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Dear Mr Delbeke,

**RE: Input into the 3rd Meeting of the Working Group on the Review of the EU Emissions Trading Scheme: 21 – 22 May 2007**

I am writing on behalf of the Environmental Industries Commission's (EIC) Carbon Trading Group regarding the third meeting of the Working Group on the Review of the EU Emissions Trading Scheme.

**Environmental Industries Commission (EIC)**

EIC was launched in 1995 to give the UK's environmental technology and services industry a strong and effective voice with Government.

With over 310 Member companies, EIC has grown to be the largest trade association in Europe for the environmental technology and services industry. It enjoys the support of leading politicians from all three major parties in the UK, as well as industrialists, trade union leaders, environmentalists and academics.

EIC have recently launched a Working Group specifically focused on Carbon Trading, which represents over 40 Member companies. These include international market leaders in the carbon-trading sector. The Group is working to build support for the environmental and economic case for effective policy measures to create a real market for carbon. The Group's has been working on a number of key issues for the carbon trading sector and specifically on the EU Emissions Trading Scheme.

We would like to take this opportunity to submit our comments on the issue of further harmonisation and increased predictability in the EU Emissions Trading Scheme (ETS).

Our comments are in response to the list of tentative topics to be discussed at the meetings of the Working Group.

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## **Cap-setting: EU-wide or National caps**

- **Options to set an EU-wide cap**

EIC is in favour of pan European harmonization of EUA allocation.

A single European cap would be a logical consequence of the pursuit of this goal and as such is seen as being a desirable outcome. However it is questionable how far Member States will support this perceived loss of sovereignty.

It is worth observing at this point that by submitting their National Allocation Plans to an approval process that is subject to a set of rules unilaterally decided upon by the Commission, Member States have already transferred the power to set the maximum European cap. So in this sense the setting of a EU wide cap decided upon by the Commission is already taking place.

Allowing the Commission to carry out installation level allocation can only be positive, provided that all installations are treated equally irrespective of their location and national circumstances.

If the Commission pursues this route, we urge that in contrast to Phase II the details of the allocation process are made public as soon as is practicable to allow industry adequate time to plan. Whilst the Commission may have held back the allocation rules for Phase II so as not to discourage Member States from instituting tighter emissions reductions than the rules dictate, no such rationale exists in the case of a centralized cap set by the Commission.

- **Pros and cons of national caps and their impacts on the internal market**

With a few notable exceptions the performance of Member States in setting their caps has been unimpressive. Of the 18 National Allocation Plans (NAPs) ruled on at the time of writing 16 have had their proposed allocation reduced, in some cases significantly so. It is hard not to draw the conclusion that national positioning for competitive advantage has, in many cases, overridden the environmental goals of the EU ETS, thereby threatening the future of the EU ETS as an effective tool to combat climate change.

EIC has welcomed the tough line the European Commission has taken in ruling on the NAPs and believes that a fairer centralised allocation system will remove the competitive distortions between Member States that a state-by-state allocation system inevitably creates.

However, if the Commission is to fully adopt the role of Member States in centralizing allocation it must also become similarly accessible and open to the valid concerns of installations and stakeholders that fall within or are affected by the Scheme. EIC believe that representations to the Commission via Working Groups or via Member States insufficient to fulfil this role.

EIC, therefore, advocate that direct lines of communication are set up between European industry and the Commission. Members would further advocate that these are fully and directly accessible to individual installations.

EIC believe that this is important to avoid alienating participants from the regulation and functioning of the EU ETS and to avoid the sense that the allocations are simply passed down without recourse or appeal procedures being in place.

All installations should have the right to participate in and question the allocation process.

- **Harmonised cap-setting procedures: upfront or NAP based**

EIC is in favour of upfront cap-setting procedures.

### **Increased Predictability**

- **Time horizons for overall allocations, sector and installation level allocations**

As time horizons for allocations increase, so does the predictability for industry and the greater the confidence in planning. However, the further into the future decisions regarding allocation are made the greater the likelihood that new scientific evidence may come to light requiring more stringent caps.

