

## Emissions Trading: Proposed EU harmonisation of Large Hydro criteria

May 2008

This Legal Alert highlights the main elements of the recent initiative by a working group<sup>1</sup> of the European Commission and Member State representatives in the Climate Change Committee ("**CCC**") to harmonise acceptability criteria for hydro projects with a generating capacity exceeding 20 MW ("**Large Hydro Projects**") in the context of the EU Emissions Trading Scheme ("**EU ETS**"). On 16 May 2008, the CCC published a draft non-paper (the "**CCC non-paper**") and a draft compliance report for consultation (the "**Compliance Report**").

The CCC seeks to harmonise the approval process for Large Hydro Projects among Member States and thereby regulate their sustainability and environmental integrity. This would ensure fair and equal treatment of project proponents (regardless of in which Member State they request approval of Large Hydro Projects). Differences in transaction costs would be prevented and clarity and legal certainty in the carbon market enhanced.

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<sup>1</sup> The working group stems from the workshop on "Implementation on the WCD Guidelines" of 28-29 February 2008 in Berlin and consists of representatives from the Netherlands, Denmark, Finland, Germany, Italy, Spain, Sweden, the UK and the European Commission.

### Large Hydro Projects

Large Hydro Projects concern the production of hydroelectric electricity by means of water turbines driven by waterfalls or fast-flowing water from dams in valleys or mountainous areas. This generates clean and relatively cheap electricity (and the water used can still be applied to other purposes, such as irrigation). However, Large Hydro Projects are controversial as they could destroy ecosystems (in dammed areas), sometimes require major relocation of people and may cause floods. Organisations such as Greenpeace and International Rivers are therefore opposed to Large Hydro Projects.

### The EU ETS Directive

Article 11b (6) of the EU ETS Directive (2003/87/EC, as amended by 2004/101/EC) provides that Member States shall, when approving Large Hydro Projects, ensure that relevant international criteria and guidelines will be respected during the development of said project activities, including the World Commission on Dams November 2000 Report "Dams and Development A New Framework for Decision-Making" (the "**WCD Guidelines**")<sup>2</sup>. The WCD Guidelines contain criteria to minimise impact on

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<sup>2</sup> <http://www.dams.org/docs/report/wcdreport.pdf>.

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ecosystems, cultural (and religious) heritage and livelihoods<sup>3</sup>. In practice, however, different Member States use different procedures when applying Article 11b (6).

### Proposed harmonisation

The CCC now proposes a common procedure for the approval of Large Hydro Projects. The project proponent should fill out a Compliance Report, certifying that the relevant Large Hydro Project is in compliance with the WCD Guidelines. The completed Compliance Report must then be validated by a DOE (for CDM), AIE (for JI) or another qualified validator recognised by the Member State, and before approving a Large Hydro Project, Member States should check whether a validated Compliance Report is available. This procedure will not be binding, however, and Member States should voluntarily decide to abide by it. The Compliance Report does not compromise the sovereign authority of each Member State to decide which Large Hydro Project activities to approve.

The CCC was inspired by the Swedish and German admission procedures and adopted several of their criteria in the Compliance Report. As it is intended that Member State representatives check the validity of the Compliance Report themselves, the process should not be very complicated or expensive for the Member States according to the CCC. The DNAs/DFPs should receive objective evidence of compliance from the project proponents, presented according to best auditing practice. When preparing the Compliance Report, best practice includes interviews and public involvement, site observation and document review.

### Discretionary power unaffected

The Compliance Report does not affect the sovereign powers of the Member States with respect to the approval of Large Hydro Projects. Member States are not obliged to use the Compliance Report, and even if they have agreed to use the Compliance Report, Member States could in principle still deviate from it or stipulate additional requirements.

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<sup>3</sup> According to the CCC, the WCD Guidelines (that include criteria applied by the World Bank and the OECD) reflect best practice on sustainability assessment and can therefore be regarded as a fair reflection of all relevant criteria and guidelines as stipulated in Article 11b (6) of the EU ETS Directive.

