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UK Summary Report of responses to the Consultation on Commission's proposals to amend the EU Emissions Trading Scheme from 2013

A report by **Enviros Consulting Ltd**

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Llywodraeth Cynulliad Cymru
Welsh Assembly Government

Department of Energy and Climate Change
3-8 Whitehall Place
London SW1A 2HH

Website: www.decc.gov.uk

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Information about this publication and copies are available from:

EU ETS Policy Team
Climate and Energy: Business and Transport Division
Area 4A, Ergon House, 17 Smith Square
London SW1P 3JR

Tel: 0207 238 4745

Email: eu.ets@defra.gsi.gov.uk

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Prepared under the management of:



Gill Proaktor – Project Manager

Directed, reviewed and approved by:



Mike Bullard – Project Director

Client Address: DEFRA
Area 4B
Ergon House
London SW1P 3JR

Marcus Brooks

Tel 020 7238 5711
Email marcus.brooks@defra.gsi.gov.uk

Enviros Contact Details: Enviro Consulting Ltd
20-23 Greville Street
London
EC1N 8SS

Caroline Doble

Tel 020 7421 6361
Email caroline.doble@enviros.com

Web www.enviros.com

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LIST OF ACRONYMS

Acronym

CCA	Climate Change Agreement
CCS	Carbon Capture and Storage
CDM	Clean Development Mechanism
CER	Certified Emissions Reduction
CHP	Combined Heat and Power
EB	Executive Board
EBITDA	Earnings before interest, tax and depreciation and amortisation
EC	European Commission
ERU	Emissions Reduction Unit
EU ETS	European Union Emissions Trading System
EUA	EU Allowance
GDP	Gross Domestic Product
GVA	Gross Value Added
IA	Impact Assessment

Acronym

IMO	International Maritime Organisation
IPCC	Intergovernmental Panel on Climate Change
JI	Joint Implementation
LEP	Large Electricity Producer
LPG	Liquefied Petroleum Gas
LULUCF	Land Use, Land Use Change and Forestry
MAC	Marginal Abatement Cost
MRV	Monitoring, Reporting and Verification
MS	Members States
NER	New Entrant Reserve
NGO	Non Governmental Organisation
UNFCCC	United Nations Framework Convention on Climate Change
WTO	World Trade Organisation

EXECUTIVE SUMMARY

This report summarises the responses received to the Defra consultation on the proposals for the EU Emissions Trading System (EU ETS) from 2013. The consultation closed on 30 July 2008 and 94 responses were received. This report presents Enviro Consulting's analysis of those responses. The views raised are those of the stakeholders that responded rather than of the authors of the report.

Context

The consultation document followed the publication by the European Commission of proposals to review the Directive for the third phase of the scheme, which is due to begin in 2013. Stakeholders were asked for their views on 54 questions which addressed a wide range of issues, from detailed questions around the way that allowances will be allocated to participants to high level questions around the regulatory framework required for the scheme.

Overview of respondents

A considerable proportion of respondents to this consultation were EU ETS participants or their representatives, particularly from the energy supply, oil and gas and chemical industries (together these sectors constituted 30% of respondents). There were also responses from NGOs/ research institutes (6%), regulators (2%), market facilitators (e.g. banks, lawyers) (3%) and the public sector (6%). On average, around 52% of respondents answered each (sub-) question; the strength of feeling is illustrated in the chart overleaf and discussed in the text that follows.

Scope of the System

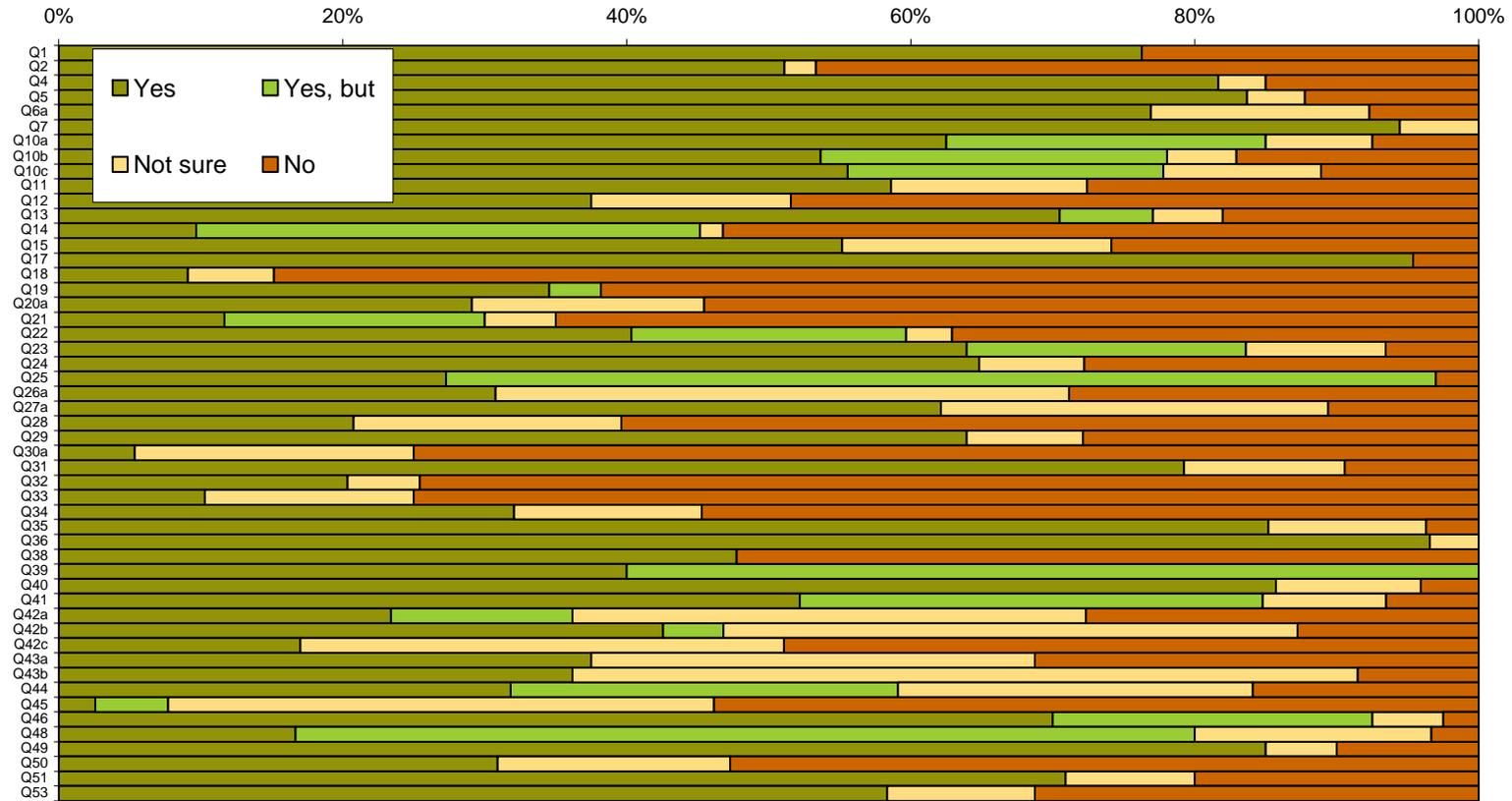
There was considerable support to use a broad definition of combustion to determine inclusion in the scheme, particularly if this facilitates harmonisation across the EU. However, views were mixed around whether the definition proposed in the Directive achieves this and respondents raised specific concerns about the impact of the approach proposed on their activities.

