

Department for Environment, Food and Rural Affairs

EU Emissions Trading Scheme – questionnaire for March 2007 Issues Paper

Background

The Emissions Trading Directive requires the European Commission to review the EU Emissions Trading Scheme (EU ETS). A short report is expected to be published by the end of June 2007, and a legislative proposal should be drafted by autumn 2007. **The review will play an important role in shaping the future of the Scheme post-2012.**

The basic tenet of the review is that the structure of the EU ETS is sound and that it is here to stay post-2012. The challenge for the review is to enable the Scheme to optimise its potential to make cost-effective real emissions reductions in the long term.

The Government issued a questionnaire in June 2006 as a first step in our stakeholder engagement programme for the review of the EU ETS Directive. Responses have helped us develop our policies in this area, as set out in the Government's Vision statement on the EU ETS. The recently-launched UK Manifesto for the EU ETS sets out a shared business, NGO, and Government view. The period between now and the European Commission's legislative proposal in autumn 2007 gives the Government and stakeholders a further opportunity to input into the future design of the scheme.

This follow up issues paper questionnaire is part of that process. **Please note that this is not a formal consultation**, but part of the ongoing stakeholder engagement process that will feed into the Government's policy development regarding the future of the EU ETS. We intend that a formal consultation will be issued later in the year.

Survey Responses

Please could you submit any responses by **11 May 2007** preferably by e-mail to: eu.ets@defra.qsi.gov.uk

Or: Sarah Nicholson
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Responses should be clearly marked "**EU ETS Review Issues Paper Questionnaire**". It would be helpful if you could use the template response form below when replying. If you would like a paper copy of this survey please write to the above address requesting this. Respondents in **Scotland, Wales and Northern Ireland** are asked to copy their responses to the relevant Devolved Administration. See contacts listed below.

Please note that information contained in your responses may be published in a summary of responses. If you do not consent to this, you must clearly request that your response be treated confidentially. Any confidentiality disclaimer generated by your IT system in email responses will not be treated as such a request. You should also be aware that there may be circumstances in which Defra will be required to communicate information to third parties on request, in order to comply with its obligations under the Freedom of Information Act 2000 and the Environmental Information Regulations.

Comments or complaints should be sent by e-mail to:
eu.ets@defra.gsi.gov.uk marked for the attention of Sarah Nicholson.

Contacts on EU ETS in the Devolved Administrations

<p>For Scotland SEERAD CCA division – Climate Change Area 1-G.2 Victoria Quay Edinburgh EH6 6QQ Email: climate.change@scotland.gsi.gov.uk</p>	<p>For Wales Ruth Gow Environmental Protection Division 1st Floor National Assembly for Wales Cathay Park Cardiff CF10 3NQ Email: ruth.gow@wales.gsi.gov.uk</p>
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NGO	<input type="checkbox"/>
Government	<input type="checkbox"/>
EU ETS Operator	<input type="checkbox"/>
Bank/Trader	<input type="checkbox"/>
Research Institute	<input type="checkbox"/>
Other (inc. consultants, Legal, etc)	<input checked="" type="checkbox"/>

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Issue: How could an EU-wide cap be set to deliver long term carbon reductions?

Question 1: If Member States continued to propose individual caps that aggregate to an overall EU-wide cap, how could the current system be made more effective and transparent?

There should be no change to the existing system whereby Member states have control over national cap setting. The EC should continue to challenge MS Naps to ensure they are inline with meeting EU wide targets. The system could be made more transparent by the comparison of actual verified data and NAP proposals. There could also be a harmonisation of reduction effort which would make comparisons easier.

Question 2: What do you perceive to be the benefits and risks associated with moving from the current system of Member States proposing their individual caps, to one where the EU-wide cap is set centrally?