EIC would, therefore, propose:

- For horizons beyond 8-10 years the use of indicative maximum caps that may be subject to further reduction.
- For current/pending phases the caveat that if either prior to or within a phase pressing scientific evidence comes to light that requires a further cut in allocation that, subject to appropriate review and consultation this can be carried out.

### **Allocation Methodologies**

- **Harmonised allocation at sector level**

EIC is in favour of harmonized allocation as far as is politically feasible, therefore if the preferred option of harmonized allocation at installation proves to be beyond the grasp of the current process, sector level harmonisation would be a reasonable fall back position.

- **Harmonised allocation at installation level**

This is EIC's preferred option, as it would create a level playing field across Europe.

- **Economic and environmental impact of different allocation methodologies (grandfathering, benchmarking, auctioning)**

EIC is not in favour of grandfathering as it has a strong potential to create the perverse incentive to emit as much as is feasible in order to maximize future allocation. It also, by definition, rewards the most polluting installations, which would undermine the overall objective of an environmentally motivated scheme.

- **Benchmarking**

EIC is strongly in favour of benchmarking as an allocation methodology. However, Members are concerned as to how benchmarking can be fairly applied.

EIC would favour sectoral benchmarks so that, for instance, all electricity generation is subject to the same benchmark regardless of the technology used. This should clearly act to favour cleaner technology.

There is a further concern, however, that the example of the German allocation system illustrates. Namely that, even with an equal benchmark, assumptions about the output of installations can be used to skew the allocation process in favour of certain technologies. In the case of Germany all coal and lignite power plants are subject to the same benchmark. On the surface this would appear to

disadvantage lignite generation, and has indeed been heralded by the German authorities as doing so. However, in reality it has been assumed that lignite plants will have a significantly higher output than hard coal plants giving them a more favourable allocation than coal.

EIC urge the Commission to avoid this situation by assuming a parity of output in comparison to capacity for all installations in the same sectors, coupled with sector level benchmarks.

### **Options for auctioning and benchmarking**

EIC welcome the recent suggestion by Stavros Dimas that in Phase III the role of auctioning should be greatly increased. Members believe that this will help the market recognise the true cost of carbon emissions.

### **New entrants**

- **Harmonised approach on new entrants**

EIC is in favour of all moves towards greater harmonisation.

- **Effects of differences in treatment**

The nature of having a new entrants reserve limited by a cap inevitably creates the risk that entrants coming to the scheme late in an allocation period may find the reserve empty. This risk becomes greater as the size of phase increases as it relies on the ability to accurately predict the need for expansion well into the future. In the case of Phase III this could be up to 10 years.

It is inevitable, therefore, that there will be some inequality of treatment unless the new entrants reserve is made so large as to negate this risk. The downside of such an approach is that it will limit the size of the allocation to existing installations.

Of the two, EIC regard limiting the size of current allocations as preferable to restricting expansion.

A further concern is that a suddenly booming sector may use up all of the reserve disadvantaging other potentially less robust sectors. EIC would, therefore, request that the reserve be to some extent allocated on a sectoral basis.

- **Use of new entrants reserve: if chosen how to ensure equal treatment**

The key to ensuring equality of treatment as outlined above, is dependent on the means of distribution, and ensuring that the reserve is sufficiently large.

EIC would request that the practise of auctioning off the unused portion of the new entrants reserve be stopped and any excess be struck off.

EIC believe that the new entrants reserve should be exactly that, a reserve for new entrants and not a source of additional income in the absence of economic expansion.

## Closure of installations

- **Scope for harmonisation**

There is a great deal of scope for further harmonisation between the Member States. We would suggest that in the event of an installation closing or significantly reducing production, it should lose all claim to its allocation. The point of cap and trade is to reward installations that reduce their emissions through positive action, not to reward installations that reduce or end production.

I trust you will find these comments useful.

Yours sincerely,

pp



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