

**Final Report of the 1<sup>st</sup> meeting  
of the ECCP working group on emissions trading  
on the review of the EU ETS**

on

***The Scope of the Directive***

**8-9 March 2007**

**Centre Borchette, Rue Froissart 36, 1040 Brussels**

**Agenda Item 1 : Welcome and Introduction of the Review Process**

The Chairman, Mr Jos Delbeke, welcomed participants to the meeting, the first of four meetings dealing with the review of the EU ETS. The Chair explained that these meetings were input to the Commission's preparation of a legislative proposal for the 2<sup>nd</sup> half of 2007.

Mr Peter Carl outlined the overall framework including the EU's commitment to limit average global temperature increases to 2°C above pre-industrial levels. In this context, he stressed the role and the importance of the EU ETS in stimulating innovation and conveying strong economic signals, to achieve a low carbon and sustainable economy. The most important feature of the EU ETS is to send a strong signal on carbon price. The current architecture is sound, and the review should streamline the current scheme by making it simpler and more predictable.

**Agenda Item 2: The Review of the EU ETS – Expectations and Challenges**

Mr Urban Rid emphasised the same priorities, adding that Germany considers the EU ETS to be the centre pillar of EU climate change measures. Germany would favour stronger harmonisation of allocation rules, and linking the EU ETS with trading schemes of third countries. He proposed including clear formula for calculating the caps in the Directive. As for the scope, Mr Rid advocated unambiguous definition of installations and a sound cost-benefit analysis for inclusion of additional activities. He also emphasised the importance of dealing with carbon capture and sequestration (CCS).

In his intervention, Mr Anders Wijkman MEP expressed his wish for the EU ETS to develop into a global system. The review should render the system more simple and easier to understand. In his view, grandfathering allowances has led to huge windfall profits and over-allocation. For the future, he would be in favour of auctioning allowances and using the revenues to stimulate and promote investments in the renewable energy sector. A maximum of harmonisation and a more important role for the Commission is necessary. Transport emissions have been growing, and need action – for aviation, the Parliament has supported a separate system, while for other transport emissions, there are opportunities and risks in pursuing trading.

The Chair thanked Mr Rid and MEP Wijkman for their interventions, noting the strong calls for harmonisation on overall levels of allocation.

He informed participants that the Commission services will produce a report after each of the four review meetings, a draft of which will be sent to participants for comments. Following consolidation of the comments, the report will be published on the EU ETS review website<sup>1</sup>. However, there will not be one single consolidated report after the four meetings, since it is considered more important to report after each meeting. The four reports will serve as a major input to the legislative work of the Commission to be carried out in the 2<sup>nd</sup> half of the year.

### **Agenda Item 3: Expanding the EU ETS to other sectors and gases**

#### **Presentations**

Mr Christian Egenhofer (CEPS) highlighted the economic rationale for expanding the EU ETS, which would generally lead to lower abatement costs and could potentially reduce compliance costs by up to 30-40% provided conditions including accurate monitoring reporting and verification issues are met.

Mr Jochen Harnisch (Ecofys) presented the technical assessment criteria used and results of an Ecofys study on expanding the EU ETS, which indicated that a number of additional sectors might be included in the EU ETS if some potential barriers can be successfully overcome. In his second presentation, he concluded that MRV (monitoring, reporting, verification) for small emitters will be greatly simplified from 2008 onwards through the revised MR (monitoring & reporting) Guidelines. While the inclusion of complex activities in the EU ETS may require amendments of the Directive, the MR Guidelines, specific verification guidance and the addition of simple activities may be straightforward.

The presentation by Mr Tore Jenssen (EFMA) advised that including N<sub>2</sub>O from the production of nitric acid and adipic acid in the EU ETS is feasible. Mr Jenssen recommended allowing opt-in of N<sub>2</sub>O from 2008, in order to gain experience, and that JI and CDM credits should be allowed.

According to the presentation by Mr Philip Luyten (CEFIC,) considering inclusion of CO<sub>2</sub> from petrochemical and chemical production processes, would depend on the solution of a number of issues with a view to improving the current scheme.

Mr Eirik Nordheim (EAA) highlighted the global competition that the European Aluminium industry is part of and stated that the aluminium industry for a number of reasons is not in favour of inclusion in the present EU ETS, but is prepared to enter into agreements with the EU authorities in order to explore further reduction possibilities based on industry benchmarks and applying MRV principles equivalent to ETS including penalties for non-compliance.