A centrally set cap could be built 'bottom up' from national caps and thus incorporate differences in national circumstances. There is a risk that a 'top down' EU imposed cap cannot be achieved by individual member states once the burden sharing is made and thus may not be as 'fair' as a bottom up arrangement. Individually based caps may also stand a better chance of achieving environmental objectives, in so far as they may incorporate national circumstance, involve industry and other consultees and thus achieve 'acceptance' and 'buy-in'. An EU imposed cap may be less acceptable and thus not achieve the same level of involvement from installations. Therefore the ability for a single EU cap to achieve consensus is less than multiple caps. In addition a centrally imposed cap may harm the competitiveness of particular sectors because of failure to take account of member state circumstances..

Question 3: Would EU-wide sectoral cap-setting help to create a more level playing field for competition within the EU?

An EU wide sectoral cap would help to minimise the intra EU competitive distortions. However, care would need to be taken not to damage the competitiveness of a whole European sector when compared to extra EU manufactures. Consequently Member States caps can take account of national circumstance and are more favourable in the interim until a global scheme can be developed when compared to the potential impact from extra EU manufactures, particularly from non carbon constrained economies.

Issue: How can the EU ETS provide longer-term certainty?

Question 4: How do you think the EU ETS could provide greater long-term certainty: a) through longer phase lengths; b) through setting EU-wide caps for more than one phase at once; c) or through a system which involved setting an indicative maximum level of cap for future phases, with the potential for downward adjustment in the light of international negotiations?

a) The investment cycle in the cement sector is around 35 years, consequently longer phase lengths are preferable. The 5 year budget periods in a 15 year phase (similar to the recent proposals in the climate change bill) would appear to strike the right balance between flexibility and certainty.

b) EU caps for more than one phase is meaningless without the breakdown on effort required at the sector level in individual member states. Investment planning in a sector such as the UK cement sector cannot take place with solely an EU cap as a basis.

c) An indicative maximum cap does not give installations certainty without having a sectoral breakdown at the national level. Cap setting should be based on abatement potential at the sector level. The allocation plans should be rolling forward plans to provide visibility at least for some 10 years at every point.

Question 5: What do you think are the key issues to consider when balancing the greater certainty of longer-term caps, and the likely flexibility required when setting caps further into the future, when conditions are harder to predict accurately?

It is a difficult balance to strike between long-term certainty and short-term flexibility. All long term cap setting should include an element of flexibility that can take account of short term changes in industrial, economic and environmental behaviour.

Issue: The extent of, and basis for distributing, free allowances

Question 6: What factors do you think should be taken into consideration when deciding what levels of free allowance allocation to give to sectors – for example: a) cost pass-through potential (including constraints related to competitiveness in global markets); b) asset life cycles; c) abatement potential; d) other (please specify)?

a) The ability to pass cost through is essential in determining the level of free allowance allocation. Recent studies (e.g. pg 27 Analysis of EUETS by ENTEC for Carbon Trust June 2006 and pg41 of International Competitiveness by McKinsey-Ecofys Dec.2006) have shown that the cement industry cannot pass through the carbon cost particularly in countries where demand is near to coastal import points. Cement is a traded commodity and Dti statistics show that imports from 3rd parties are steadily increasing

b) Asset life cycles are also an important factor in determining free allowance level. In the cement industry investment cycles are around 35 years. Full free allocation is essential to avoiding stranded assets.

c) Abatement potential is crucial to determining the free allocation level. In the cement sector considerable early action has already been demonstrated (over 3.7Mt of CO₂ reduction between 1990 and 2005). A recent study on the cement sector concluded that abatement potential is low in this sector because significant investments have already been made and because of the high proportion of irreducible process CO₂.

d) The proportion of process CO₂ and the CO₂ intensity per unit of profit are two key factors in determining the level of free allocation. The cement sector has the highest proportion of process CO₂ of the major manufacturing sectors and as a consequence the highest CO₂ intensity per unit of profit. The cement sector is particularly more vulnerable than most to the rise in the cost of carbon i.e. relatively low price compared to the cost of carbon because irreducible process emissions (60% of emissions) can only be influenced to a small extent without affecting production level of the product. This should be recognised and reduction of sector target should be limited to combustion

emissions only.

