



for a living planet

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WWF submission to the EU Emissions Trading Scheme Review.

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WWF welcomes the opportunity to contribute to the review of the EU Emissions Trading Scheme (EU ETS) for the post-2012 period. We fully support an EU ETS on the condition that it delivers significant greenhouse gas reductions in the EU as well as acting as a catalyst for facilitating global greenhouse gas reductions. However, to fulfil this potential, essential improvements are required. This contribution outlines principles on the direction and emphasis that these improvements should take:

- **Environmental integrity** – all reforms and improvements must enshrine the ‘polluter pays principle’ and facilitate maximum greenhouse reductions in the most efficient and cost effective manner;
- **Uniformity** – All newly agreed principles of the EU ETS must be unambiguous and applied uniformly across all sectors and stakeholders to ensure fairness;
- **Transparency** – All details, processes and procedures must be included in the new/revised EU ETS Directive to ensure market stability, fairness and transparency;
- **Continuous improvement** – An infrastructure must be established to continually seek to improve the overall operational efficiency of the EU ETS in areas such as monitoring processes and technologies, etc;
- **Developing an international brand** – It is essential that the EU continues to engage with the development other international emission trading schemes to evoke international commitment and global greenhouse gas reductions.

WWF stresses that cap and trade legislation can only be effective if it is part of a wider package of environmental and climate policy measures. WWF, therefore, encourages the Commission to propose a transparent long term target for EU ETS based on its share of the 30% greenhouse gas emissions reduction target committed for 2020 by the EU Heads of State Spring Council in March 2007.

Improving the current infrastructure

1. Transparent and effective cap setting

The cap is the most essential aspect of an effective EU ETS. WWF recommends that the cap setting process is transparent and aligned to the core objectives of the EU’s environmental and climate policy objectives. In view of this WWF proposes:

- The total number of permits to be released into a trading period is determined by the Commission for the entire EU. This should take account of historic emissions, economic growth, projected environmental improvements, abatement opportunity and importantly the 30% greenhouse gas reduction target for 2020 from 1990 levels;
- To provide stability the EU must give a clear indication of the likely EU wide target greenhouse gas emission reductions that are to be achieved in 2030, 2050 and 2080 and the expected contribution from the EU ETS in meeting these targets. This will provide business and industry with a clear understanding of the direction of future EU policy and commitment and thus facilitate investor confidence;

- Trading and compliance periods should be 5 years. This allows the scientific consensus of the day to influence the level of emission reduction and therefore ‘effort’ that the EU ETS is required to meet.

2. Allocation methods – 100% auctioning

ALL permits must be allocated on an auctioning basis.¹ This ensures:

- The ‘Polluter Pays Principle’ is maintained;
- All participants have equal access to permits either through the initial auction or through the secondary market;
- Permits are distributed in an open and transparent manner;
- There is no need for a ‘new entrants reserve’ which greatly inflated national allocation plans as well as incentivising investment in coal-fired power plant. The Carbon Trust report “EU ETS Phase II allocation: implications and lessons” highlights that the fact that many in many allocation plans new entrants rules favour more carbon intensive fuels and that the German rules favour lignite which is the most polluting form of coal.² Furthermore, auctioning of permits provides a continued means of distributing permits if participants close their operations;
- There is no need for complicated closure rules which may discourage the closure of old inefficient plant;
- Participants are able to internalise the costs of pollution and therefore have a stimulus to reduce their carbon emissions and simultaneously improve their overall business efficiency;
- Transferring wealth for free through the grandfathering method is avoided. This ensures equity with other sectors not included in the EU ETS who did not receive free money to make CO₂ reductions;
- Participants will have had eight years to prepare for 100% auctioning which is sufficient time to invest in energy conservation and business efficiency measures.

At present, no viable alternative distribution system has been proposed that has the same level of efficiency, openness and environmental effectiveness as 100% auctioning. Importantly, this avoids ‘windfall’ profits for certain sectors such as power generation and aviation. In other sectors it provides the most effective and transparent access to permits without the need to surrender confidential production/cost data that would be required for other proposed methods.

