CPI Response to the European Commission Consultation on Structural Options to Strengthen the EU Emissions Trading System

Dear Sir/Madam,

Thank you for inviting comments on the structural options and views on EU ETS contained within the 'State of the European Carbon Market in 2012' report.

CPI

Confederation of Paper Industries - Transparency Register ID 453515910702-95

The Confederation of Paper Industries (CPI) aims to unify the UK's Paper-based Industries with a single purpose in promoting paper's intrinsic value as a renewable and sustainable fibre-based material, enhancing its competitiveness through seeking to reduce legislative and regulatory impacts and in spreading best practice. CPI represents the supply chain for paper, comprising recovered paper merchants, paper and board manufacturers and converters, corrugated packaging producers and makers of soft tissue papers.

CPI works to promote:

- a positive image for paper
- secure energy supplies at competitive prices
- resource efficiency within a coherent waste strategy
- the benefits of packaging
- a sustainable UK Paper Industry
- manufacturing as a vital part of a balanced economy
- a competitive, level playing field for the UK's Paper-based Industries

CPI represents 70 Member companies from an industry with an aggregate annual turnover of £5 billion, 25,000 direct and more than 100,000 indirect employees. Members range in size from large multi-national organisations with multiple sites in the UK, to single site SMEs.

Summary

The CPI view is that the EU ETS market is working as intended and will deliver the EU ETS GHG reduction target by 2020. A low allowance price simply means the target is being achieved at a lower cost than envisaged when the scheme started – this is not a problem and should not be seen as such. The scheme is not designed to raise revenue for national exchequers nor to be the fundamental underpinning of low carbon investment decisions – rather it is intended to be a market based instrument to deliver the overall carbon reduction target at the lowest cost. Current low prices are simply a reflection of the working of the market. The current Phase III should function as intended through to the end of 2020, with structural changes only implemented in Phase IV - post 2020.

Accordingly we do not support any of the six options outlined in the Commission paper, rather our preferred option is not to intervene at all in Phase III and allow the scheme to operate as intended.

Such an approach obviates the need for controversial rushed legislative changes and intervention in a supposedly market based system with consequent long term damage to investor confidence. Changes from 2020 onwards ensures time for a reasoned and well informed debate

concerning the future of EU ETS across the whole of the European Union. In particular specific additional polices in individual Member States will only serve to distort competition between Member States and add to the regulatory burden on European based operators. In this respect the UK only Carbon Price Floor is a particular problem – with no link to EU ETS, the policy will simply be an additional cost burden on UK industry with no overall reduction in carbon emissions.

We would make the following generic comments of the operation of the EU ETS;

- **A changed international energy market.** EU ETS is only one factor affecting energy investment decisions and this should be more widely accepted by policy makers. In particular the underlying cost of the physical fuel is the most important factor driving investment decisions - EU ETS cannot realistically be used to counter the relative changes in fuel costs. Developments in North American energy markets have fundamentally changed the original impact assessments expected from EU ETS and specifically the carbon abatement curves underpinning the principles of the scheme. In North America, low cost natural gas has displaced large amounts of coal in electricity generation - displaced coal being exported, with a consequential reduction in the commodity price of coal, especially in relation to gas prices (outside North America). This low price has increased the use of coal in European electricity production, though the increased running of coal plant due to close under the LCPD (especially in the UK) may be distorting the market. Accordingly, anything less than massive increases in EU ETS prices can no longer be expected to lead to fuel switching within the generation sector. By contrast industrial users (with no opportunity for short-term fuel switching) simply suffer a cost increase and damage to their international competitive position.

- **There is still no global agreement.** Without a genuine global agreement, European based energy intensive installations are at a competitive disadvantage to competitors based in less carbon constrained economies – an increasingly important issue as differences in energy costs grow between global regions. Addressing this issue requires complex methodologies to protect sectors at risk of carbon leakage. However (in the UK) such protection is only partial – in EU ETS Phase III UK pulp and paper mills will only receive around two thirds of the necessary allowances free of charge (even less if the 'c' factor is applied), while measures to protect mills from indirect costs for electricity is limited to two-thirds of the impact.

- **Including both the power sector and the industrial sector under the EU ETS umbrella is not possible.** The two sectors are fundamentally different and need different policies to incentivise change. Critically the power sector is not exposed to international competition, can pass increased costs through to customers and can fuel switch. This in stark contrast to the industrial sector. Additionally consideration of industrial CHP electricity alongside grid produced electricity has resulted in a devastating impact on the economic case for continued operation of sector CHP as well as damaging the investment case for new plant.