There was also relatively strong support for excluding small emitters; a larger number of respondents supported a threshold of 25ktCO₂ or more than supported the alternative (10ktCO₂) suggested. There was some agreement that the capacity threshold proposed was unnecessary and that the emissions threshold is more appropriate. Those that did not support the opt-out were typically keen to avoid complexity and to maximise the scope of the scheme.

This idea fed through to the questions around the expansion of the System to new activities and gases. There was support to include the activities proposed¹, on the basis that all parts of the economy, particularly large industrial installations, should do their bit. This support extended to the inclusion of the aluminium sector and coal mines (although some of the respondents from each of these sectors were against the idea). There was also a view that carbon capture and storage (CCS) should be included in the scheme, although some concern that this alone would not be sufficient support to drive the investment required.

1 (A) CO₂ emissions from petrochemicals production, ammonia and other chemicals including process emissions (B) CO₂ & PFC emissions from the production of aluminium (both primary and secondary) (C) N₂O emissions from the production of nitric, adipic and glyoxal and glyoxylic acid production (D) Methane from active coal mines

Figure 1 Strength of responses to yes/ no/ not sure questions²



² The majority of questions could be summarised into yes/ no/ not sure answers. The summary responses to these types of question are illustrated in the chart above. The more red or green in a particular row, the stronger the view across all respondents; the more yellow the more mixed the response.

Respondents expressed some concern around whether the EU ETS is the appropriate mechanism to deliver emissions abatement from surface transport and shipping, particularly given the practicalities of monitoring, reporting and verification (MRV). Although only a relatively small proportion of respondents commented on the inclusion of agriculture, forestry and land management, there was some agreement amongst those that did that these should not be included at the moment (again due to concerns around MRV). There was support for excluding combustion installations that (predominantly) burn biomass³.

Cap setting

Views were mixed around the level of cap proposed; similar numbers agreed with the level proposed as did consider it too low (a smaller number considered it too high). This was reflected in concern that it was not clear that the level of effort required from the non-traded sector was comparable. There was support for measures to increase long term certainty (like the introduction of a linear trajectory and longer phase lengths) but, with this in mind, some concern around the idea of a flexible review date. Although there was some support for responding to an international agreement with a tighter cap, views were mixed and there were questions around the definition/ scope of an international treaty and when the adjustment would apply.

Around half of respondents that commented consider that there could be a role for a new independent body to oversee/ implement administrative functions and/or provide independent advice rather than to decide on or implement policy. However there was a view that 'European Carbon Bank' is not the appropriate term for such an institution. In relation to market operation, there was relatively strong agreement with the approach for banking and borrowing proposed.

Allocation methodology

The first part of this section discussed proposals for auctioning. It is worth noting that although some support the move away from grandfathering, other respondents are against the idea of auctioning at all and so this affected their view. There was strong opposition to the idea that only the minimum level should be harmonised and support instead for the Commission proposal of consistent absolute levels.

Respondents also voiced disagreement with the idea of using auctioning rather than free allocation for on-site generators, although the power sector supported the idea in the interests of consistency. One reason for this was the impact it would have on investment in distributed generation. The methodology proposed for allocation to combined heat and power CHP⁴ was not widely supported; it raised concerns that this would not be an adequate incentive for the technology.

There were mixed views around the approach proposed for sectors other than electricity producers⁵. Although some consider a move towards auctioning positive, others are concerned around its impact on (both inter- and intra-EU) competitiveness and how the risk of sectors (or subsectors) to carbon leakage will be established. As a result, there was support for the Commission to undertake further analysis into which sectors are most affected, but concern that the timetable proposed will result in prolonged uncertainty.

3 Respondents highlighted that it is rare that an installation will burn only biomass since fossil fuels are used for start up/ back up.

4 i.e. providing electricity generators free allocations for heat produced under CHP

5 Respondents from the electricity supply flagged their disappointment that the choice of full auctioning for their sector was not a matter for consultation

There was some agreement, particularly amongst EU ETS participants, that in principle free allocation could help to mitigate the risk of carbon leakage (although not all respondents agreed).

The most common alternative suggestion to address carbon leakage was trade agreements/ cross border tariffs (although other respondents expressed concern around the use of these). Views were very mixed around whether sectoral agreements were a viable option, particularly within the time available, and varied from sector to sector⁶.

Sector specific considerations were raised again in conjunction with the idea that the need for sector caps should be eliminated in Phase III; respondents commented that sector caps are necessary to ensure equitable treatment/ certainty and there was some support for the UK non-paper on this issue.

There was a view that a single EU-wide new entrant reserve (NER) would be the most equitable approach and strong support for the UK Government view that the percentage proposed (5%) is too high. The idea that closed installations should no longer receive allowances was also largely supported. However there was concern around the definition of new entrant proposed, particularly that expansions at existing sites would be disincentivised even if they are the more efficient approach (in carbon and financial terms).

One of the questions that received the strongest response was around the use of auction revenues. There was a strong view from a wide cross section of respondents (75% of respondents to the question) that revenues should be used to fund climate change measures and that they should not be transferred to the consolidated fund (which many respondents would view as a tax). Equally, there was a strong view that funds generated from an environmental policy should not be used for economic development or to bridge the economic differences between Member States (MS). There was also more moderate concern around a single historic year being used as the basis for distributing auctioning revenues (some supported the simplicity and transparency of this approach).