3. Revenue from auctions

The revenues generated from the auctioning of permits provide an invaluable opportunity for Member States to make significant investments in clean carbon solutions. WWF strongly supports this goal and offers its assistance to Member States in identifying suitable clean carbon solutions.

WWF also encourages Member States with strong commitments to social justice, equity and clear focus on global relations to spend a proportion of their income outside the EU and support options such as clean carbon technology transfer, mitigation and/or adaptation measures.

¹ Detailed analysis of the merits and conduct of auctioning is presented in a paper from the Oko Institute commissioned by WWF entitled: “Auctioning in the European Emissions Scheme”. Oko Institute. (June 2007). At the time of writing this submission, the paper had not been launched.

² EU ETS Phase II allocation: Implications and lessons. The Carbon Trust. (May 2007)

4. Access to Kyoto Protocol Project Credits

WWF fully supports the principle of facilitating net global greenhouse gas emission reductions. However, we are concerned about the lack of effective scrutiny on 'loose' applications of additionality, sustainable development and overall environmental impact.³ For example, an expert presentation from the Oko-Institut to the fourth ECCP EU ETS Review Working Group concluded that up to 50% of CDM projects were 'hot-air'.⁴ This is compounded further when EU based companies use these credits to offset emissions from new infrastructural investments in high carbon energy solutions of which the most important is the current plunge for coal. This trend worsens without clear and immediate regulatory requirements to capture CO₂ from these new build and existing fossil fuel power generation plants. Therefore, WWF strongly urges:

- The EU, as one of the largest consumers of CDM credits, to use its consumer power to champion reform of the CDM system;
- Prior to entry into the EU ETS, projects must undergo a quality check to ensure that they meet strict environmental integrity requirements that were outlined in the Kyoto Protocol Article 12. Therefore, we propose that only good quality products such as 'Gold Standard'⁵ credits which demonstrate a equal levels of genuine environmental improvement can enter the EU ETS;
- The majority of emission reductions required by the scheme eg more than three quarters, MUST be made in the EU;
- There must be an EU wide quota on the total number of permits that can enter the EU ETS. This provides a level of certainty to companies who will be able assess emission abatement options that are available to them.

With respect to avoided deforestation it must be noted that:

- Reduced deforestation and degradation (REDD) is NOT included in the Kyoto Protocol crediting system. It is impossible to discuss this subject without clear understanding of the associated methodologies and regulatory framework (monitoring, reporting, verification, and enforcement). During the EU ETS Review discussions no sound system was proposed.
- Credible deforestation credits may be very expensive because the opportunity cost (land price will be equivalent to the income from palmoil or timber or cattle). Although this is not an argument why they should be excluded, it does counteract the argument that these credits will be cheaper than other projects and raises important questions about the methodology that is likely to be applied to reduced deforestation and other sinks.

5. Monitoring, reporting, verification and enforcement

This is the most important operational foundation of the EU ETS. It is essential that there is continual review to identify the most effective and efficient means of monitoring, reporting, verification and enforcement. The following measures must be incorporated into the Directive:

- Site assessment of a plant must take place before or within 3 months after the monitoring protocol is granted to ensure its full application;

³ For further information see Emission Impossible: Access to JI/CDM credits in phase II of the EU Emissions Trading Scheme. WWF. (June 2007). http://www.panda.org/news_facts/newsroom/index.cfm?uNewsID=106640

⁴ At the time of writing this document the presentation was not listed on the Commission's website. However, it will be listed here at http://ec.europa.eu/environment/climat/emission/review_en.htm in due course.

⁵ For further information about the Gold Standard see www.cdmgoldstandard.org

- Enforcement procedures must be common for all participants irrespective of their geographical location. Therefore, the mandatory process and penalties to enforce non-compliance measures must be included in the directive.

The EU must investigate the greater application of technological applications which will streamline the monitoring and reporting aspects in terms of compliance but also for the benefit of participants.

6. Small installations

WWF recognises the cost implications of the verification process which is placed on small emitters. It welcomes suggestions to reduce this burden but stresses that a full cost benefit analysis between inclusion in the EU ETS and the harmonised alternative solutions is required PRIOR to the possible exclusion of small emitters. If, however, the verification process can be streamlined then this should remove much of the financial barriers to verification. In this context, small emitters should NOT be removed from EU ETS.

