Shanghai Emissions Trading System Pilot

This information is based on the **Shanghai Draft Rules for Emissions Trading Guidelines first published in 2012** **and the Shanghai's Draft Measures on Emissions Trading Pilot** in the summer of 2013. The Draft Rules are the working plan for Shanghai's government on establishing an ETS pilot between 2013 and 2015. The draft rules will need to be reviewed by other agencies in the Shanghai government and go through a stakeholder consultation round before being finalized.

- **Participation:** Participation for industries located within the Shanghai municipality annually emitting CO_2 of more than 20,000 tons during any year between 2010 and 2011 (including both direct and indirect emissions), as well as those non- industrial firms in aviation, ports, airports, railways, commercial enterprises, hotels and financial institutions that are emitting CO_2 annually of more 10,000 tons during any year between 2010 and 2011.
- **Trading:** Trading will include **direct and indirect CO_2 emission rights** and "verified cap and trade permit" for voluntary participants. Both direct and indirect emissions will be covered. Direct emissions are from energy-related activity and industry production. Indirect emissions stem from purchased electricity and heating power.[1]

Trading will take place in a designated trading platform at the **Shanghai Environment Energy Exchange (the Exchange)**. The Exchange will establish trading types, auction procedures, purchase contracts, and the level of transaction fees. All of these will be submitted to the Shanghai DRC for approval.

- **Sector Coverage:** Steel, petrol, chemicals, ferrous metals, power, construction materials, textiles, paper-making, rubber and chemical fibers industries. Sectors not covered during this period, but emitting over 10,000 tons annually should establish a carbon emissions

[1] Article 2 of the Shanghai's Draft Measures on Emissions Trading Pilot

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reporting mechanism to prepare for participation at a later date. A full list of companies/entities covered by the ETS will be made available at a later date.

- **Banking:** Covered entities will not be allowed to receive forward allowances, but are permitted to bank unused allowances from the previous year. After an entity surrenders its allowances into the registry system, surplus allowances can be banked for future use.[2]
- **Allowances:** Pilot enterprises will receive a carbon emission quota/allowances based on emissions during the period from 2009 to 2011 and begin management of those allowances, then receive a "carbon emissions inspection," and then assume "carbon emissions control responsibilities" according to the carbon emission reporting mechanism. Interestingly, allowances will be awarded in the future based on industry-specific growth patterns- meaning that increasing caps, rather than the declining, absolute caps seen in ETSs in Europe and elsewhere will be created.
  One allowance in Shanghai ETS pilot is called **SHEA (Shanghai Emissions Allowance)**, meaning to allow releasing 1 tonne of CO_2. Covered entities will need to surrender their allowances to the registry system between 1 June and 31 June each year.[3]
- **Allocation:** The allowances for the entire period from 2013-2015 will be allocated all at once. For those sectors that have a 'clear and standardized emission record', benchmarking could be adopted (to be confirmed). **During the pilot ETS, the primary allowances will be allocated for free**. If needed, an allowance auction may take place.
- **Financials:** Shanghai is studying how to include institutional investors to participate in the ETS at a 'suitable time'.
- **Offsets:** GHG offsets verified by the national or local government will be included. At present, the Shanghai DRC is actively exploring 'innovative products' related to carbon emissions trading. China Certified Emissions Reductions (CCERs) can be used to offset actual emissions in the place of allowances. The amount of CCERs cannot exceed 5 per cent of a covered entities total allocation amount.[4]
- **MRV:** All covered entities in the Shanghai pilot ETS will have to set up an organisational carbon emissions monitoring, reporting and verification system. Entities will have to submit a report each year, and it must be verified by a 3rd party.
  - **-Monitoring[5]:** Covered entities will need to make a monitoring plan for each subsequent year during the last 3 months of the previous year. For the year 2014 for example, an entity will need to make its monitoring plan during the period Oct.-Dec., 2013.
  - **-Reporting[6]:** Covered entities will be required to complete a carbon reporting analysis by March 31 each year and submit this to the Shanghai DRC. For example, an entity will need to submit its 2013 reporting analysis by March 31, 2014.
  - **-Verification[7]:** A verification report compiled by a 3rd party verifier will need to be submitted annually. All 3rd party verifiers must be domiciled in China.
  - **-Administrative Check[8]:** The Shanghai DRC will perform an emissions check for each covered entity based on the emissions monitoring report from the company and the

[2] Ibid, Article 17.2
[3] Ibid, Article 17.1
[4] Ibid, Article 18
[5] Ibid, Article 7
[6] Ibid, Article 8
[7] Ibid, Article 9 and Article 22
[8] Ibid, Article 10

verification report from the 3rd verifier. The Shanghai DRC will then send its confirmation to each entity.

