it can earn up to EUR 10-12 billion within five years.

It is also mentioned that the distribution of monetary funds will be strictly regulated. Money will be used to modernise housing and communal services and to improve parks and forests. The local and central authorities have already submitted around 150 applications to take part in these programmes. The National Agency of Ecological Investments will review them all and will

choose the best ones to implement and finance.

The Kyoto Protocol ends in 2012. During an international conference on the Indonesian island of Bali in December 2007, the participants adopted the so-called "road map" (the plan of new negotiations on global warming that envisage substantial reduction of carbonic gas emissions into the atmosphere) and agreed to draw up the agreement which will replace the Kyoto Protocol.

The European Commission has already developed the legislation on CO2 emissions reduction. It was proposed to all EU members to ensure a gradual transition towards the sale of all CO2 emission quotas through auctions, starting in 2013. In 2013 a fifth of quotas will be sold through the auctions, increasing to 100% in 2020.

Much legislation has been adopted in Ukraine to establish and operate the national emission trading scheme, but even more legal and organisational measures must be performed before real progress is made.

European countries are successfully trading emissions, and billions of dollars are involved in the emissions trading market, but Ukraine, unfortunately, is not an active player. Further delays may lead to the loss of potential profits from the sale the quotas, so the upcoming changes to the Ukrainian legislation must be carried out promptly.

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