In terms of the legislative framework for the operation of the auction, the overwhelming majority supported the need to ensure that auctions are open, transparent and non discriminatory. Respondents considered that ensuring this is a key role for the Commission. However not all stated explicitly that they agreed a regulation was necessary or the best way to achieve this. Although views were mixed over the timetable for the regulation, there was considerable concern amongst the power sector in particular that the timetable is too long and may result in a delay to the issue of allowances.

Linking to other systems and project credits

A common theme ran through responses to all the questions in this section: there is a role for linking and the use of project credits, but the inclusion of such credits must be balanced against the need to ensure that the stability and rigour of the EU ETS is not threatened.

As a result, there was some support for linking with other systems using the criteria suggested by the Commission (with some suggested amendments). There was also a view that some consideration should be given to the type of credits from baseline and credit systems and whether limits on those credits should be imposed. However, views around whether credits post 2012 should be recognised in anticipation of international agreement were mixed, but slightly more support for recognising projects in less

6 A list of the sectors that considered them viable is provided in Table 8 on page 45.

developed countries approved after 2012. More respondents considered that CERs from particular projects should not be excluded than agreed that they should be.

Views were very mixed around the approach that should be taken to access to project credits on reaching an international agreement, but some agreement that project credits from countries that have ratified the agreement should be preferred. Similarly views were mixed around whether the EC should seek bilateral agreements with third countries in the absence of international agreement; respondents commented on the level of access that should be around and on ensuring credit quality.

There was a general feeling that the project credit limits proposed by the Commission are too restrictive and a number suggested there should be no limits at all. Respondents were in some agreement with the Government that project credit limits in Phase III should be harmonised between Member States in order to avoid distortions. Views around whether particular sectors should be included or excluded in advance of an international agreement were very mixed. The avoidance of any provisions for the recognition of credits in advance of an international agreement, at least not at an EU level, was marginally favoured.

As was the case for surface transport, concerns around the robustness of MRV were raised in relation to land use, land use change and forestry (LULUCF) projects. There was some support that these types of project should be included if these difficulties could be overcome. Equally, respondents consider that domestic projects should be provided for, with the qualification that they must be proved to be additional.

Monitoring, Reporting and Verification

The section on MRV asked whether two different regulations should be introduced, one to replace guidelines on monitoring and reporting and the second to harmonise verification and accreditation. Respondents consider there to be less benefit in the first of these and saw the merits of remaining with the status quo. However, the second idea was supported quite widely, although some made the point that it is the enforcement and interpretation of the regulation that is key.

There was some support for penalties to increase with inflation over time in order to ensure they pose a credible threat. The last question in this section asked whether there should be a central registry run by the Commission; more respondents answered yes than no, but there were some concerns that the level of service and access achieved by national control would be lost.

Other points made

Respondents also raised a variety of points that were not the subject of specific consultation questions. These ranged from comments on the scope and process of this consultation to questions around the appropriate route for decision making in Brussels. A common point was around timing, reiterating the need for long term certainty and concerns that the Commission timetable is too slow. Respondents also provided detailed information on the impact of the issues on their own activities, providing comments on the partial impact assessment (IA) and proposed amendments to the Directive.

Introduction and objectives

This report summarises the responses received to the Defra consultation on the proposals for the EU Emissions Trading System (EU ETS) from 2013. The consultation closed on 30 July 2008 and 94 responses were received. This report presents Enviro Consulting's analysis of those responses. The views raised are those of the stakeholders that responded rather than of the authors of the report.

Background

The EU Emissions Trading System⁷ (EU ETS) is a mandatory cap and trade scheme that covers large emitters of carbon dioxide (CO₂) across Europe. Phase I of the EU ETS began in 2005 and ran for three calendar years (until 2007), followed by Phase II, the current five-year phase, which will run until 2012. The key rules and underlying principles for these first two phases were set out in an EU Directive. In January 2008, the European Commission (EC) published its proposals to review the rules for the third phase of the scheme. The UK Government has published its view on these proposals. The consultation to which this report relates asked stakeholders whether they agree with the UK and/ or Commission positions in a wide range of areas (illustrated in the diagram below).

Figure 2 Areas covered in the consultation



Key: Carbon Capture and Storage (CCS). Nitrous Oxide (N2O). Methane (CH4). Perfluorocarbon (PFC).

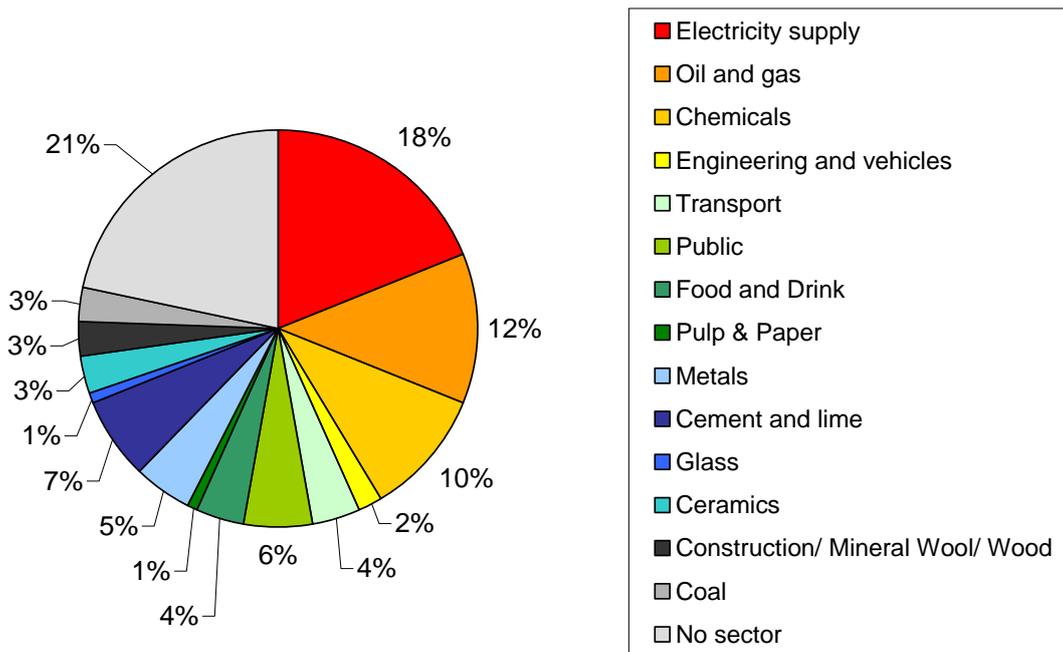
7 In the past, the acronym EU ETS has been used to mean EU Emissions Trading Scheme, however, consistent with the title of the amended Directive and the consultation document, it is used to mean EU Emissions Trading System in this report.