The Shanghai DRC will need to perform an additional layer of checks under the following circumstances:

(1) If there is a gap of over 100,000 tonnes of CO_2 between the emissions report and the verification report;
(2) If emissions amount from the current year are a 20% increase compared to the emissions amount from the previous year;
(3) If a covered entity does not agree with the verification report and has data to prove said report is not complete or wrong.

- **Post-2015 Trading:** According to the draft guidelines, the Shanghai DRC will conduct an overall assessment of the pilot's experience and prepare for a national ETS after 2015.
- **Governing Agency:** The Shanghai Municipal government will set up a leading working group, to manage the overall pilot ETS design and execution. It will be led by the deputy mayor that is in charge of environmental issues, and will be composed of members from the Shanghai DRC, Shanghai City's Economic Information Bureau, City's Commerce Bureau, City's Finance Bureau, City's Construction and Transportation Bureau, City's State Assets Bureau, City's Statistic Bureau, City's Tourism Bureau, City's Ferry and Ports Bureau, City's Quality Control Bureau, City's Government and Law Office, and the City's Finance Working Office.
  The Shanghai DRC is the competent authority to implement the emissions trading pilot.[9]
- **Linkage:** The Shanghai ETS is encouraged to link with other ETS pilot[10], however provisions to link are not included in the draft rules.
- **Registry:** The Shanghai DRC will make an allocation plan and issue allowances to covered entities via a registry system.[11]
- **Penalties for non-compliance:** Non-compliance of reporting: If an entity does not report its emissions, the Shanghai DRC will issue a penalty in the range of ¥10,000 to ¥30,000.[12] Non-compliance of verification: If an entity provides false information or hides information altogether during the verification process, the Shanghai DRC will issue a fine in the range of ¥10,000 to ¥30,000.[13] If an entity resists a verifier's work, or provides a fake verification report, the Shanghai DRC will issue a fine in the range of ¥30,000 to ¥50,000.[14]
- **Non-compliance of surrendering allowances:** If an entity cannot surrender enough allowances to the registry compared to its reduction target, the Shanghai DRC will order the entity to surrender the undue amount within a defined period; otherwise, the Shanghai DRC will issue a penalty in the range of ¥50,000 to ¥100,000.[15]

In addition to the above, if an entity is found to be in non-compliance, the following will also occur:

1) The Shanghai DRC can refer the entity to the Shanghai Tax Bureau, Shanghai Finance Bureau and the Shanghai Industry and Commerce Bureau to start a credit investigation on the company itself.

[9] Ibid, Article 4
[10] Ibid, Article 16
[11] Ibid, Article 6
[12] Ibid, Article 30
[13] Ibid, Article 30
[14] Ibid, Article 31
[15] Ibid, Article 32

2) The Shanghai DRC can annul the company's qualifications to gain future government financial support (subsidies), and annul its qualification to participate in a government competition as a 'good performer' in energy-saving and other emissions reduction policies.
3) The Shanghai DRC and other relevant government Bureaus can ignore the application of new projects from the company, in effect revoking or not issuing construction or operating licenses for the company
4) If the company is a State-Owned Enterprise (SOE), the non-compliance with the ETS violation will be included into the annual performance assessment system; this system is connected to the salary of the chief executive member (the CEO). In effect, the CEO of an SOE's review will now include performance with the Shanghai ETS.

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References:

[1] The Shanghai Draft Rules for Emissions Trading Guidelines first published (The Shanghai Government, 2012)

[2] The Shanghai's Draft Measures on Emissions Trading Pilot (The Shanghai Government, Summer 2013)