A true harmonisation in this respect would require the amendment of the EU ETS Directive.

### EU ETS Compliance

Unfortunately, the CCC non-paper does not address the issue whether CERs and ERUs from Large Hydro Projects that have been approved in accordance with the harmonised Article 11b (6), will be accepted for compliance in all Member States.

Pursuant to Article 11a (1) of the EU ETS Directive, Member States *may* allow operators to use CERs and ERUs from CDM and JI project activities in the EU ETS up to a percentage of allocation of allowances to each installation, to be specified by each Member State in its national allocation plan for the respective period.

The word "may" indicates that Member States have a discretionary power when assessing the admissibility of project-based credits. Thus, CERs/ERUs that have been admitted for compliance purposes by one Member State may be refused by another. This creates commercial as well as legal uncertainty.

The current CCC proposal is a welcome first step towards making credits from Large Hydro Projects fungible among Member States, as it seems unlikely that Member States that have committed themselves to the Compliance Report would subsequently refuse credits from Large Hydro Projects that have been approved on the basis of the Compliance Report for compliance. However, true fungibility of CERs and ERUs for compliance purposes throughout the EU can only be achieved by amending Article 11a (a) or by having all Member States voluntarily commit themselves to accept such CERs and ERUs.

### The way forward

The CCC non-paper and Compliance Report are still in draft form. The drafts have been sent to industry and public interest groups for comments. It is envisaged that the CCC non-paper and Compliance Report will be finalised and approved by the CCC in early July. We understand that the CCC then hopes that Member States will voluntarily commit to using the Compliance Report and implement its criteria in their national legislation.

It would be highly beneficial to entities requesting letters of approvals from DNAs/DFPs if the

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Compliance Report does not remain a voluntary tool, but is eventually made binding on all Member States. Further, it would be desirable if the CCC would also focus on harmonising the criteria for accepting CERs/ERUs for compliance.

In order to reach such result, the EU ETS Directive would need to be amended, which requires the co-decision by the Council and the European Parliament.

### Contact information

If you have any questions on the subject of this Legal Alert, please get in touch with your contact person at De Brauw Blackstone Westbroek or with any of the following individuals.

#### Amsterdam

Rutger de Witt Wijnen  
T +31 20 577 1090  
M +31 6 5378 1417  
E [rutger.dewittwijnen@debrauw.com](mailto:rutger.dewittwijnen@debrauw.com)

Viviana Luján Gallegos  
T +31 20 577 1785  
M +31 6 5154 2718  
E [viviana.lujan@debrauw.com](mailto:viviana.lujan@debrauw.com)

Sander Simonetti  
T +31 20 577 1603  
M +31 6 5154 1289  
E [sander.simonetti@debrauw.com](mailto:sander.simonetti@debrauw.com)

#### London

Niek Biegman  
T +44 20 7337 3511  
M +44 78 8426 1678  
E [niek.biegman@debrauw.com](mailto:niek.biegman@debrauw.com)

#### New York

Ton Schutte  
T +1 212 259 4101  
M +1 917 434 0028  
E [ton.schutte@debrauw.com](mailto:ton.schutte@debrauw.com)

**Amsterdam**  
Tripolis  
Burgerweeshuispad 301  
P.O. Box 75084  
1070 AB Amsterdam  
The Netherlands  
T +31 20 577 1771  
F +31 20 577 1775

**London**  
5<sup>th</sup> Floor East Wing  
10 King William Street  
London EC4N 7TW  
United Kingdom  
T +44 20 7337 3510  
F +44 20 7337 3520

**New York**  
650 Fifth Avenue, 4th floor  
New York, NY 10019-6108  
United States  
T +1 212 259 4100  
F +1 212 259 4111

**The Hague**  
Zuid-Hollandlaan 7  
P.O. Box 90851  
2509 LW The Hague  
T +31 70 328 5328  
F +31 70 328 5325

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