Respondent characteristics

The EU ETS is a key tenet of EU and UK greenhouse gas (GHG) policy which has supported the development of an international carbon market. As such, it affects not only those that are required to participate in the scheme, but also organisations that work in those markets. Figure 2 below illustrates the proportion of respondents by sector⁸; it shows that a considerable proportion of respondents to this consultation were EU ETS participants or their representatives, particularly from the energy supply, oil and gas and chemical industries.

The largest number of respondents were in the electricity supply sector (18%), closely followed by the oil and gas sector (12%), chemical sector (10%) and cement and lime (7%). In addition to responses from organisations that would be covered by the scheme, there were also responses from other stakeholders, classified as 'no sector' in the chart below e.g. regulators and non-governmental organisations (NGOs).

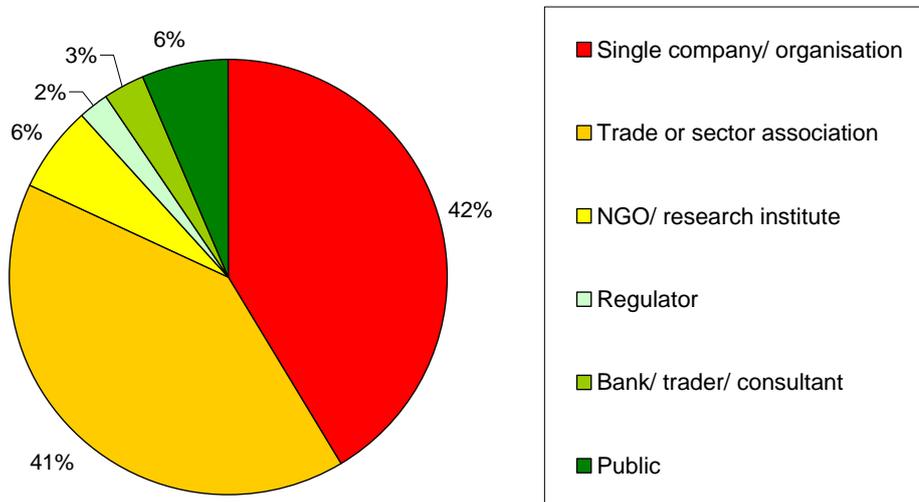
Figure 3 Respondents by sector



We also grouped the respondents by organisation type (Figure 4). Just over 40% of responses represented single firms and a similar number were submitted by trade or sector associations. The public sector and NGOs were responsible for a further 6% of responses each and the remainder were regulators and other market players (banks, traders, consultants etc.).

8 For the purposes of the analysis these sectors were also split into subsectors e.g. transport into aviation and rail, electricity sector into large electricity producers and others. In the interests of simplicity the higher level sector categorisation is shown here.

Figure 4 Respondents by organisation type



Response rate

Figure 5 illustrates the response rate to each consultation question⁹. The average response rate was about 52%, reflecting the fact that there were a number of multi-limbed questions and, respondents did not always answer every part of these, even though many respondents answered the majority of questions. Two of the most commonly answered were Q3¹⁰ and Q33¹¹. Question 37¹² received the least responses, in part because some organisations do not support the use of auctioning at all.

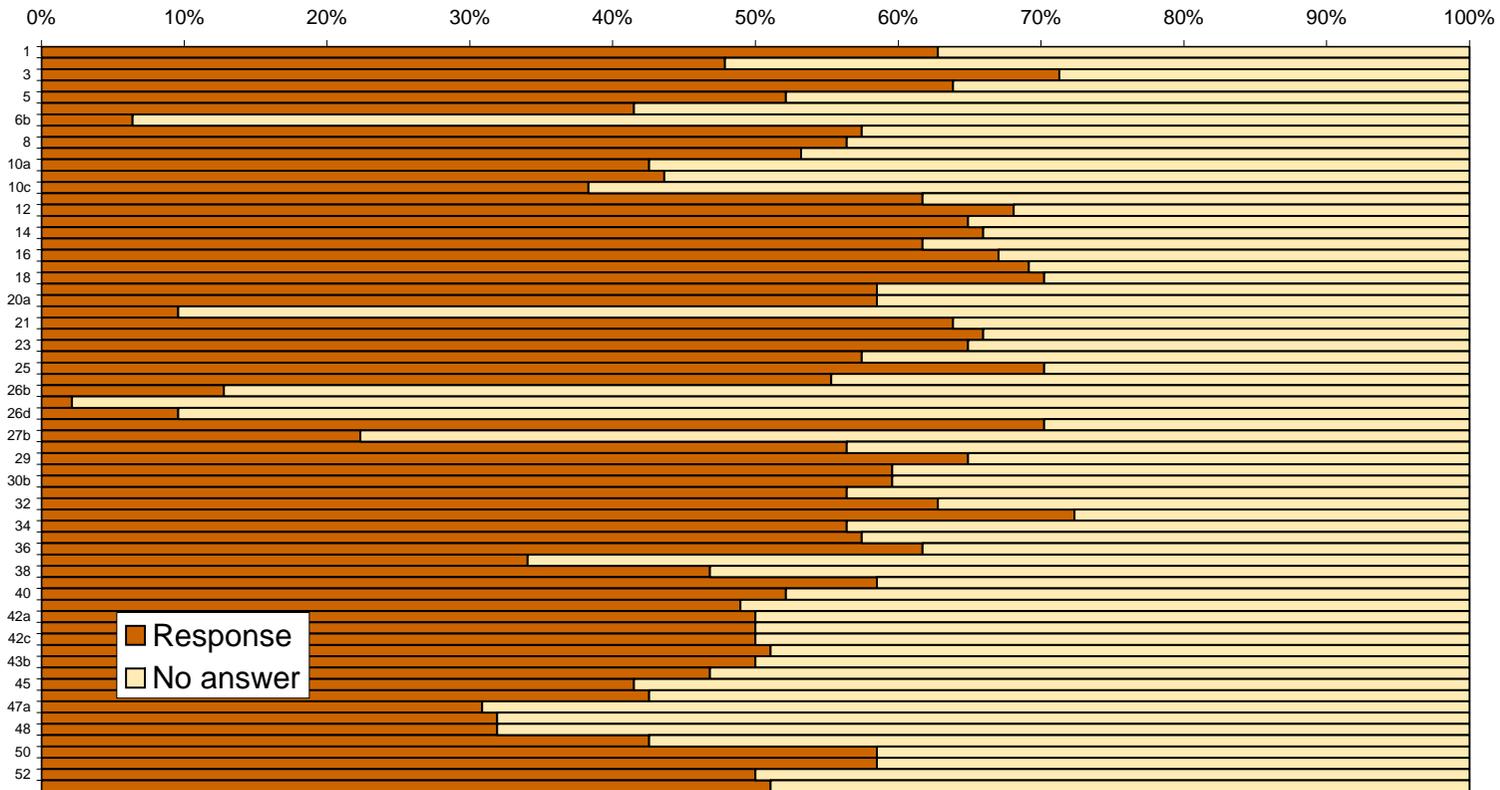
9 The majority of respondents indicated to which questions their comments related. For those that did not, where possible, we related the comments to a particular question. General comments were counted against Q54 (Do you have any further views on any aspect of the Commission’s proposals to amend the EU ETS from 2013). Given the breadth of views expressed under Q54, we have treated separately to other questions and provide a summary of the views in Section 0.

