

# Prototype Project of Voluntary Domestic Emissions Trading Scheme for Fiscal Year 2003

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## 1 . Purpose of the Project

Global warming is one of the major environmental problems that human beings have ever faced. It is important for each individual to commit themselves to global warming prevention measurements. In particular, actions in industrial sectors (including commercial sector and freight transportation), which account for 70 percent of Japan's greenhouse gas emissions, are indispensable.

In June 2002, Japan ratified the Kyoto Protocol and committed to reduce the GHG emissions between 2008 and 2012 by 6% below the level of 1990 emissions. The public in Japan are paying attention to policies and measures for GHG reductions.

However, it takes considerable expenses, for each private company to reduce its GHG emissions further through fuel switching and improvement of energy efficiency, and therefore there are limitations for their individual measures.

Under such circumstances, emissions trading can allow different industrial sectors and companies to cooperate each another through trading allowances and credits, and those who have taken initiatives to reduce GHG emissions would be able to receive benefits by selling their emission reduction credits. Emissions trading schemes are known to achieve GHG emission reduction in a cost-effective manner. The schemes are not "command-and-control" types of regulation and they can minimize the total social cost required to reduce GHG emissions.

Internationally, emissions trading schemes have been increasingly introduced. For example, the UK launched the Domestic Emissions Trading Scheme in April 2002, and in 2005, the first multilateral trading market is being established in the EU. Also, the Kyoto Protocol stipulates international emissions trading to be operated from 2008.

However, in Japan, we have no experiences in emissions trading, and, therefore, we are lacking of knowledge and information on how to monitor, verify and report GHG emissions from each source, how to deal with credit transactions, and how to set appropriate initial targets.

Accordingly, research about these technical methods would be beneficial for both private companies and governments. Here, Ministry of the Environment Japan ("MoE") has decided to operate a prototype project for voluntary domestic emissions trading scheme in the fiscal year 2003.

## 2 . Framework of the Project

During the period of 2002 to 2004 (1<sup>st</sup> step period), MoE is planning to operate a simple emission trading scheme on a voluntary basis, and ask participants to acquire experiences.

In FY2002, MoE supported an emission trading simulation program by Mie prefecture (enforced in January 2003) which involved 30 private companies in Mie. In FY2003, we will operate the "Prototype Project for Voluntary Domestic Emissions Trading" in order to obtain practical experiences. In FY2004, the "Guidelines of Measures to Prevent Global Warming", which are the Japan's action plan to address climate change will be reviewed based on the results of the project

and international situation. As a result of the review, an emissions trading system will be designed, if necessary. Finally, the government of Japan will decide whether to launch the emissions trading scheme during the first commitment period (2008-2012) of the Kyoto Protocol.

### 3 . Proposed Contents of the Project

Project Operator  
Ministry of the Environment

#### Approach

With voluntary participants of private companies which are interested in researching about emission trading schemes, MoE will operate domestic emissions trading on a trial basis, study technological methods for monitoring and verification of emissions, and publish the results as a report.

#### Requirements for Participation

Type 1: Private companies or parties that can set reduction targets for their 2003 emissions and estimate their actual emissions. : 34 participants (including companies to be participated)

Type 2: Private companies or parties that are currently undergoing or planning an emission reduction project at internal or external sites. : 5 participants

Applications were accepted from April 25 until May 16. The participants were selected, taking into consideration balance of the industrial types, amount of emissions and previous achievement.

The organizational boundary of type 1 participants should be basically a separate incorporated company or group of companies within the same holding company. It also could be a separate plant/branch or project.

Type 1 participants are allowed to set intensity targets for their goals.

Participants can take part in both Type 1 and Type 2 projects.

Participation in this scheme will not go under emission reduction obligation.