Activities that must not be included in the EU ETS

ETS is designed to address emissions from large industrial point sources. The emphasis of the Review must therefore be primarily on improving the operational and environmental effectiveness of the existing scheme prior to expansion of other schemes.

The following sectors must not be included in the EU ETS:

7. LULUCF

WWF does not support the inclusion of LULUCF into the EU ETS. Also, the purchase of carbon sinks projects through the CDM and JI should be avoided. The following points must be taken into consideration when assessing this issue:

- Soils are the main reservoir of any biological sink;
- Sinks can easily become sources. An example of this was the heatwave of August 2003 during which carbon sinks released circa 400 megatonnes CO₂ in a few weeks in Europe;
- Forest emissions savings vary depending on location. Research by Lawrence Livermore National Laboratory concludes that new forests in high latitudes could create net warming and that more trees being planted in Europe would create at best marginal climate improvements.
- To date, no sound system for monitoring, reporting and verifying emission reductions from sinks has been developed. An expert presentation at the second ECCP EU ETS Review Working Group Meeting entitled the “status and challenges in monitoring biological sinks” concluded that “current monitoring/reporting of biological sinks may not be adequate to always guarantee accurate estimates.”⁶
- This means that there is a practical barrier which prevents entry into the EU ETS;
- The permanence of biological carbon sequestration has led to discussions about temporary certified emission reduction credits (tCERs) being issued. These are open to abuse and cannot be treated as other CERs in the compliance market.

⁶ <http://ec.europa.eu/environment/climat/emission/pdf/etsreview2/3b.pdf>

8. Surface Transport

WWF considers surface transport emissions can be addressed effectively by measures such as fuel standards, fuel taxes and other modal shift incentives and NOT by including it in the EU ETS. The main reasons are:

- It is not likely to lead to fuel efficiency improvements in vehicles;
- If manufacturers are included they are likely to be net purchasers of credits. This means that they are not likely to make any greenhouse gas reductions themselves and instead increase the burden on other sectors in the EU ETS;
- Manufacturers have no control over fuel consumption and lifetime carbon emissions once the vehicle has been sold (e.g. how the vehicle is driven, what distances it covers etc.). Although methods have been proposed for calculating manufacturers' greenhouse gas emissions, significant uncertainties would surround many of the figures used e.g. what would be the average emissions from a flex-fuelled car which could run on bio-fuel or petrol? The uncertainty over emissions levels and hence the accuracy of the cap that was set could therefore undermine the integrity of the EU ETS as a whole.
- Inclusion is not likely to lead to direct emission reductions in the sector and could 'lock in' high carbon infrastructure and behavioural choices which will be difficult or costly to reverse at a later date;
- Other more effective and efficient measures for addressing surface transport issues must be given priority such as the current Fuel Quality Directive discussions.

9. Domestic offsets

WWF is opposed to the inclusion of domestic offsets into the EU ETS for the following reasons:

- If there is significant greenhouse gas abatement potential in a sector (for example transport) then arguably it should be governed by a separate policy and not be used to allow emissions from the ETS sectors to grow.
- Ad hoc development of projects is not a particularly effective way of tackling emissions from a sector. Indeed the inclusion of domestic offset projects may be used as an excuse to delay the implementation of a more focussed policy for a sector.
- Inclusion of domestic offsets may make it more complicated to determine the direct contribution of the ETS sectors to EU greenhouse gas emission reduction targets and to determine whether they are playing their fair share or not.
- There is the risk of double counting of emissions reductions - both as a contribution to meeting the EU ETS cap, and towards achieving international emission reduction targets.
- Access to project credits (be they from from JI/CDM or domestic offset projects) could make it cheaper for ETS sectors to meet emissions caps. But access to significant volumes of credits could disincentivise investment in clean technology within those sectors and slow down innovation. Crucially, it could help to "lock in" decisions on high-carbon infrastructure (of particular pertinence here for the power sector) which would have a significant impact on emissions from those sectors for many years to come.

