

Sakhalin Carbon Neutrality Pilot Scheme

6 August 2021

The draft federal law on the Pilot Regulation of the Greenhouse Gas Emissions and Absorption in the Sakhalin Region (the “**Draft Law**”) was developed by the Russian Ministry of Economic Development and submitted to the Russian Government in July 2021.¹ This Draft Law, together with Federal Law No. 296-FZ on the Restriction of Greenhouse Gas Emissions dated 2 July 2021 (the “**Emissions Restriction Law**”),² is one of the first steps aimed at introducing carbon regulation in Russia.

The Draft Law provides for the implementation of a pilot scheme in the Sakhalin Region from 1 January 2022 to 31 December 2025 involving special regulation of greenhouse gas emissions and absorption. The purpose of the pilot scheme is to achieve carbon neutrality in the Sakhalin Region, i.e., the condition when the volume of greenhouse gas emissions is equal to the volume of their absorption during the calendar year, and to test the proposed procedures and tools of carbon regulation, including the likelihood of their international recognition.

The Draft Law is special law in relation to the Emissions Restriction Law, and sets forth more rigorous rules for regulated entities³ by introducing the emission quota mechanisms and special charges for exceeding quotas and requiring verification of the carbon reporting by independent expert organisations. If the Draft Law is adopted and the mechanisms contemplated by it (including the quota system) prove their effectiveness, the respective approaches to carbon regulation may be spread to other

¹ The full text of the Draft Law is available on the Federal Portal of Draft Regulations at <https://regulation.gov.ru/p/114717>.

² For further details on the Emissions Restriction Law, see our recent Client Update on the First Steps to Introduce Mandatory Carbon Regulation in Russia at <https://www.debevoise.com/insights/publications/2021/05/first-steps-to-introduce-mandatory-carbon?translationGuid=2994950b-5f7b-40d5-bffc-0ea55114294e>. The full text of Federal Law No. 296-FZ on the Restriction of Greenhouse Gases Emissions dated 2 July 2021 is available on the Official Internet Portal of Legal Information at <http://publication.pravo.gov.ru/Document/View/0001202107020031#print>.

³ The regulated entities are legal entities and sole entrepreneurs whose business involves emissions of greenhouse gases and which owe certain duties under the Emissions Restriction Law and the Draft Law. The regulated entities are legal entities and sole entrepreneurs whose businesses involve emissions of greenhouse gases and which owe certain duties under the Emissions Restriction Law and the Draft Law.

Russian regions. At present, the Kaliningrad and Nizhny Novgorod Regions announced their willingness to join the scheme.⁴

Key Definitions. The underlying definitions used in the Draft Law are those contained in the Emissions Restriction Law.

For example, the Draft Law contains a definition of the carbon footprint as the total volume of emission and absorption of greenhouse gases generated in the full production cycle or at its various stages or in the provision of services which includes direct emissions of greenhouse gases (generated by business or any other activities) and/or indirect emissions of greenhouse gases (related to the consumption of power and/or heat energy and/or any other resources used for the support of business and any other activities obtained from third parties) and/or absorption of greenhouse gases as a result of business or any other activities. The carbon unit is defined as a verified unit of the climate project implementation expressed in the volume of greenhouse gases equivalent to one tonne of carbon dioxide.

The Draft Law also introduces new concepts. In particular, the new concepts are those of the “quota” defined as the target volume of emission of the greenhouse gases generated by business or any other activities of the regulated entity determined by the competent agency for the purposes of achieving carbon neutrality in the pilot area; and the “quota compliance unit” defined as a verified result of compliance/non-exceedance of the quota expressed in the volume of greenhouse gases equivalent to one tonne of carbon dioxide.

Emission Quotas. According to the Draft Law, the emission quotas for the regulated entities located in the Sakhalin Region will be approved on the annual basis and for the period from the beginning until the end of the pilot scheme. If the regulated entity ensures compliance with the quota, it will accrue carbon units and quota compliance units equal to the difference between the quota and the actual greenhouse gas emissions in the reporting year. As discussed above, the carbon units are envisaged by the Emissions Restriction Law while the quota compliance units are not.

Emission Trading. The regulated entities, in addition to applying the quota compliance units and carbon units to comply with their quotas and reduce the carbon footprint of their products and/or services by offsetting against the volume of the carbon footprint, will also be able to sell them to third parties. At present, the Draft Law does not specify what persons will be able to purchase such quota compliance units. The transfer of the quota compliance units to a third party will be made on the basis of the owner’s

⁴ For more detail, see *Vedomosti* articles “Three Regions Are About to Launch Quota Auctions for Carbon Emissions” dated 1 April 2021 at <https://www.vedomosti.ru/economics/articles/2021/03/31/864074-tri-regiona>.

instruction to debit its quota compliance units from its account and credit those to the purchaser's account.

Charges for Exceeding Quotas. The Draft Law introduces charges for exceeding emission quotas.⁵ The regulated entities will calculate the charge for exceeding their quotas on their own by multiplying each tonne of the carbon dioxide equivalent in excess of the quota by the relevant payment rates. The payment rates for exceeding the quotas will be established by the Russian Government pursuant to the Emissions Restriction Law. Upon fulfilling their obligation to make payment for exceeding the quota, the regulated entities will be required to file a report (in the form of a special return) with the competent authority.

Failure to make payment for exceeding the quota timely or in full will result in the regulated entity being required to pay a penalty equal to one three hundredth of the Bank of Russia's key rate effective on the date of penalty payment, but not more than two tenths percent for each day of delay. The penalty accrues for each calendar day of delay.

Verification of the Carbon Reporting. Unlike the Emissions Restriction Law, which does not set forth the procedure for verification of the carbon reporting, the Draft Law provides that the carbon reporting of the regulated entities is subject to verification by independent expert organisations accredited in the national accreditation system as an agency for validation and verification of greenhouse gases or accredited by the State Development Corporation VEB.RF (provided that the expert organisation meets certain criteria, for example, it has a certificate of compliance of its internal procedures with the international standards in respect of determination of greenhouse gas emissions and absorption; no bankruptcy proceedings, overdue tax liabilities or liabilities for payments to the state extra-budgetary funds or affiliation with foreign entities, etc., during the period of verification of carbon reporting).

⁵ The Emissions Restriction Law does not provide for such charges.

To become federal law, the Draft Law must be approved by relevant ministries and tabled to the Russian State Duma, adopted by the State Duma in three readings, approved by the Federation Council and signed into law by the Russian President.

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Please do not hesitate to contact us with any questions.

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