---

<sup>1</sup> [http://ec.europa.eu/environment/climat/emission/review\\_en.htm](http://ec.europa.eu/environment/climat/emission/review_en.htm)

Regarding CH<sub>4</sub> emissions from coal mines, Mr Bogalla (Euracoal) expressed doubts on whether some a sufficient degree of accuracy of monitoring, reporting and verification would allow their inclusion in the EU ETS. He also underlined the need to ensure an acceptable cost-benefit ratio when including methane emissions from coal mining in the EU ETS.

Mr Matthias Duwe (CAN Europe) emphasised that any change to the EU ETS must make it more reliable in ensuring absolute reductions in emissions. He identified a number of sectors suitable for inclusion in the EU ETS, subject to these fulfilling certain environmental criteria.

### **Discussion**

The discussion confirmed that an expansion of the EU ETS would in principle further reduce abatement costs and thus renders the scheme more efficient. More harmonisation across sectors and Member States would be required in particular with respect to monitoring, reporting and verification. Opt-in provisions in the second trading period would offer the possibility to gather experience and learn with a view to arriving at a more harmonised approach from 2013 onwards. The availability of reduction potential may constitute a criterion in the short term, but in the view of many stakeholders should not play a role in the longer run, since there are already sectors included in the EU ETS with a limited reduction potential.

According to some representatives from the industry, such as BusinessEurope, sectors that have already carried out abatement measures at low costs but would face high costs to implement additional measures following inclusion in the EU ETS should be very carefully considered.

The energy intensive industry highlighted the matter of international competitiveness and the pass-through of costs as well as the positive environmental contribution emerging from indirect emission effects (e.g. lighter and better material entailing lower transport emissions). Improvements to the EU ETS should also address these problems.

In their view, environmental additionality should also play a role. Companies, in particular small and medium sized ones, should only face additional burden, if there is a positive environmental effect. In this regard, the exclusion of sectors and the matter of process emissions may be worth considering. Other industry representatives, such as the Carbon Trading Sector, suggested that the make-or-buy rule as criterion should apply to the various ETS sectors. All installations should face reduction requirements. The matter of competitiveness should not constitute a reason not to include a sector, since it could be addressed by alternative means, such as linking or allocation methodologies.

Double regulation should be avoided as much as possible, which is ensured by Article 26 of the ETS Directive relieving installations to be covered by the ETS Directive from an emission limit value under the IPPC Directive.

It was also stressed that the EU ETS may and should serve as a nucleus for a global system. For this reason, too, the scheme should be kept simple.

## **Conclusions**

Following a broad-ranging discussion, the Chairman summarised the findings of the presentation and the results of the discussion as follows:

1. There are solid economic reasons indicating that further extension of the EU ETS could reduce abatement costs and thus render the scheme more efficient.
2. While there is no objection in principle including new sectors should be subject to certain conditions, such as an harmonised approach across Europe including MRV, clearer legal definitions, recognizing technology and the international dimension.
3. Opt-in might be used as a test ground for benchmarks and robust rules on monitoring, reporting and verification.
4. All sectors need to contribute to the reduction of GHG emissions, however, it might be a question which policies should be applied.
5. The matter of international competitiveness of ETS sectors must be seen in the context of alternative measures and instruments available to authorities.

### **Agenda item 4: Unilateral inclusion of additional activities and gases under Article 24 of Directive 2003/87/EC**

## **Presentations**

Mr David Mjureke (Swedish EPA) suggested that the definition of installation in the Directive should be amended to allow treatment of a complete district heating system as one single installation. In addition he recommended applying a general opt-in for all known and unknown installations complying with certain opt-in criteria.

Mr Magnus Cederlöf from the Finnish Ministry of Environment suggested simplifying the opt-in procedures with a view to avoiding separate approval from the Commission, if certain conditions were met.

In his presentation on the opt-in of N<sub>2</sub>O, Mr Christophe Ewald from the French Ministry of Ecology and Sustainable Development, highlighted the emission reduction potential of this option as well as the most important elements linked to opting-in N<sub>2</sub>O from the French point of view.