10 Would a 10,000tCO2 or 25,000tCo2 emissions threshold be most appropriate?

11 Do you agree with the UK position that there should not be a system of hypothecation or earmarking of auctioning revenues?

12 Which elements of auction design would you support or oppose being set by the Commission

Figure 5 Proportion of respondents to each question



Note: some questions were divided into a number of parts if they addressed a range of different issues (labelled a, b, c etc.). The relatively low response rate to some sub-questions e.g. 26b, c & d reflects where a respondent did not answer all parts to the question.

Report contents

The purpose of this report is to summarise the range of opinion contained in the responses to each question and to highlight the key messages and themes that emerge. We have structured the remainder of the report as follows:

- ◆ Section 0 summarises the key points raised in the responses to each question;
- ◆ Section 0 highlights the views of particular sectors;
- ◆ Section 0 illustrates themes specific to different types of organisation;
- ◆ Section 0 summarises other issues not explicitly raised by particular questions or submitted in response to Q54 (which asked for any other comments).

Responses to each question across all respondents

The text below summarises the information provided in response to particular questions. Each chart indicates how many respondents supported a particular view. Where respondents raised a number of issues, their response was categorised against each relevant view and as a result the number of respondents (and percentage figures) next to each chart may sum to more than 94 (or 100%)¹³. In the text, we comment on the proportion or number of respondents that answered a question; subsequent percentages usually relate to the proportion of organisations that responded to that question. A number in brackets (e.g. (2)) indicates the number of respondents that raised a particular view.

Overview of responses

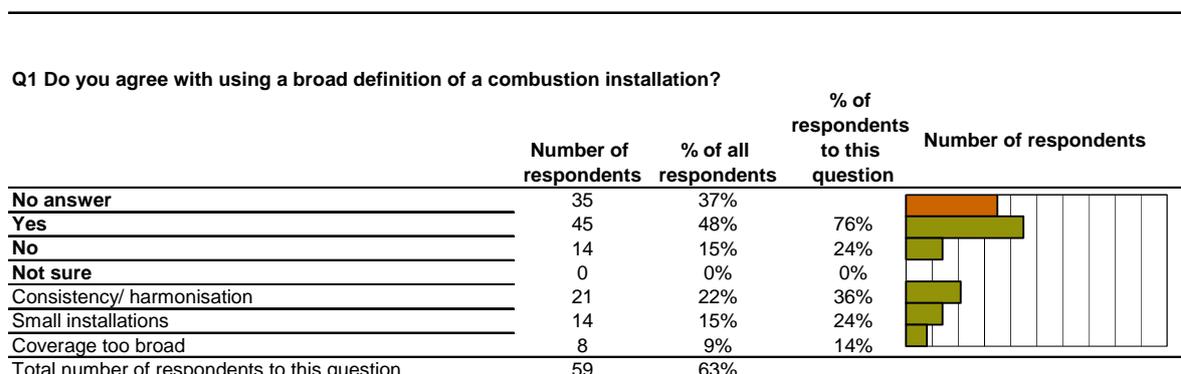
The majority of questions could be summarised into yes/ no/ not sure answers. The summary responses to these types of question are illustrated in Figure 7 overleaf. The more red or green in a particular row, the stronger the view across all respondents; the more yellow the more mixed the response.

Scope

Q1. Do you agree with using a broad definition of a combustion installation?

Around two thirds of respondents answered question 1. The majority of those that answered (just over 75%) supported the use of the broad definition. This support was qualified with the need for appropriate rules to exclude small emitters by around a quarter of respondents¹⁴. Around a quarter of respondents did not support the use of the broad definition; a common concern being that it would result in too broad a coverage (see table below for sector specific concerns).