Future developments

10. Linking with other schemes

WWF believes that the EU ETS has a significant role in facilitating international engagement and cooperation on global greenhouse gas reductions. However, there are certain preconditions that must be met prior to any formal linkage with another national scheme or other solution:

- EU ETS must be streamlined, effective and deliver significant environmental reductions;
- Policy direction and commitment must be aligned to ensure that there are similar ambitions expressed in the schemes;
- It must be mandatory and have an absolute cap;
- There must be equally robust monitoring, reporting, verification and enforcement processes and procedures;
- *Domestic carbon sinks, domestic offsets, nuclear and other credits of dubious origin and/or bad environmental integrity cannot be allowed to enter into EU ETS;*
- Allowances must be distributed to all participants in an open and transparent manner through auctioning;
- Price ceilings cannot be included as they are inherently anti-competitive.

11. Alleged exposure to International competition and leakage

WWF has yet to be presented with clear and unequivocal facts about the exposure to full extent of exposure to international competition that the industrial sectors covered by the EU ETS claim. We are disappointed that industry was not required to detail the extent of its alleged exposure, historic investment decision-making and future prospects during the EU ETS Review process.

At present, WWF is engaging with some market leader and responsible energy intensive companies covered in the EU ETS to understand their concerns regarding climate change measures and international competition. *Until this information is made clear, the Commission MUST start from the basis of full auctioning. Furthermore, the Commission must not pursue potentially damaging policies such as boarder tax adjustment until industry is able to provide unequivocal evidence which is open to scrutiny. This must be counterbalanced by the views and needs of the all consumers in the EU economy.*

12. Carbon Capture and storage

WWF accepts that carbon capture and storage may be a necessary evil to addressing the global plunge to fossil fuel use. Prior to inclusion the following aspects must be delivered:

- A robust regulatory framework detailing monitoring, safe storage practices and liabilities must be agreed. This must be coupled with urgent mapping of potentially safe geological stores;
- As it is likely that carbon storage facilities will revert back to state ownership, state expenditure on this research can be justified to ensure that storage is safe and that the associated support mechanisms are in place. In view of this, WWF urges that a significant proportion of the 12 CCS demonstration projects are on commercial scale carbon storage projects;
- A CO₂ emissions limit for firstly all new and secondly all existing fossil power stations must be introduced to allow for mandated high efficiency capture of CO₂ emissions from all fossil fuel power generation. WWF does not believe that the EU ETS alone will provide sufficient price certainty at the

appropriate levels (€70 plus EUA prices) to facilitate the introduction of CCS. An immediate moratorium is required on all new business as usual fossil fuel power generation.

- Public funding must not be spent on carbon capture as this will be in the industry's interest. Furthermore, it already receives more than 80% of all CCS research support;
- Furthermore, WWF recommends that some of the CCS demonstration projects are outside the EU to build confidence and capacity in the technology.

13. Including the aviation sector

Although WWF welcomes the inclusion of the aviation sector it is concerned that the level of forecast emission reductions are significantly lower than those required from other sectors in the EU ETS. Furthermore, inclusion must be seen as the first step in addressing the climate change impacts of the sector and therefore other measure and policies are clearly needed. The following issues are important for successful inclusion:

- The aviation sector must be required to make net greenhouse gas emission reductions. This means it must have a strong cap that is aligned to the effort that other sectors in the EU ETS are required to meet;
- Permits must be allocated through 100% auctioning. There is no environmental, climate and economic justification for any other solution. A report by CE Delft (commissioned by WWF) showed that full auctioning of allowances to the aviation sector offers the most incentives for airlines to reduce their emissions themselves, would not unduly damage profit margins and would result in extremely modest increases in ticket prices (when put into the context of increasing disposable income);⁷
- Access to Kyoto Protocol credits must be limited to quality checked credits. A quota limiting the total number of credits coming into the entire EU ETS is required to ensure that the majority of emissions reductions take place within the EU;
- The non-CO2 impacts of aviation must be included at the start of the scheme through the use of a 'multiplier' of at least 2;
- All flights departing and arriving in the EU should be included from the start of the scheme.

Further information

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⁷ For further information see the report commissioned by WWF entitled "The allocation of allowances for aviation in the EU ETS – The impact on the profitability of the aviation sector under high levels of auctioning". CE DELF. (June 2007). http://assets.panda.org/downloads/eu_ets_aviation_summary.pdf