Question 7: How do you think reducing the level of free allowances for power generation would impact on: a) running existing plant; b) investment in new capacity?

The BCA is not in a position to comment upon plant operation in the ESI, however we would expect that the ESI would pass on the full cost of carbon to its customers as it has done in Phase I. A reduction in free allocation for the ESI should help to reduce windfall profits.

Question 8: What are your views on whether the free allocation of allowances to sectors should be harmonised across Europe?

Yes there should be full and free allocation for sectors sensitive to extra EU competition.

Issue: Free allocation based on benchmarking

Question 9: What do you think are the advantages and disadvantages of moving from grandfathering to benchmarking for allocation of free allowances?

Grandfathering in future phases of the EU ETS has the disadvantage of being historically focused and the use of historical emissions that have been subject to earlier phases of the scheme is inappropriate.

Benchmarking, can be simple, transparent and can reflect the technological potential of industries if designed properly. If applied across all sectors benchmarking can provide a scientific and controlled means for driving improvements. Experiences in the design of Phase II benchmarks for the cement sector have not been satisfactory and have resulted in the reduction of a number of important variables from the Phase I benchmark formula. Benchmarking in the cement industry should be clinker or 'Portland cement' (CEM I) based.

Benchmarking criteria for the cement industry should be the following, as a minimum:

**capacity factor,
moisture,
non carbonated carbon,
energy/combustion CO2 efficiency factor,
bypass adjustment,
fuel mix,
process CO2 factor**

Benchmark criteria can be based on a number of boundaries (BAT, Upper quartile, upper decile, world best, national best, EU best etc). BCA believes that the scope of the criteria should be the same as the scope of the benchmark application i.e. UK factors for UK application, EU factors for EU application.

Question 10: What is the feasibility of defining a UK-wide and EU-wide benchmark for specific sectors?

The UK could lead in developing national benchmarks as EU benchmarks are not required at this stage of the scheme development. A UK benchmark methodology is possible for the cement sector in Phase III EU ETS. However, experiences in the design of Phase II new entrant benchmarks for the cement sector have not been satisfactory and have resulted in the reduction of a number of important variables from the Phase I benchmark formula. Benchmarking in the cement industry should be clinker or 'Portland cement' (CEM I) based.

If a UK benchmark methodology is developed it should use UK benchmark factors. The development of UK benchmarks should be the priority for phase III as the preferred allocation methodology. This will be a challenge for some industrial sectors particularly where a diverse range of products are manufactured. EU wide benchmarks could be developed from MS benchmarks in future phases.

Question 11: What types of benchmarks do you consider to be the most suitable for specific sectors?

Benchmarks that take account of national conditions and sector specificities are the most suitable. Benchmarks should incentivise a shift to clean technology without promoting the shift of industry overseas, and thus avoiding emissions relocation. Consequently benchmarks for incumbents should avoid creating stranded assets.

Benchmarking criteria for the cement industry should be the following, as a minimum:

- capacity factor,
- moisture,
- non carbonated carbon,
- energy/combustion CO₂ efficiency factor,
- bypass adjustment,
- fuel mix,
- process CO₂ factor

If a UK benchmark methodology is developed it should use UK benchmark factors.

A cement sector benchmark should therefore result in a CO₂/ t Clinker figure

Issue: Free allocation to new entrants

Question 12: What do you think are the advantages and disadvantages of maintaining a new entrant reserve of free allowances as regards: a) competition; b) incentives for investment in the EU?

It is important to incentivise new investment and thus the UK should maintain an NER which is freely allocated. The national NER should be contributed to by those sectors expecting to benefit from the free allocation and not other sectors because there may be inter-sector competitive issues. A free NER should be provided to incentivise technology shift and there should be an allocation based on need. There should not be a reduction for CHP from sectors that cannot use CHP e.g. the cement industry.

