



10 July 2007

European Climate Change Programme (ECCP) stakeholder group

BUSINESSEUROPE views on the issues highlighted by the Commission for the review of the EU Emission Trading Scheme (ETS)

BUSINESSEUROPE published in October 2005 a position paper outlining industry's views on the issues that were to be considered in the 2006 review i.e. in article 30 of the ETS directive (2003/87/EC). Some additional elements were also commented upon in the position paper. Among these issues are the indirect effects, including the pass-through of the allowance price to power prices, transparency and timing of submission of National Allocation Plans (NAPs).

This paper describes the BUSINESSEUROPE views on the four issues that have been discussed at the Commission European Climate Change Programme (ECCP) stakeholder meetings on the EU ETS Review.

1. SCOPE OF THE DIRECTIVE

1.1. Clarity of specific types of combustion installations, including more specific technical description, to facilitate harmonised application in the Member States

It is essential that similar combustion installations and process emissions are treated in the same way across Member States. To ensure similar treatment, there is a need for a better technical description of the different kinds of combustion installations. This technical information could be provided by the installations concerned or be part of a sector approach, if any. So far the enforcement in Europe has been patchy and it is therefore needed to inform the Commission about the necessity of a follow up by Member States. Member States must monitor and verify that the definition of combustion installations is followed.

1.2 Cost-effectiveness of covering small installations.

1.2.1. Optional inclusion of smaller installations

The inclusion of many small and medium sized companies within the EU ETS places on them unnecessary reporting and administration burdens whilst their greenhouse gas emissions are negligible. It is recommended that an emission threshold be set (for example, at least 25,000 tonnes CO₂eq/year). This corresponds to 55 percent of the installations included today, but only 2.5 percent of the total EU CO₂-emission (Report of July 2005 from a special Task Force of the Centre for European Policy Studies-CEPS).



Below this threshold a company would be excluded from the EU ETS unless it expressly chooses to be included. In any period, once this threshold is exceeded in any single year, the company remains within the ETS for that period.

It is vital that such an opt-out is in place (either formally or informally) for the period 2008-12. Such a change could be included in the proposal concerning the inclusion of aviation within the EU ETS.

Member States shall maintain a register of those companies “opted-out” and require a specified level of emissions monitoring and reporting.

BUSINESSEUROPE recommends that small installations are excluded from the scope of the Directive, mainly due to the fact that these installations have little capacity to take part in trading and therefore do not contribute to the liquidity of the market. Furthermore, the EU ETS places on the small emitters a disproportionate administration burden as has been demonstrated by studies in the UK and the Netherlands.

If small emitters were opted out of the EU ETS, many of the observed problems may be simpler to solve, for example, harmonisation of allocations, use of benchmarks etc.

If a small installation prefers to be included in the ETS, instead of being regulated outside the Directive, it should have a possibility to be voluntarily included. A small installation included in the ETS should have to follow the normal monitoring reporting and verification rules. That is to avoid a devaluation of the carbon market. The High Level Group on Competitiveness, Energy and the Environment has also recommended an exclusion of small installations in its report on 2 June 2006.

1.3 Inclusion of other greenhouse gases where feasible and appropriate (N₂O, CH₄) and harmonised inclusion of other activities

1.3.1. Other gases

The scope of the ETS should be broadened to be consistent with the Kyoto Protocol, where monitoring techniques permit sufficient accuracy of measurement and where protocols exist. This should be consistent with the point above with respect to the exclusion of smaller installations. The linkage between the inclusion of sectors and gases should be recognised and taken into account. An inclusion of additional greenhouse gases probably implies a concomitant inclusion of additional sectors, since the new gases are likely to be emitted from installations that are currently not covered under the scope of the ETS Directive.

1.3.2. Other sectors

Consideration should be given to the inclusion of other sectors in the Directive for the period post-2012. Any discussion must consider and take into account a package of items including, the potential impacts of inclusion (and its timing) on those companies that are already within the ETS, in particular on the price of allowances and the impacts on the international competitiveness.



