

DG Environment
European Commission
B-1049 Brussels

Friday 29 June 2007

ICC UK COMMENTS ON THE EU ETS REVIEW

The International Chamber of Commerce (ICC) is the largest, most representative business organisation in the world. Its thousands of member companies in over 130 countries have interests covering every sector of private enterprise. The United Nations, the World Trade Organisation, and many other international intergovernmental bodies are kept informed of the views of international business through ICC. A worldwide network of national committees keeps the ICC international Secretariat in Paris briefed on national and regional issues and informs national governments and other interested parties on the work of ICC. ICC United Kingdom is one such national committee. Members in the UK include 18 of the top 20 FTSE companies, many smaller firms, law firms and business associations. In this instance the views expressed are the views of ICC UK, which has produced this submission, rather than of ICC as a whole.

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1 Introduction

- 1.1 In November 2006 the European Commission launched the review of the EU Emissions Trading Scheme (EU ETS) in a Communication entitled “Building a global carbon market – Report pursuant to Article 30 of Directive 2003/87/EC” (COM(2006)676 final). The aim of the review is to consider how the design and functioning of the EU ETS could be improved for the post-2012 era and will culminate in the publication of a legislative proposal to amend the EU ETS Directive in autumn 2007.
- 1.2 The review is focusing on the following broad issues:
- (a) the scope of the Directive;
 - (b) further harmonisation of the EU ETS and increased predictability;
 - (c) compliance and enforcement; and
 - (d) links to third countries.

- 1.3 The Commission has invited all interested parties to submit their views, which will be taken into account in the preparation of the proposed amended Directive. ICC UK welcomes this opportunity to input into the future shape of the EU ETS as part of this ongoing process. We believe that the review presents a significant opportunity for the Commission to map out a long-term policy framework that will help create security and confidence for business.
- 1.4 ICC UK considers that the broad objectives of the review should be to ensure that the EU ETS meets the needs of business and the environment in the most cost-effective way. Better harmonisation, efficiency and transparency within the EU ETS are essential across the Member States.
- 1.5 The EU ETS needs to send appropriate long-term carbon price signals to enable regulated businesses to make informed investment decisions. It must also be flexible enough to avoid negative impacts on competitiveness, ensuring that the greenhouse gas abatement effort in the EU is consistent with the level of effort being made in competing business sectors in other parts of the world. Consideration should also be given to whether policy measures would be useful to establish a level playing field across the EU in terms of the treatment of sectors that fall outside the trading scheme.
- 1.6 We believe that, if the design and functioning of the EU ETS is improved, it can provide a robust contribution to a global carbon market that provides harmonised and fair conditions for the delivery of cost-effective emissions reductions. To that end, the EU ETS should be designed to allow the fullest opportunities to link, where practicable, with similar schemes in other regions and countries. It must also continue to direct investment towards carbon abatement in developing countries by guaranteeing the validity of carbon credits from emissions reduction projects beyond 2012.
- 1.7 In the remainder of this paper we comment on particular issues raised by the Commission in its Communication.

2 The Scope of the Directive

- 2.1 The meaning of “combustion installation” needs to be fully harmonised and given greater clarity across the EU to ensure that equivalent businesses are treated equally. We believe this would be readily achievable through the development of a series of EU-wide technical descriptions for specific types of combustion installation.
- 2.2 The cost-effectiveness of the participation of small installations needs to be improved. In our view, the removal of small emitters from the EU ETS is justifiable and could substantially reduce the overall administrative burden of the EU ETS with minimal impact on the environmental outcome. This should be achieved through a combination of an emissions threshold for

inclusion and a de minimis rule to exclude small combustion units from calculations of aggregated total capacity at an installation.

- 2.3 We regard expansion as one of the most important design features for the EU ETS post-2012. Expansion both within the European Union and in the degree of international linkage is important to share the abatement burden and to lessen impacts on competitiveness in trading sectors. Expansion of the EU ETS to new sectors and greenhouse gases, if done appropriately, will deliver a more liquid, better functioning market. But any expansion needs to be fully harmonised and should proceed only after proper consideration of its practicability and impact.
- 2.4 A new sector should be brought into the EU ETS only if there is a genuine economic case for its inclusion, if its baseline emissions can be accurately measured and if the allocation to that sector is equitable when measured against the treatment of existing EU ETS installations. A new sector should not be included if there is limited abatement potential in that sector.
- 2.5 A greenhouse gas should be included only if its emission level can be effectively monitored, reported and verified and does not lead to the inadvertent inclusion in the EU ETS of small installations. A greenhouse gas should not be included where there are other mechanisms in place which limit or regulate its emission.
- 2.6 We believe that the widest possible range of abatement options should be recognised within the EU ETS in order to minimise the costs of reducing emissions. We support in principle, therefore, the recognition of carbon dioxide capture and geological storage (CCS) activities and urge the Commission to give full consideration to the structure and design of a regulatory framework for CCS having regard to not just the European Union but also international treaties which may impose barriers to the long term underground storage of CO₂. Given the uncertainty surrounding the development of new technologies in the future, the design of the EU ETS must not attempt to pick winners but allow the market to determine the most appropriate investment based on the long term carbon reduction trajectory.
- 2.7 In order for businesses to have the widest range of abatement options, we would also welcome an investigation into the desirability and feasibility of an approval process for emission reduction projects within the Community that are not already covered by the Linking Directive (2004/101/EC). Allowing such projects would increase the range of cost-effective abatement options available to EU ETS installations and add liquidity to the market.