- **Investor uncertainty.** Frequent regulatory intervention undermines investment confidence. With long investment cycles investors need to have confidence that the regulatory background will provide stability to recoup the investment.

- **The industrial competitiveness of European industry must be considered in a long term review of EU ETS**. It is simply not sustainable to impose carbon costs on EU installations without affecting their competitive position. In a global climate change context it makes no

sense to drive investment out of Europe and them simply import manufactured product with embedded emissions.

- **Support for innovation and investment in energy efficiency.** Our sector 2050 Roadmap ("Unfold the Future – The Forest Fibre Industry 2050 Roadmap to a low-carbon bio-economy") clearly illustrates that breakthrough technology is required to meet long term decarbonisation targets. Revenue raised by carbon related policies should be re-invested into industry to retain competitiveness and drive investments in carbon efficiencies. Unallocated NER allowances should be placed into an innovation fund.

- **There should be no 'c' factor.** Phase III allowances are based on efficiency benchmarks set by the most efficient sites. Accordingly any further reductions are simply an additional cost on industry. It is also clearly unacceptable that three months into Phase III, delays in the agreement of Member State allocation plans means installation operators are a quarter way through the compliance year with no confirmation of the actual number of allowances that will be received and so the impact of EU ETS on operational cost for the current year.

- **Regulatory overlap.** Other policy measures interfere with the operation of the carbon market with consequential impact on the demand for allowances and indeed energy costs – these overlaps must be reduced; in particular if an installation is regulated by EU ETS is should be exempted from requirements originating in other Directives. We draw particular attention to overlaps with the Energy Efficiency Directive, the Renewable Energy Directive and the Industrial Emissions Directive. We also have a particular concern that national support schemes for renewable energy are unsustainably expensive but also inevitably reduce the demand for EU ETS allowances.

Specific Comments

Our specific comments on the six options outlined in the Commission paper are as follows;

Option a – Increasing the EU reduction target to 30% in 2020. The provisions within Article 28 that provide guidance on changes in response to a global agreement have not been met. When EU ETS was designed and implemented, there was reasonable confidence there would be a global agreement on climate change. **The delivery of a genuine global agreement now seems much less likely, but must remain the priority for Member States and the Commission.** In the absence of a genuine global agreement (as opposed to a loose amalgam of local and regional promises), then the EU cannot trigger the move from a 20% target to a 30% target without damage to the competitive position of the European economy. With general agreement that the only way to resolve the present economic crisis is by growth, there is no sense in implementing policies making such growth less likely in large parts of the existing European manufacturing base.

Option b – Retiring a number of allowances in phase 3. Removing a number of allowances from the market is intended increase the value of remaining allowances and so the cost of compliance. This will push up the cost of grid electricity as well as direct compliance cost. Such a policy can only increase the energy price gap between the EU and the rest of the world, as well as reducing the available pool of investment capital. Increased energy costs can only increase the risk of carbon and investment leakage to locations with lower overall energy costs.

Option c – Early revision of the annual linear reduction factor. Revising the linear reduction factor before the end of Phase III requires the re-opening of the whole directive, as it impacts the allocation of free allowances. The linear reduction factor already decreases free allocations by

1.74% each year in total - an unrealistic efficiency improvement target across whole sectors. Indeed the UK Government have recently concluded new Climate Change Agreements for UK paper mills and agree that an electrical energy efficiency target in the region of 0.5% each year is challenging but realistic for existing installations.

Option d – Extension of the scope to of the EU ETS to other sectors. If the addition of new sectors is to impact on the overall demand for allowances, it follows the cap will not be properly adjusted to allow for their inclusion in the scheme. The only effect of this would be to marginally increase revenue for Government, and increase costs for industry. It is also not clear which other sectors would be included – sectors fundamentally different from those already regulated would require fundamental changes to the operation of EU ETS.

Option e – Limit access to international credits. Access has always been limited and is already being further restricted to remove allowances not providing genuine reductions from the market. Further restrictions would potentially reduce the scope for cost effective emission reductions in developing nations where there is potential for large increases in emissions in the absence of drivers for reduction.

Option f – Discretionary price management mechanisms. CPI is firmly against efforts to manipulate the price of carbon – such a proposal is fundamentally against the market based principles of EU ETS. The proposed Carbon Price Floor in the UK is already damaging operational confidence for energy intensive industries.

Yours faithfully
Steve Freeman

Steve Freeman
Director of Energy & Environmental Affairs
Tel: 01793 889625
Mobile: 07775 696514

Paper – the sustainable, renewable choice