## **Discussion**

The Commission clarified that subject to full legal checks where required and appropriate there is no need for second time application for installations already opted in the scheme. Concerns that unilateral inclusion into the EU ETS may lead to a non-harmonised scope were not confirmed.

Experience gathered so far showed that pooling did not prove to be interesting for the operators. This may relate to the need of having a legal entity to take responsibility for all pooled emissions. Generally, opting-in should be considered a useful option, since

emissions trading ensures the reduction of emission at least costs, but it was also stressed that the same environmental effects might be achieved through IPPC permits. Double regulation. i.e. applying both the ETS and the IPPC Directive to the industry may only be justified under specific circumstances, such as the risk of impacting negatively on human health.

### **Conclusions**

Summing up the discussions, the Chairman concluded that

1. The opt-in option was generally considered a solid option.
2. Until a harmonised approach is available from 2013 onwards, the opt-in of new gases and sectors should be applied pragmatically and as far as possible in a harmonised way, in order to prevent distortion of competition.
3. While in principle double regulation should be avoided, as laid down in Directive 2003/87/EC, there could be exceptions to this rule for the sake of higher-ranking values, such as protection of human health.

### **Agenda item 5: Streamlining the application of the current scope**

#### **Presentations**

According to Mr Stefan Moser (European Commission), competitive distortions on the internal market with respect to the application of the scope of the ETS Directive are thought to be considerably reduced in the 2<sup>nd</sup> trading period thanks to the guidance submitted by the Commission and the pragmatic approach taken by Member States. Including additional emitters meant to increase the environmental benefit of the EU ETS. Discussions should focus on how the definition of combustion installation in Annex I of the ETS Directive can be improved.

In her presentation on “Further improvement in harmonising the application to installations in the current scope”, Mrs Dian Phylipsen (Ecofys) pointed out most important gains could be achieved by harmonising the application of definition of furnaces, especially including ammonia plants as well as by harmonising the definition and treatment of process emissions.

#### **Discussions**

The achievements of the Climate Change Committee in terms of streamlining the application of the Directive allowed considerable improvements in the national allocation plans for the 2<sup>nd</sup> trading period. However, further legal certainty and clarity with respect to the definition of a combustion installation is needed.

As for how to define a combustion installation, the matter of process emissions was raised. There is no unanimous view on whether a clear definition of process emissions is preferred or whether Annex I of the Directive should be extended through adding new activities. The Commission took the view that with the EU ETS internalising the costs of carbon, process emissions ought to be included.

According to some industry representatives, including all large installations in the EU ETS, in order to exclude small ones would meet some resistance, as it may make some industrial sectors leaving Europe.

Industry representatives raised a number of specific concerns, in particular relating to the production processes of lime, the ceramic industry, but also to the treatment of the glass industry and its competing products.

The need to keep the EU ETS simple, also with a view to evolving a nucleus of a global carbon market and to rendering it attractive to other parts of the world, was generally highlighted.

### **Conclusions**

In concluding the discussions, the Chairman highlighted the following points:

1. The definition of combustion installations should be improved or a definition of process emissions should be established with a view to ensuring consistent application across the EU.
2. In this respect, there is a need for further harmonisation, legal certainty, but also simplification.
3. On the basis of written input from stakeholders, a meeting of the Climate Change Committee with participation of industry experts could, if need be, further examine relevant definitions.
4. Further work should be built on codifying the agreement achieved in the Climate Change Committee.

### **Agenda item 6: Improving cost-effectiveness as regards small installations**

#### **Presentations**

Mr Paul van Slobbe (Netherlands) identified a misbalance between the number of installations and the share of allowances allocated to them as well as high MRV costs for small installations. He proposed first, for small installations, to ensure the same scope in all Member States, then to exclude small installations by means of a list of these installations and finally cut down the costs of participating in the EU ETS for all installations.

Mr Stefan Moser (European Commission) set out the pros and cons of including/excluding small installations as well as a number of policy options to deal with the issue. His analysis addressed the possibility of both changing the currently existing aggregation clause and identifying specific categories of combustion installations for targeted exclusion.

#### **Discussion**

The discussions showed that there is a trend of improving the cost-benefit ratio for small installations under the EU ETS. Representatives from the energy intensive industry did not confirm this observation.