These items are detailed below. Any inclusion should also be consistent with the exclusion of smaller installations. It is recommended that any inclusion of gases and/or sectors must be based on comprehensive impact assessments, showing cost-effectiveness and environmental benefit, and that the following conditions are applied:

- a) the environmental benefit is clearly demonstrated by technical measures and monitored with sufficient accuracy beyond any reasonable doubt
- b) that reducing emissions is technically feasible and leads to demonstrable environmental benefits,
- c) that there are no significant competitiveness effects on industries covered by the EU ETS as well as those not covered due to either direct or indirect effects,
- d) that there is recognition for early actions to reduce emissions,
- e) accuracy of monitoring, reporting and verification of emissions,
- f) the price signal can be linked to opportunities to reduce emissions,
- g) proportionate administration costs for both governments and covered sectors,
- h) that abatement costs are lower or similar to those in the covered sectors.

1.4. Opt-in provisions of the Directive

Use of the opt-in within the ETS must not lead to a competitive advantage for companies within a specific sector or lead to a competitive disadvantage to those sectors currently in the scheme.

1.5. Carbon dioxide capture and geological storage (CCS)

CCS will be an essential technology to enable a reduction of industrial emissions from large point sources of CO₂. It is vital, therefore, to develop a regulatory framework to give predictability; it is also necessary to consider how to incentivise investment in this technology, as a carbon-price is likely to be insufficient. The inclusion of CCS in the ETS should not lead to a distortion of the scheme. It will be important to clarify any impact that provisions of CCS in the ETS may have on the setting of electricity prices.

The CCS technology must not be mandatory, it must compete with other technologies i.e. there must be equal treatment for all technologies that are energy-efficient or emit a low or zero amount of carbon (technology neutrality). Technology developments must in the long-term be driven by the market i.e. by the price of carbon and in the short term receive equal public support outside the scope of the ETS.

Careful consideration needs to be given to the funding, development and access to CO₂ transport and storage infrastructure, taking into account, in particular, large emitters.



There is also a need for very clear definitions and monitoring of CCS. It is essential that it is made clear from the very beginning how liabilities as well as the mitigation resulting from CCS will be taken into account in the EU ETS, e.g. should responsibilities lie with the installation carrying out the sequestration or the storage provider.

Furthermore, due to the importance of CCS as a mitigation technology, it should be possible to be credited through the Kyoto mechanisms, JI (Joint Implementation) and CDM (Clean Development Mechanism), when it is used in developing and emerging economies.

1.6. The feasibility of a community-level approval process for projects

Domestic offset projects may provide useful opportunities to enable cost-effective emissions to be identified and should be encouraged. It is essential that any process is not bureaucratic and takes into account issues such as double-counting.

2. ROBUST COMPLIANCE AND ENFORCEMENT

2.1. Monitoring and reporting

2.1.1. Guidelines or Regulation

To maintain competitiveness and a level-playing field within the EU, it is essential that companies report to similar standards through the Union. To this end, an analysis of the reporting standards required by different Member States should be conducted. Flexibility must be maintained in any system. Turning the Decision into Regulation would be too prescriptive and will not solve in itself the problem of non-compliance and enforcement.

2.1.2. Means to ensure EU-wide minimum standards of application and timing

Monitoring and reporting must be harmonised across the Member States. Any system should be on an annual basis to reduce the administrative burden on time and costs.

2.2. Verification

2.2.1. Ensure improved stringency and oversight of the verification and the accreditation process in Member States including possible Community accreditation

Verification of emissions is vital to the establishment of a trustworthy ETS and a reliable price for CO₂ within the EU. Furthermore, it is of huge importance for the potential linking with other regional and national systems. It is essential that uniform standards are adopted and maintained. The administrative burden on companies should not be increased by monthly or quarterly verified reporting. However, Commission control over the release of national verified data is essential to avoid market disruptions as occurred with the unplanned release of 2005 verified data.

More frequent reporting will not significantly improve market information as “long” positions do not necessarily come to market.



2.2.2 Internal market aspects

It is essential that verifiers accredited in one Member State are able to operate under identical conditions in all Member States.

2.3. Compliance provisions

2.3.1. Enforcement of verification process

Uniform standards and enforcement must be established throughout the EU.

2.3.2. Harmonisation of existing compliance provisions

Uniform standards and enforcement must be established throughout the EU.