3 Harmonisation and predictability

- 3.1 Experience from the operation of the EU ETS to date reveals that much closer harmonisation is needed across a number of different design elements, particularly allocation methodologies and new entrant and closure rules, in order to ensure equal treatment across the EU. We believe that achieving greater harmonisation will require the rebalancing of the role of the Commission

against that of the Member States. The nationally-driven allocation process adopted to date appears to have increased barriers to trade and investment and inhibited competition between sectors within different Member States. While we recognise the Commission's tighter scrutiny of National Allocation Plans (NAPs) for Phase II of the EU ETS, we consider that the appropriate level of discretion for Member States with respect to allocations and caps needs to be fully examined.

- 3.2 We consider that the present system for the setting of the overall EU ETS cap – the overall cap being the aggregate of each Member State's national cap – is one aspect of the EU ETS which has not functioned properly. Over-allocation by some Member States has undermined the credibility of the EU ETS and resulted in unequal treatment of competing businesses across the EU. Although the Commission has used its oversight role to much greater effect for the Phase II NAPs, we believe there is merit in a single, EU-wide cap being set centrally by Member States acting collectively.
- 3.3 Greater harmonisation of allocation methodologies is another key consideration for future trading periods. Allocation methodologies need to be simple, predictable and ensure equal treatment across the EU. In our view, the best approach for most cases is a free allocation of allowances based on benchmarking. But benchmarking needs to consider appropriate factors and criteria that account for country-specific conditions and will not be suitable for all sectors. We are opposed to anything more than limited auctioning, perhaps set as a harmonised minimum after 2012. We consider that anything more than limited use of auctioning would present unacceptable costs for businesses and place them in a significantly detrimental position against competing industries in other parts of the world. Greater use of auctioning may be an appropriate issue to consider but only when equivalent conditions exist across an industry sector internationally, or if border taxes can be utilised effectively to compensate for adverse competitive impacts on EU industry. We also believe that further consideration should be given to the issue of recycling of auction revenues to reduce other business taxes in the EU economy.
- 3.4 We also support harmonisation of the treatment of new entrants for internal market reasons, given the considerable differences in approach during the first trading period to the rules governing access to and allocation out of new entrant reserves across the Member States. Such harmonisation should proceed in the form of common rules that accord with the principle of equal treatment of new entrants and existing installations, taking into account that new entrants are better able to factor carbon abatement costs into their operations than incumbents.
- 3.5 To address global warming in the most economic manner, effective planning and effective investment decisions require an EU ETS that provides long term predictability. The current five-year periods are too short to give that predictability to capital-intensive industry sectors that need a longer-term carbon price signal to guide their investment decisions. Longer allocation periods would provide more certainty and stability, and assist long term planning. But the review needs to give careful consideration to the optimal length of trading periods. Whereas

longer periods give more certainty, sufficient flexibility needs to be built into the design of this aspect of the EU ETS so that adjustments can be made to reflect, for example, changes in economic or trading conditions or a post-Kyoto Protocol international climate change agreement.

4 Compliance and enforcement

- 4.1 We regard current monitoring and verification requirements to be overly burdensome and inflexible and would welcome their replacement with EU-wide uniform standards that remove any duplication of the requirements of other environmental monitoring and reporting regimes. We see merit in the Commission's suggestion that monitoring and reporting guidelines could be laid down in a Regulation in order to aid more harmonised application. We also support greater harmonisation of compliance rules so that all installations are treated equally across the Member States.
- 4.2 The current mechanism for reporting actual emissions should in our opinion be re-examined. The approach of annual reporting on a country-by-country basis of actual emissions has led to information asymmetries and undue price volatility around the time of the announcements. It is important that any steps taken to rectify the situation do not impose any additional costs or undue administrative burdens on participants in the carbon market, but the current situation creates unpredictability and inefficiencies in the market and hence additional costs for businesses participating in the EU ETS.

5 Linking with other schemes

- 5.1 In our view it is vital that the design of the EU ETS allows the greatest opportunity for linking with emissions trading schemes in third countries. Properly constructed links to other regional or national schemes would increase liquidity and benefit all participants. The more emission reductions are traded across international borders, the more cost effective it will be for businesses to achieve emissions reductions. Accordingly, we believe that the EU ETS needs to be as open as possible to linking with other compatible emissions trading schemes that incorporate the necessary design features, such as comparable monitoring, reporting and verification requirements. To foster a global carbon market, the EU ETS also needs to be able to link not just with ratifying Parties listed in Annex B to the Kyoto Protocol but also to mandatory national or regional emission trading schemes within third countries that have yet to ratify the Protocol. The establishment of these links, however, needs to be carefully considered to ensure that the environmental integrity of the scheme is not diminished.

To further this goal, we would recommend that the Commission give consideration to the potential merits of evolving the EU ETS from a cap-and-trade scheme to a baseline-and-credit scheme, to the extent that this may help foster internationally functioning, effective market

signals for carbon management without the need for market manipulation by governments via altered caps or other artificial means.

- 5.2 We welcome the Commission's commitment to maintain recognition of Kyoto credits beyond 2012 and to consider ways to strengthen the participation of developing countries and countries in economic transition in emissions abatement activities. Continued recognition of carbon credits from emissions reduction projects in developing countries is vital for the transfer of low carbon technology to those countries. It also aids market liquidity in the EU ETS and provides low cost abatement opportunities. In the interests of equal treatment and opportunity, however, we believe that access to project credits should not just be equitable but also that rules governing the permitted level of project credits that can be used should be harmonised across the EU. We are not in favour of any higher or additional barriers to the type or quantity of project credits that can be used for compliance purposes, and we would support the relaxation of existing restrictions, such as for forestry and sinks-based projects, provided that the integrity and credibility of project credits is not compromised.