While some participants advocated excluding small installations from the EU ETS, others advised to be cautious when discussing restricting the scope of the ETS. If it comes to exclusion of small installations/emitters, the question of alternative, equivalent measures would clearly arise. In the event of excluding installations or sectors, a harmonised approach at EU level was considered necessary in view of the potential to link the EU ETS with other trading systems in third countries.

In order to define a threshold for including/excluding small installations, some stakeholders suggested an approach based on emissions, while others would prefer either capacity, or a combination of both capacity and emissions or refused any emissions based threshold. It has also been suggested to exclude those installations from 2013 onwards the emissions of which were below 25 kt/yr during the period 2008-12.

The diversity of the various industrial sectors, such as ceramics, pulp and paper was highlighted. Voluntary agreements were suggested as a possible solution, but did not meet much agreement, but rather doubts on the credibility of such an approach at EU level.

While participants from the pulp&paper industry considered the matter of strategic behaviour of companies not really relevant, others reported strategic behaviour of companies aiming at updating their permit with a view to staying below the threshold of being included in the ETS.

### **Conclusions**

Following the discussions, the Chairman identified a number of major elements emerging from the debate:

1. Monitoring, reporting and verification costs still represent a higher per ton cost for small installations despite the considerable progress achieved.
2. All sectors need to contribute to the reduction of GHG emissions, however, it might be a question which policies should be applied.
3. Feasible options in order to define “small installations” might be a capacity and an emissions threshold.
4. With respect to harmonisation, a possible starting point could be to draw up a list of small installations of, for example, hospitals, to exclude from the scope of the Directive.
5. Opting-out small installations has to be measured against alternative instruments, while the opt-in should be maintained as an effective way of dealing with emission reductions.

## **Agenda item 7: Carbon dioxide capture and geological storage activities**

### **Presentations**

In his presentation, Mr Scott Brockett (European Commission) gave an overview on the various aspects and risks related to CCS and presented suggestions how to cope with existing barriers. He highlighted the role of CCS for meeting the reduction targets as well as the need to manage the risks involved.

Mr Tim Dixon from the UK Department of Trade and Industry presented the work on CCS undertaken in the UK with a view to opting-in CCS in the EU ETS. He stressed the CO<sub>2</sub> mitigation potential of CCS and highlighted the efforts currently underway to give confidence for an environmentally sound CCS.

Mr Göran Lindgren from Vattenfall and Mr Hans-Aasmund Frisak from Statoil presented the CCS projects employed by their companies demonstrating the various technologies applied.

For Mr Stefan Singer, WWF, CCS represents an uncomfortable, but necessary option and should become mandatory for all stations by 2020 at the latest.

### **Discussion**

The debate acknowledged the potential contribution of CCS to the overall GHG emission reduction objectives.

However, a number of issues were raised on the relation between CCS and ETS: It was argued that the EU ETS should cover the full chain of CCS. In this context, the questions arose whether a new type of storage credits should be created and whether one ton of CO<sub>2</sub> put in storage should equal one ton of CO<sub>2</sub> avoided. If storage credits were to be created, they should be part of the allocation process, in order to provide the necessary incentives for the upstream CCS chain. It was generally considered very important to formally recognise CCS in the EU ETS Directive from the 3<sup>rd</sup> trading period onwards rather than relying on a pure opt-in approach.

In the light of the costs of CCS, industry representatives highlighted their concerns as for the ETS to bring about the financial incentives for CCS. Therefore, CCS should enjoy political and financial support from technology programmes in the short term, while in the long term markets will give the necessary price signals. In this respect, some stakeholders raised concerns, whether a mandatory approach on CCS would be able to deliver by 2020 and would prefer an incentive based one.

Participants of the meeting were pleased to note that both the steel and the cement sector are interested in the abatement potential offered by CCS. The steel sector set up a consortium looking at breakthrough technologies in this respect, which, however, will need adequate support in the framework of the 7<sup>th</sup> Framework Programme and from the European Investment Bank.

Representatives from the energy intensive industry were worried about CCS plants that may serve as marginal supplier of electricity. Against this background, the



Commission clarified that economic theory requires internalisation of external costs. The industry concerned was invited to provide a detailed analytical and empirical analysis on CCS as a marginal supplier of electricity.