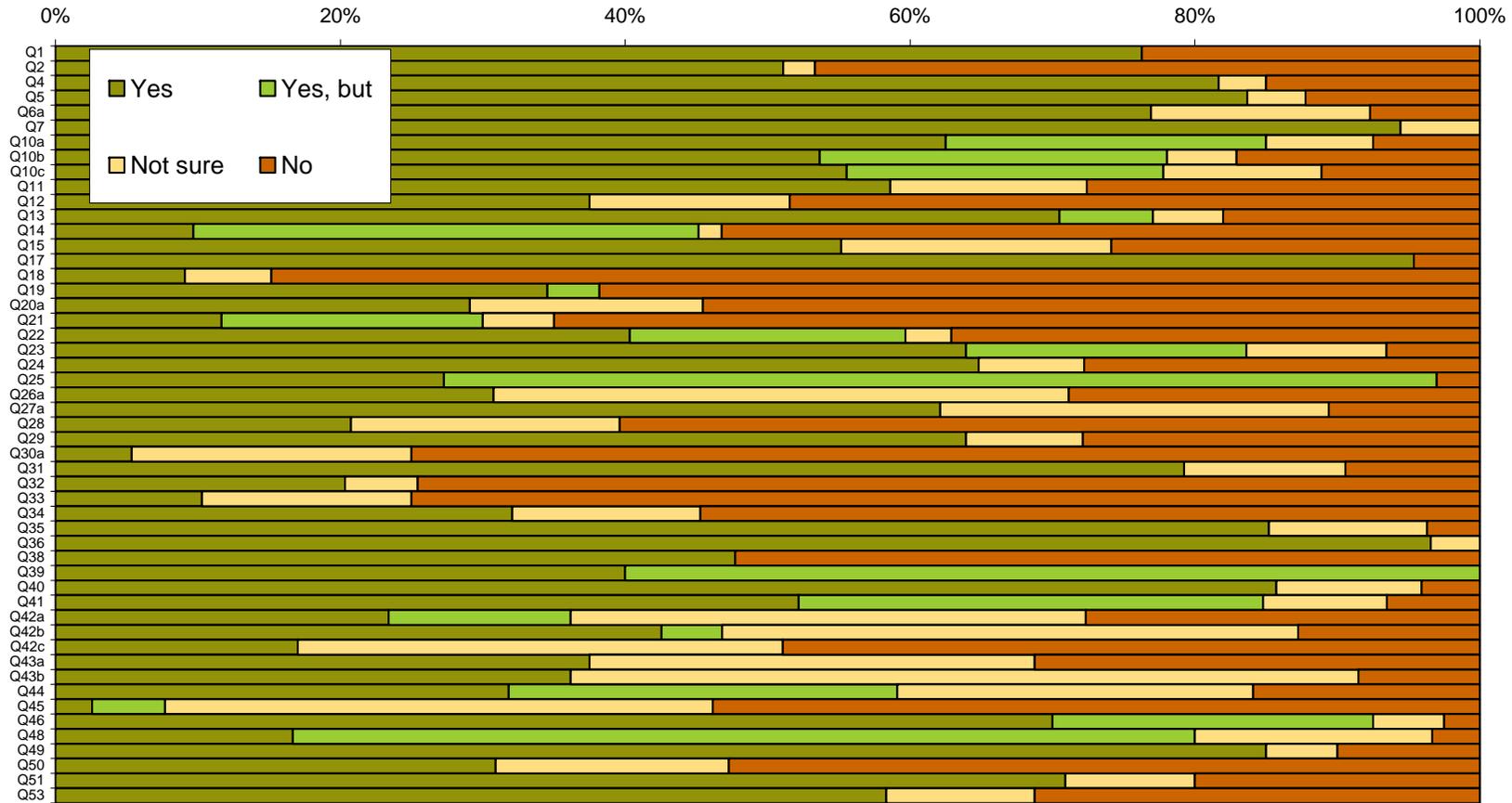
Figure 6 Summary of responses to Question 1



13 In the charts for particular questions in bold indicate the summary answers, only one of which is chosen for any respondent.

14 The treatment of small emitters and the application of the opt-out are included in later questions.

Figure 7 Strength of responses to yes/ no/ not sure questions



Note: Shows only respondents who answered a particular question. Refer to Figure 5 to show the proportion of respondents that this represents or to the detailed explanation in the sections that follow.

The most common reason cited in support of the use of the broad definition was to facilitate harmonisation in approach in the EU¹⁵. A smaller number of respondents commented that the broad definition would reduce the administrative burden¹⁶, although a similar number commented that it would increase it. Other reasons given in support of the broad definition were that it would avoid competitiveness impacts although again, a number considered that it would introduce such impacts.

A number of organisations highlighted that were the definition to be changed, the historic emissions data that it is proposed is used for allocation would not match the new scope. Others commented that the definition was not clear and required clarification¹⁷. Common concerns from specific sectors are shown in the table below.

Table 1 Specific concerns about the proposals

Sector	Overview of comments
Aluminium:	The definition is confusing and would bring in activities that would not otherwise be included
Power stations:	Industrial generation is not currently treated in the same way as power generators in Article 3
Cement:	The broad definition would not include all combustion activities
Food and drink:	The definition would bring in some new dairy operations and distilling operations. both sectors were concerned about the admin burden that results, the latter was concerned about competitiveness compared to non EU countries
Chemicals:	The broad definition would bring in small emitters increasing the admin burden; the sector supported the use of Climate Change Agreements (CCAs) to regulate emissions from these activities
Motor manufacturers:	The broad definition is supported only if the de minimis rule effectively excludes small emitters (see next question)

Q2. Do you consider the activities listed at Annex 1 of the revised Directive mean a broad definition has been achieved? If not, what amendments would be needed to the Directive to achieve this?

Around half of respondents answered this question and views were very mixed; approximately half of respondents to the question (23) agreed that the Directive did achieve a broad definition while a similar number (21) consider that it did not.

15 Some noted that a common definition would not in itself deliver this.

16 A regulator went further to say that they would urge *'making it mandatory that where a site or installation falls within the scope of the scheme then all GHG emissions generated at that site should be covered by the scheme'* in order to increase coverage and reduce the MRV burden.

17 One respondent asked for clarification as follows: *'Does a combustion unit with a rated thermal output of 2.6MW qualify as being under 3MW? In British Standards the rule is that the actual value is rounded to the same number of decimal places as the limit value. On this basis, '2.6'MW would round to '3'MW and not be "less than 3MW". We suggest that either the limit should be expressed as "under 3.0MW" or better still "not exceeding 3MW". The latter would exclude units up to 3.4MW.'*

Figure 8 Summary of responses to Question 2

Q2 Do you think the activities listed at Annex 1 of the revised Directive mean a broad definition has been achieved? If not, what amendments would be needed to the Directive to achieve this?

	Number of respondents	% of all respondents	% of respondents to this question	Number of respondents
No answer	49	52%		
Yes	23	24%	51%	
No	21	22%	47%	
Not sure	1	1%	2%	
Further comment provided	26	28%	58%	
Total number of respondents to this question	45	48%		

Concerns around the approach proposed were raised by respondents from the following sectors: Aluminium, Ceramics, Cement, Chemicals, Construction, Electricity, Glass, Iron and Steel, Paper, Services and also regulators. These varied from questions over how the list had been drawn up to specific comments on the impact that the approach would have on particular sectors. One respondent asked the UK Government to provide clear guidance on what will be included in the scheme under the definition. Another commented that it was not confident it had found the appropriate document.

Q3. Would a 10,000 tCO2 or 25,000 tCO2 emissions threshold be most appropriate?