3. FURTHER HARMONISATION AND INCREASED PREDICTABILITY

3.1. Setting of a cap at EU or national level

BUSINESSEUROPE supports the development of a level playing field globally. In that respect, all possible options for setting the new burden for the “covered” sector of the EU ETS should be carefully evaluated including, current system of burden-sharing at a Member State level as well as the setting of the cap at the EU-level for the covered sector. The existing division of the burden, according to the current burden-sharing agreement, is inequitable in today’s situation within the EU.

The division of the EU cap among Member States or sectors, should take into consideration, the potentials to reduce emissions in each country based on GDP, the potential to reduce emissions in individual sectors, earlier investments to reduce emissions, energy mix, etc. Whilst it is recognised that the EU wishes to lead the issue of climate change, it is vital that measures taken within the EU do not damage international competitiveness. Any system of allocation must take into account the international competitiveness of EU business.

BUSINESSEUROPE emphasises that it is unacceptable and contradictory to a well-functioning internal market, including the ETS, if potential differences in a new EU-burden-sharing agreement for post-2012 translates into different allocations, and thereby competitive distortions, among companies in the “covered” sector and if the system hampers free movement of capital within the EU in the covered sectors.

3.2. Extensions of allocation certainty to increase predictability.

Many businesses have investment cycles that are considerably longer than the 5 year allocation period within the ETS. It is recommended that there is an assessment of the possibility and impacts of a longer period of allocation. Such long allocation periods may facilitate business planning and optimise the cost-effectiveness of the system if it is not interrupted by sudden changes during the allocation period.



It is vital that any future periods take into account developments under the UNFCCC and its Kyoto Protocol. In order to do so, a judgement must be made as to the attainment of an international agreement involving all countries and regions. In agreeing this judgement, it will then be possible to develop future periods of the ETS to take into account impacts on international competitiveness.

However, predictability is linked to flexibility, so even longer periods – e.g. 10 years - must not prevent a sensible investment pattern in the companies. There is a need to set long term goals, while short/medium term goals should allow for flexibility, this can be done by allowing banking and borrowing across periods. This would allow the right technology choice to be made at the right time and could prevent a situation where such decisions are simply governed by stringent short and medium term fixed targets. This would allow for cost-effectiveness in the system.

3.3. Allocation of allowances to sectors and installations

Allocation rules must be formulated and put into a common protocol to create a level playing field within Europe.

The targeted introduction of performance-based allocation (e.g. through benchmarks under a cap and trade or through a baseline and credit system) could be applied to large emitting, homogeneous processes. Other activities may remain with an allocation based upon grandfathering based on historical emissions. It is vital that any benchmarks should be agreed by both the respective sector organisations and the Commission.

However, it should be noted that sector organisations do not have the legal mandates to be responsible for the allocation of allowances within their sectors. The allocation would have to be under the responsibility of a public authority.

3.4. Allocation based on projections, emissions data and efficiency parameters

It was essential that free allocation based upon grandfathering was adopted for the first commitment period of the EU ETS. Grandfathering is a system for which there is now experience that must be carefully taken into consideration. Free allocation must be maintained in order to avoid damaging the competitiveness of EU industry until a comprehensive international agreement involving all major emitting countries undertaking comparable efforts is established. Whilst real emission data are now available for the years 2005 and 2006, BUSINESSEUROPE stresses that these data may not give a true reflection of emissions in certain sectors or installations due to cyclic demand and production in many industries. As such they can provide guidance for future allocations but other issues such as real production/performance, economic growth, increased exports, early actions, weather conditions in a particular year etc., must be taken into account.



The Commission in its Communication (2006) 676 on the ETS review (published 13/11/2006) clearly stated as regard allocation of allowances to sectors and installations that *“it should, e.g., be considered whether to abolish allocations based on projections and whether allocations should continue to be based on emissions data in a historic base period or rather/also on efficiency parameters.”*

A number of potential allocation methodologies have been suggested by different industry sectors, including methodologies including an ex-post correction. The impacts of these methodologies on the competitiveness of EU business, their impacts on the EU economic growth and on the existing EU ETS and the EU ETS which would incorporate the necessary changes, must be carefully assessed prior to adoption.