#### Overview of the Scheme (tentative)

- Type 1 participants shall set their 2003 emission reduction targets in 2003, and draw up a plan to achieve them. In planning their measurements, they shall show their emission reduction options and calculate their costs.
- Type 1 participants shall initially make efforts to reduce their emissions considering their own emissions reduction targets similar to the AAU (Assigned Amount Unit) of Kyoto Protocol (hereinafter “temporary-AAU”), and utilize the emissions trading scheme to achieve their goals. Participants are allowed to buy and/or sell their credits, however, since this project is implemented on a trial basis, the trading will not entail financial transactions (transactions will be only virtual).
- Type 1 participants, at the end of the year, should calculate their actual emissions for the whole year and be subject to a third party audit. The result will be compared to the “temporary-AAU” they initially hold. If there are not enough credits, participants are required to obtain credits from other participants. On the other hand, they are allowed to provide any surplus credits.(transactions would be only virtual)

- Type 2 participants can estimate their emission reduction units according to an ongoing or planned GHG reduction project, and be subject to a third party audit. These emission reductions can be regarded as credits and traded with other participants virtually.
- A broker consigned by MoE will operate virtual transactions of “temporary-AAU” or emission reduction credits. Also, the broker can obtain credits virtually, taking into account future overseas emission reduction, and provide them to participants.
- Issuance, acquisition, transfer of temporary-AAU and emission reduction credits should be operated using the National Registry developed by MoE and METI for the Kyoto Mechanism, with additional function necessary for this project.
- The nominating organizations for AOE of CDM will be third party auditors for this project. In choosing the organizations by MoE, opinions from the participants would be considered.

#### Working Group of the participants

- The aim of this project is that private companies and governments could work together on decision making of the domestic emissions trading scheme, through sufficient discussion. Any suggestion from private companies would be taken into consideration. The contents of the project (especially setting of individual emission reduction targets, estimation and verification of emissions, methods of transaction, management of reduction credits) would be decided after several working group meetings. (The overview of the scheme described previously is just a tentative plan.)
- The first working group meeting was held on June 10, 2003. The participation of the registered observers will be admitted after the second meeting.

#### Budget

The 2003 budget is 300 million-yen in total. The details are as follows:

- (1) Type 1 participants can be granted the actual expenditure for setting of individual emission reduction targets, planning of their emissions reduction, measures, implementation of transaction, estimation of emissions, personnel costs for a third party verification, travel expenses, and contributing their knowledge and experiences.  
 : Total 180 million-yen  
 (The exact grant will be determined in October after taking into account the participants' scale.)
- (2) The expenditure for verification will be granted to a third party audit chosen by MoE.  
 : Total 70 million-yen (Both Type 1 and Type 2 participants can receive a third party verification for free of charge. The exact grant will be determined in October.)
- (3) The expenditure for project administration, research of internal and external relative information, transactions, management of the National Registry will be granted to a corporation consigned by MoE.

: Total 50 million-yen

#### Advantages for participants of the project

- Participants can obtain experiences in credit transaction process and managing the National Registry prior to the international emissions trading scheme starting in 2008.
- In the working group meeting, participants can obtain internal and external information about setting up reduction targets and estimation methods from various eminent experts with a variety of backgrounds
- By a third party audit, participants can enhance their knowledge in their own emissions.
- Type 1 participants can receive subsidies for costs necessary to calculate their emissions and receive a third party audit. Type 2 participants can receive a third party audit for free of charge.

#### Others

The names of participants, each individual targets, emission reduction plans, emission data and verification results are not be open to the public basically. Working group meeting is also held internally.

#### 4 . Proposed timetable for the project

June to October : Working group meeting will be held once every 2 to 3 weeks (Researching on domestic and international progress in emissions trading, the subjects such as methods of estimation, verification, techniques of transaction and systems of emissions trading will be discussed. Then, the contents of the prototype project will be fixed.)

November and December : Experimental transaction will be operated using temporary-AAU and other emission reduction credits, thus experimental transfer and acquisition will occur on the national registry.

January and February 2004 : Calculation for annual 2003 emissions

February and March 2004 : Third party auditing will be performed, achievement of targets will be verified and reported, and matching of actual emission and holding credit will be checked.

March 2004 : The project will be evaluated based on the results.