Question 13: In a context where incumbent installations receive reduced levels of free allocation, what level of allocation to new entrants do you think would be fair?

There should be full allocation for new entrants in order to incentivise new technologies.

Issue: Closure rules for allocating allowances

Question 14: Assuming a harmonised rule across the EU, what do you think are the advantages and disadvantages of maintaining the current closure rule, versus one where closed installations continued to receive allowances? For how long would it be appropriate for closed installations to continue receiving allowances?

Closing installations should retain until phase end to encourage closure. Transfer of allowances from old installations that are shut down or modified should be allowed to the new installation where company rationalisation occurs. Given that the EU is a single market, an excellent way to foster investments would be allow transfer across borders, this should also be given consideration.

Issue: Treatment of small emitters

Question 15: What do you think are the advantages and disadvantages of the following proposed methods for removal of small emitters: a) raising the 20MW capacity threshold for inclusion in the scheme; b) introducing an emissions threshold; c) providing a legal basis for a *de minimis* rule?

BCA has no objection to the removal of small emitters from the EU ETS as long as they contribute to emissions reduction in some way.

Question 16: Do you think there would be a significant reduction in EU ETS abatement potential without small emitters?

It depends on where the threshold is set and which installations are removed from the scheme. At the national level abatement should be the same if the small emitters are moved to a simplified scheme in which the targets require the same reduction effort.

Issue: Harmonisation of the definition of a combustion installation

Question 17: Do you think there would be competitiveness impacts, or any other adverse impacts, from broadening the definition of combustion (assuming small emitters were excluded)?

BCA supports a broad definition of combustion. There should be no intra EU competitiveness impacts if the definition is harmonised

Question 18: Do you think that the definition of a combustion installation should be replaced by EU-wide sector specific definitions? If so, please suggest ways in which your sector could be defined.

The cement sector is included in the EU ETS by the manufacture of clinker >500 t/day this should remain as the sector definition

Question 19: Do you think that all CO₂ emissions (combustion and process) should be covered at installations falling within the Scheme? What are the implications of this on monitoring, reporting and verification costs?

The cement sector already reports all fuel and process emissions that relate to clinker manufacture, however for target setting purposes, process emissions should be seen as irreducible

Issue: Expansion to include additional activities and gases

Question 20: Please rank the criteria listed above in order of importance. Are there any other criteria which should be considered? Are any of those listed not important in determining an activity/gas's suitability for inclusion?

1. • quantity of emissions, and number and size of installations;
8. • feasibility of clear, harmonised installation/sector definitions;
4. • feasibility of monitoring, reporting and verification;
- 5 • feasibility of developing a robust allocation methodology;
6. • impact of inclusion on the carbon market;
2. • availability and cost of abatement options;
7. • existing competitive distortions;
3. • implications for future competitiveness;
9. • interaction with existing regulations;
10. • appropriateness of trading for regulation.

Question 21: Do you think some/all of the activities and gases listed by the Commission are suitable for inclusion? Are they adequately covered under the existing framework? Please provide details/evidence to support your answer.

Question 22: What other activities/gases do you think should be considered for inclusion in the Scheme?

Incinerators because at present waste is incinerated and energy is not recovered in many cases.

Landfill sites because methane is a significant GHG.

Both the inclusion of landfills and incinerators will have the added advantage of diverting waste away from disposal options towards recovery options.

Question 23: What issues do you think need to be considered in order to minimise the impact of the inclusion of non-CO₂ gases on the carbon market?

Global warming is a consequence of all GHGs and as such all GHGs should be included within the EU ETS provided they are above sensible emission or energy thresholds. All trades should take place in CO₂e.

Issue: Expansion to include additional non-industrial sectors

Question 24: What should be the key criteria upon which the inclusion of additional sectors (such as surface transport, shipping, heat, and land use sectors) are decided?