3.5. Pass through of allowance prices

The actions taken by Member States in the preparation of NAPs for the second allocation period, whilst reducing the “windfall profit” issue, will not affect the problem of the pass through of the price of allowances in the electricity price. In fact, in many cases it may reinforce the pass-through. In addition, the pass through of allowance prices causes substantial volatility in the power prices; this risk is also passed on to electricity consumers, e.g. in wholesale prices or long-term contracts. The impact on the competitiveness of EU businesses resulting from the pass-through must be addressed through a thorough analysis of:

- the allocation methodologies
- the factors outside the scope of the ETS which affect the way it is implemented, one of which is the absence of a truly competitive and interconnected internal energy market.

As long as :

- the financial burdens on EU industries, due to the unilateral EU climate commitments, are not reduced and
- deficiencies on EU energy markets persist,

BUSINESSEUROPE urges policy makers to consider mitigating measures for highly electro-intensive internationally-impacted industries.

BUSINESSEUROPE urges in particular policymakers to create, without hindering the development of the internal energy market, a framework in which energy-intensive industrial consumers can fulfil their electricity and natural gas needs in the medium and long-term at reliable, internationally competitive prices. Long-term contracts between producers and users, oriented to the actual cost incurred by existing import contracts or generation facilities i.e. not on short term market indexes, can play an important part in solving the issue while guaranteeing planning stability for the electricity and gas industries.



BUSINESSEUROPE calls for favourable conditions and incentives to be created for the development of such contractual arrangements, in line with EU and national competition law.

Furthermore, fewer restrictions on company access to JI and CDM credits would reduce the EUA (European Emission Allowance Unit) price and thereby reduce the opportunity cost passed through into the electricity price.

3.6. Auctioning

As long as there is no global agreement and equivalent commitments by the large emitters, including global emissions trading that does not disturb competition, BUSINESSEUROPE firmly rejects making auctioning the standard allocation tool in the ETS System since that would harm EU competitiveness without improving the environment. In some circumstances, differentiated allocation between sectors may be possible. In these cases, the use of auctioning may be possible but taking into account a number of considerations:

- auctioning can incentivise carbon leakage, since energy intensive industry outside the EU becomes more profitable. This will gradually lead to the relocation of production to outside the EU.
- the inability of various covered sectors to pass the additional related costs to the customers. This is very difficult in a global competition.
- the removal of value from industry through the need for companies to make large upfront payments which could be better employed in research and development, growth and for emission reductions.

Where auctions do take place, it is vital that revenue is recycled for supporting research and development of mitigation and adaptation technologies and for protecting the international competitiveness of EU business. Such a process must not be subject to political manipulation and must follow pre-determined guidelines.

3.7. Benchmarking

From 2013 onwards, regulatory stability is needed and is required to ensure the necessary investments to reduce emissions and to prepare for those investments already in the second trading period. To this aim, to solve the pressing problems, some industry sectors have proposed an alternative: performance-based allocation based on actual production.

The issue of performance-based allocation based on actual production in a baseline-and-credit-system as well as the use of (sector-specific) benchmarks in a cap-and-trade-system must be carefully assessed. For some sectors it could be a good option whilst for others an inappropriate allocation methodology. If benchmarks are to be applied, they must be determined on an EU-wide basis.



3.8. New entrants and closures, including definition, harmonisation and reserves

Harmonised rules and guidelines for New Entrants and Closures should be applied. A New Entrant should be defined consistently as either a new installation or an existing installation that has become covered by the ETS Directive due to significant changes in its production or production process. New Entrants should receive all the allowances needed if their emissions are at a level of the sector specific emissions or more efficient, while facilities of a comparable standard in existing installations across Europe should be treated similarly. In principle, new entrants should be treated in a similar way to incumbents. In the absence of full international agreements new entrants should continue to receive free allowances to safeguard the competitive investment position of EU industry. Any New Entrants Reserve should be made at an EU-level.

As is already recognized in the current ETS Directive, the allocation methodology should include specific provisions allowing accounting for increases in greenhouse gas emissions resulting from other Community measures, and the evolution of market demand.

If the reserve of allowances is insufficient to cover new entrants, this should be addressed through the purchase by Member States of CERs (Certified Emission Reductions), ERUs (Emission Reduction Units) or AAUs (Assigned Amounts Units).

Some Member States seem to prefer no allocation to new entrants arguing that this will only bring forward fossil fuel power generation. BUSINESSEUROPE wishes to emphasize that such conclusion does not take into account the EU target on renewables. Investment decisions within power generation are strongly dependent on assumptions of fuel prices, the long term conditions of the EU ETS (length of trading period etc.). If all factors are taken into consideration, it is likely that no New Entrant Reserve would reduce the speed within all sectors of investment in new technology.