This was one of the questions with the highest response rate (over 70% of respondents answered it). There was considerable (but not unanimous) support for excluding smaller emitters from the System. Around 27% of those that did respond (18) supported either the 10ktCO2 threshold or a lower level; reasons typically given were to ensure maximum emissions coverage or to avoid competitive distortions that a 25ktCO2 threshold might create (see below). There was some support for relaxing the monitoring, reporting and verification (MRV) burden on small emitters were the lower threshold to be implemented.

Figure 9 Summary of responses to Question 3

Q3 [To exclude small emitters] would a 10,000tCO2 or 25,000tCO2 emissions threshold be most appropriate?

	Number of respondents	% of all respondents	% of respondents to this question	Number of respondents
No answer	27	29%		
<10,000tCO2/ as low as feasible	4	4%	6%	
10,000tCO2	14	15%	21%	
25,000tCO2	30	32%	45%	
at least 25,000tCO2/ as high as possible	12	13%	18%	
Not sure	7	7%	10%	
Balance admin burden/ scope i.e. cost effective	22	23%	33%	
Equivalent measures are/ should be in place	8	9%	12%	
3MW de minimis welcomed	7	7%	10%	
Competitiveness impacts	7	7%	10%	
Total number of respondents to this question	67	71%		

However, there was more support for either the 25ktCO2 threshold (30), or an even higher level (a further 12) (the most commonly cited alternative was 50ktCO2). Respondents that supported this option argued that it would strike a more appropriate balance between the costs of participation and the emissions coverage of the scheme. One respondent commented that it would facilitate the development of benchmarks. Even those that support the exclusion of small emitters commented that it was important that they should be (or are already) subject to equivalent



measures. Some respondents (7) also took this opportunity to support the exclusion of units less than 3MW from the aggregation rule.

Only a small number of respondents (7) were not sure or had no strong view over which of the two thresholds they supported. Some respondents commented that it was important that the impact of the move to a broad definition be taken into account in determining the threshold. A small number of respondents suggested that installations should only have to come back into the scheme if their three year rolling average emissions exceeded the threshold.

Specific comments about the choice of a threshold included the following.

- ◆ Ceramics: there was concern that the choice and application of a threshold will have implications for competitiveness in this sector (both within the UK and across the EU)¹⁸. There was support for excluding process emissions from the threshold calculation and for ensuring that they are calculated consistently across the EU.
- ◆ Healthcare: there was some support for the NHS being excluded from the EU ETS altogether.
- ◆ Distilleries: this sector suggested eliminating the 20MWth inclusion criteria and switching to one based on actual emissions. It also stated that small emitters opting out should be allowed to join the sector's CCA.
- ◆ Mineral Wool: this sector supported the lower (10ktCO₂) threshold on the basis that a higher threshold would result in some installations being included and others being excluded.
- ◆ Wood Panel Industries: although all installations fall above 10ktCO₂, some are below 25ktCO₂ and there was therefore concern that the higher threshold would result in competitors being treated differently.
- ◆ A small number of respondents supported a flexible de minimis threshold.

Q4. Should all installations be eligible to apply to opt out, not just combustion installations with a thermal rated input of less than 25MW?

Question 4 was another relatively popular question (around 64% of respondents commented on it). There was strong support for an opt-out for all small installations regardless of whether or not they are included via combustion or another Annex 1 activity (just over 80% of those who responded).

¹⁸ This is driven in part by the difference in emissions between intermittent and continuous kilns and the fact that level of process emissions varies depending on the raw materials, the choice of which is predominantly driven by location, and this can have a significant impact on whether installations in this sector would fall above or below the threshold.



Figure 10

Summary of responses to Question 4

Q4 Should all installations be eligible to apply to opt out, not just combustion installations with a thermal rated input of less than 25MW?

	Number of respondents	% of all respondents	% of respondents to this question	Number of respondents
No answer	34	36%		
Yes, all installations	49	52%	82%	
No, no opt out	9	10%	15%	
Not sure	2	2%	3%	
Yes...base on emissions not capacity	35	37%	58%	
Equivalence of effort must be demonstrated	5	5%	8%	
Exclusion would be better than opt out	1	1%	2%	
No...maintain coverage and reduce MRV burden instead	3	3%	5%	
No...only nationally important infrastructure	3	3%	5%	
Total number of respondents to this question	60	64%		

However, a number (9) argued that there should not be an opt-out at all. There was some concern that exclusions are unnecessarily complex and/or could create distortion and so would weaken the scheme or that they would reduce liquidity. One suggestion was that the cost effectiveness of these installations' inclusion should be ensured through reducing the MRV burden. A small number of respondents that did not agree with the opt-out consider that installations required for security of the national infrastructure could be made an exception. Only two respondents were not sure. One respondent commented that the exclusion of these installations would be preferable to an opt-out.

A considerable number (35) took the opportunity to comment that they consider the capacity threshold unnecessary when determining eligibility to opt out and that the threshold should be based purely on emissions. The most common reason cited for this was to enable the exclusion of oversized equipment or installations that operate only for backup/ standby¹⁹.

There was a view that any opted out installations should be subject to equivalent measures and one respondent commented that it was important that the administrative burden to demonstrate equivalence is not too great.

A trade association argued that the threshold should be set at a different level (35MWth) for combined heat and power (CHP) installations to take into account the fact that they compete with standalone electricity and steam capacity that falls outside the EU ETS²⁰.

Q5a. Do you agree with the Commission's proposal to include: (A) CO₂ emissions from petrochemicals production, ammonia and other chemicals including process emissions? (B) CO₂ & PFC emissions from the production of aluminium (both primary and secondary)? (C) N₂O emissions from the production of nitric, adipic and glyoxal and glyoxylic acid production? Please give your reasons.

Around half of respondents commented on this question. A considerable number (41) supported the view that the scheme would benefit from expansion and so therefore that the new activities should be included. There was a concern that all parts of the economy, particularly large industrial installations, should do their bit. Often comments did not relate to the activities proposed in any detail, but

¹⁹ One respondent noted the Commission's IPPC Directive Proposal which excludes 'stand-by/emergency equipment i.e. operating <350hours/year (and <50MW)'.
²⁰ View detailed in their response.



commented that inclusion should be on the basis of various criteria (e.g. that robust MRV is possible, that the EU ETS is the most cost effective option to deliver abatement in these activities and that their inclusion did not have a negative impact on the market). Only one organisation considered that none of the new emissions should be included; it preferred reinforcing existing legislation at these sites.