There should be a separate scheme/measures for all transport. Aviation, surface transport and shipping should be included in their own scheme because abatement and cost pass through options are very different when compared to the industries currently within the scheme.

Question 25: What are your views on whether domestic projects should be allowed for EU ETS compliance purposes?

Domestic projects should be allowed in the EUETS. The use of alternative fuels to replace traditional fossil fuels in the cement industry is a good example where emissions outside of the EU ETS (in the landfill and incineration sectors) are avoided due to the use of alternative fuels in the cement industry.

Issue: Linking the EU ETS with carbon trading schemes in other countries

Question 26: What do you think are the key issues and criteria to be addressed when considering whether to link different emissions trading schemes to the EU ETS?

Links to any other scheme/region, sector or nation should be carefully managed. There should be an equivalence in effort and in monitoring, reporting and verification. There should be an equal level of transparency of allocation methods and emission results. There should be equivalence in currency (CO₂e).

The global cement sector has initiated discussions concerning a global sectoral scheme.

Issue: Use of CDM and JI project credits

Question 27: What level of project credits should be eligible for use within the EU ETS? Should this be harmonised across the EU? Should this change over phases?

There should be no limit for the use of project credits within the EU ETS. This should be harmonised across the EU and harmonised domestically with the climate change bill target mitigation measures.

Issue: Transposition of Monitoring and Reporting Guidance into regulations

Question 28: The proposal by the Commission would simply reinforce current guidance. In your experience would this affect operations in Member States across the EU?

Monitoring, reporting and verification needs to and can be simplified without reducing accuracy e.g by increasing the use of standard emission factors

Question 29: How would this additional regulation impact on industry?

The UK cement industry does not need further regulation of climate change issues. The current system, its overlaps and inefficiencies are already over regulated. Government should seek to rationalise the overlaps between CCA and EU ETS.

Issue: Independent verification

Question 30: Would verification completed by competent authorities (as opposed to private accredited verifiers) improve the verification process?

Competition between verifiers is essential to cost control. The use of competent authorities for emissions verification would increase cost to industry. BCA does not support the suggestion to change from verifier to competent authority..

Question 31: How would a more harmonised approach allow the EU ETS to become more robust?

Harmonisation is desirable in some areas however, making the system more robust could lead to a rigid and inflexible system that is not desirable.

Issue: Independent accreditation

Question 32: How much of a role should the Commission have in the provision of accreditation services for each Member State?

None

Issue: Harmonisation of compliance rules across Member States

Question 33: Should all Member States enforce the same set of compliance rules? And should those rules carry the same penalty in each Member State?

Yes

Issue: Harmonisation and operation of Registries

Question 34: How much influence over the development of each Member State's registry should the Commission have?

BCA member companies are content with the operation of the UK registry and see no reason to change this.

Summary

Question 35: Are there any issues which you believe should be considered as part of the Review which have not been highlighted elsewhere in this questionnaire?

Post 2012 climate change policies could, if designed properly, promote resource conservation and contribute to UK waste management. The scheme should encourage and incentivise the use of waste alternative fuels. The benefits of this are two fold. Firstly the replacement of traditional fossil fuels with waste derived fuels extends the life of finite natural resources. Secondly, valuable outlets for UK domestic, commercial and industrial wastes could be secured at a time when other routes, particularly landfill, are under significant pressure. The use of waste alternative fuels in the cement sector has other advantages. The cement industry is subject to extremely rigorous emission limits under the Waste Incineration Directive but more importantly the combustion heat is recovered in the process and no further waste is produced because the ash becomes integral to the cement product. Consideration could be given to classifying the recovery of heat from wastes as CO₂ neutral (same as biomass) under the scheme. This should be applied where this replaces fossil fuel use and avoids emissions of CO₂ where these wastes are disposed of without recovery of heat (such as incineration and disposal to landfill with subsequent emissions of CO₂ and other GHG's). This would incentivise the use of many types of wastes for heat recovery and expedite the replacement of fossil fuels.