### **Conclusions**

The chairman identified the following major elements emerging from the debate:

1. The option of CCS is important and promising. While it does not provide a silver bullet, it effectively contributes to the overall solution.
2. De facto, there are two time frames available now:
  - The opting in procedure, immediately available, which, for instance, will be followed by the UK for the 2<sup>nd</sup> trading period;
  - A harmonized approach from 2013 onwards. In that respect, account will need to be taken of the different technologies applied, their specific aspects in the short and in the long-term as well as the potential to include specific provisions on CCS in the 3<sup>rd</sup> phase of the EU ETS.

### **Agenda item 8: Emission reduction projects within the Community**

#### **Presentations**

In his presentation on "Emission reduction projects within the Community", Mr Frank Convery, UCD Dublin, highlighted positive and negative aspects of domestic offset projects (DOPs, here used as equivalent to emission reduction projects within the Community). The former could only come true provided that a number of conditions are met. The extension of the EU ETS to DOPs would inevitably require harmonisation across Member States and compliance with a number of pre-conditions. Mr Convery proposed a pilot scheme to be set up, in order to test the viability of these projects under field conditions.

Mr Ignacio Sánchez García from the Spanish Ministry of Environment addressed the various aspects such as how to link domestic projects with the EU ETS without affecting the well functioning of the trading scheme, how additionality could be ensured, how to deal with eligibility criteria and MRV.

#### **Discussions**

In the debate, stakeholders highlighted the various benefits and drawbacks of domestic offset projects: On the positive side, it was argued that in order to achieve a 20% GHG emission reduction, all opportunities including DOPs should be used. As for sectors not included in the ETS, DOPs could unfold some synergies between the ETS and non-ETS sectors, as they may allow preparing the ground for later inclusion in the ETS by discovering the price of carbon in the non-ETS sector. Furthermore, DOPs may bring about new business opportunities for industry and may lead to increased liquidity on the market.

On the other side, adverse effects from DOPs interfering with both the ETS and non-ETS sector may appear: declining prices on the carbon market triggered by DOPs may reduce the incentives accruing from the ETS to reduce emissions and for this reason may justify some limitations, while DOPs are also seen as a potential barrier for identifying new policies and measures in the non-trading sector.

It was generally admitted that complex approaches would be required to allow DOPs, since there are no convincing concepts available yet to ensure environmental additionality, to avoid double counting, to ensure the necessary monitoring, reporting and verification, to set the necessary emissions development baseline and to set up a sufficiently simple design of the DOPs.

In the event that the inclusion of DOPs into the EU ETS should be further pursued, these problems must be overcome. Monitoring, reporting and verification requirements, but also the overall design of the system should preferably be harmonised at European level. A list of potential DOPs projects or pilot projects might be set up to decrease the uncertainty for project developers.

### **Conclusions**

Following the debate, the chair highlighted three major points emerging from the debate:

1. There is a mixed perception of emission reduction projects within the Community (or domestic offset projects) showing a number of drawbacks:
  - they are administratively complex to handle;
  - they may bring about adverse price effects on the market;
  - the requirement of additionality is difficult to ensure and finally,
  - they may interact with existing domestic policies and measures
2. A pilot scheme with a limited list of projects to establish the merits and demerits of DOPs might be envisaged. Among others, transport might represent a potential area in this respect.

In the context of the debate on emission reductions projects within the Community, the UK made a brief presentation on the matter of road transport. It was concluded that the issue merits further reflection.

### **Agenda item 9: Concluding remarks**

Before concluding the meeting, it was requested to introduce a new agenda item on the functioning of the carbon market including the impact of the EU ETS on power prices, which might be dealt with in one of the forthcoming meetings. The suggestion should be further elaborated, in order to provide a sound basis for decision.

The Chair concluded the meeting by pointing out that

- a report will be established, which will be sent for comments to participants. The deadline for submitting comments should be fully respected as otherwise the process might be very cumbersome to manage. The report will not be verbatim and will not identify the positions of the various stakeholders, but rather sum up the issues discussed with a view to identifying converging and diverging views on the various subjects.
- the presentations will be put on the web. The relevant address is [http://ec.europa.eu/environment/climat/emission/review\\_en.htm](http://ec.europa.eu/environment/climat/emission/review_en.htm).
- the next meetings will take place as indicated in the invitation to this meeting.