The closure of an installation should be defined in the same way across European countries. At least the allowances, which are already transferred into the installation's accounts (in the registry), should be entitled to the installation and should not immediately have to be returned after closure. The transfer of allowances during the rationalisation of production facilities, by closing inefficient plants and transferring production to a second facility either within the same, or different, Member State must be addressed.

4. PROVISIONS FOR LINKING THE ETS WITH OTHER SCHEMES AND INSTRUMENTS

4.1. Relationship of ETS to third country schemes

BUSINESSEUROPE encourages the linking of the revised EU ETS to third countries and also to regional schemes, such as RGGI (the US Regional Greenhouse Gas Initiative) and the planned Californian schemes, where such schemes have comparable main principles and targets. Arrangements within third countries that have not ratified the Kyoto Protocol should also be encouraged, where appropriate. The EU should more deeply analyse the criteria of linking in a way that does not distort



competition.

However, on short and medium term it seems more likely that a well-functioning JI and CDM market can pave the expansion of a global carbon market through indirect linking to regional systems.

A further method of encouraging linking could be the development of sector approaches, for certain sectors, as expressed by the Commission in the January Climate Change package (COM 2007-2) which notes *“another option is the introduction of sector-wide company-level emissions trading in sectors where the capacity exists to monitor emissions and ensure compliance particularly for energy-intensive sectors such as power generation, aluminium, iron, steel, cement, refineries and pulp and paper, most of which are exposed to international competition. Such schemes would be either global or national; if national, schemes in developing countries should be linked with schemes in developed countries, with targets for each sector covered being gradually strengthened until they were similar to those set in developed countries. This would also limit the transfer of high-emission installations from countries where they are subject to reduction commitments to countries where they are not.”*

4.2. How to strengthen developing countries and economies in transition to participate in abatement activities (CDM and JI)

There is already a lot of interest in the CDM and JI projects in developing countries and economies in transition. This could be further encouraged by ensuring that more project proposals are approved and that the approval processes for such projects become clearer and are simplified. At the moment the process is lengthy and bureaucratic that requires time, skills and money as well as discriminating against small projects.

In the absence of a comprehensive international agreement, including global sector approaches, it is essential to preserve the existence of safety valves that limit the price of CO₂ and encourage business and industry in Europe to engage in new CDM and JI projects. In that respect, it is vital that the EU continues to guarantee the continuation of CDM and JI projects beyond 2012 through their recognition in the EU ETS post-2012 if there is no global emissions trading scheme in place. This guarantee for CDM could be made without conditions to developing countries, while for other countries in transition, in the case of JI, it could be made on the condition that they take on appropriate emission reduction commitments.

BUSINESSEUROPE has explained its views on how JI and CDM can be improved in a position (13 June 2007) submitted at the ECCP meeting on 14 June 2007.

4.3. Community-level arrangements for authorisation of projects

It is essential that CDM or JI project approval becomes less bureaucratic and lengthy. In that respect, it must be further investigated if a community body, which can authorise projects, is a way forward to reduce bureaucracy and the time it takes to get a project approved. However, BUSINESSEUROPE believes efforts should be put into ensuring the well-functioning of the UN bodies of JI and CDM, rather than developing parallel EU-bodies thereby creating "A" and "B" CERs and ERUs.



Furthermore, if there is interest in domestic offset projects by stakeholders, the EU should agree on a pilot phase for a limited period of time to test whether such projects can provide value-added to the EU ETS.

4.4. Possibility of further harmonising project credits accepted by Member States

The current exclusion of certain projects from use within the ETS is counter to the need, stressed by the EU Council, to achieve global reductions in emissions of greenhouse gases. The exclusion of certain categories of projects from the CDM concludes end-2012. It is vital that the EU follows international consensus on the projects that can generate credits under the CDM and JI.

4.5. Harmonising the percentages of project credits

It is vital that EU business has full and flexible access to the credits generated from the Kyoto mechanisms. The setting of restrictive “caps” on the use of such credits from JI and CDM will undermine the potential cost-efficiencies of the ETS and will act to reduce the number of possible projects proposed by business, thereby reducing technology transfer.