Figure 11 Summary of responses to Question 5

Q5 Do you agree with the Commission's proposal to include [each of the sources listed (A), (B), (C)]?

	Number of respondents	% of all respondents	% of respondents to this question	Number of respondents
No answer	45	48%		
Yes (all)	41	44%	84%	
No (not specific activities)	5	5%	10%	
No (all)	1	1%	2%	
Not sure	2	2%	4%	
No (Ammonia)	1	1%	2%	
No (soda ash)	1	1%	2%	
No (aluminium)	2	2%	4%	
No (aluminium PFC)	1	1%	2%	
Also include Chlor Alkali	1	1%	2%	
Total number of respondents to this question	49	52%		

Part A

For Part A, one organisation suggested that ammonia should not be included because of the energy intensive nature of its production and the lack of opportunities for emission reductions²¹. Another considers that soda ash and sodium bicarbonate should not be included due to the cost impacts²². One organisation expressed its support for the proposal to include petrochemicals to avoid differential treatment with similar activities undertaken at refineries. Three organisations called for the definition of petrochemicals in Annex 1 of the Directive to be modified to remove any ambiguity, and two of them proposed a modified definition. One respondent commented that in addition, the Chlor Alkali industry should be included subject to certain conditions.

Part B

Part B was the area that received detailed comment from the most respondents. In particular, 24 respondents commented explicitly on aluminium (a common view being that they disagree with the UK position and consider that aluminium should be included). The most common reason was because they consider the competitiveness similar to those of other industries and that they should be treated consistently²³. There was a view that concerns about competitiveness impacts on the aluminium sector could be allayed by providing free allocations.

One organisation considered that only CO₂ emissions should be included given the difficulties of MRV for PFC emissions²⁴. Only two organisations argued that emissions from the aluminium sector should not be included. A key part of their argument was that manufacturers would not be able to pass cost increases on. This view was emphasised by a small number of organisations who listed the challenges facing the sector. However, others commented that the issues created by cost pass

²¹ Refer to response for detailed cost estimates of the impact of inclusion.

²² The response provides a detailed report on this activity.

²³ For instance, respondents from the sector commented that aluminium often competes in use with cement.

²⁴ It is interesting to note that another respondent commented explicitly that PFC emissions should be included because they can be estimated.



through to the electricity price would not be solved by excluding aluminium. Two other organisations argued that including aluminium production would stimulate research into emission reductions.

Part C

There was limited comment on these activities. One respondent highlighted that there is no glyoxal or glyoxylic acid production in the UK. It also emphasised that these activities are subject to similar competitiveness pressures as the aluminium sector.

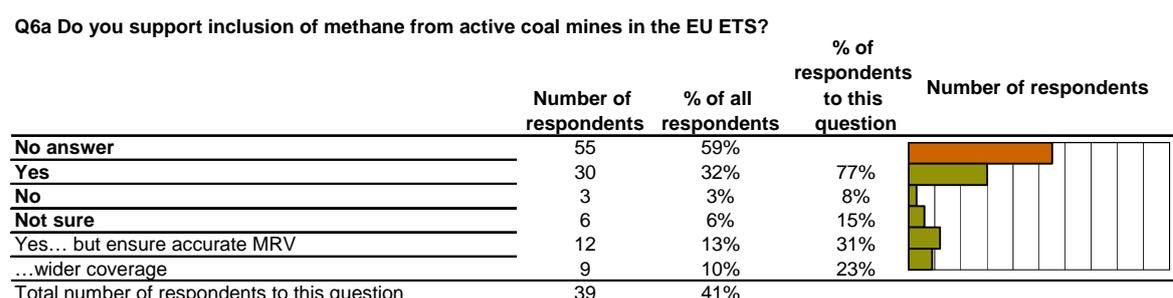
Other general comments

- ◆ Government should avoid acting unilaterally in extending the scope.
- ◆ Expansion should not include healthcare-related laboratories or clinical waste incinerators.
- ◆ The calculation should consider the amount of time that GHGs remain in the atmosphere.
- ◆ Newly included activities must not be over-allocated.

Q6. Do you support inclusion of methane from active coal mines in the EU ETS? If not, how else might this sector’s methane emissions be regulated?

Less than half (41%) of respondents provided an answer to this question. The majority (77%) of those that answered supported the inclusion of methane from active coal mines, a smaller number (6) were not sure and three respondents answered no or that they foresaw considerable problems with their inclusion.

Figure 12 Summary of responses to Question 6



Support for the proposal was predominantly due to the additional coverage it would deliver, which respondents considered will make the EU ETS more efficient and provide greater potential for abatement. The high global warming potential of methane was commonly cited as a key reason for this abatement potential. A small number of respondents (2) agreed with the proposal because they consider that administration costs will decline, but a similar number commented that this would make it increase. However, a considerable number of those that agreed (12) commented that the standards for MRV must be as high as in other sectors²⁵. One organisation agreed on improved safety grounds. A small number of respondents

²⁵ Concerns cited included around technological problems relating to measuring emissions and the lack of agreed verification methods.



argued that the extra cost burden should be subsidised for example through free allocation.

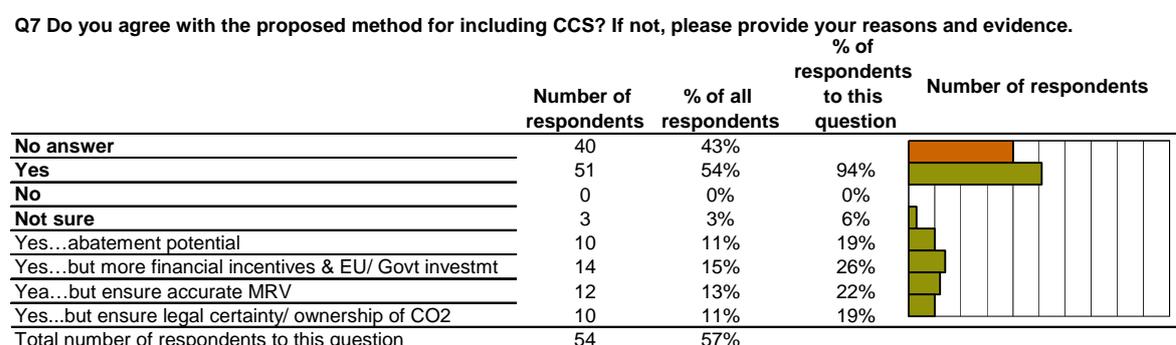
The main reasons for answering ‘no’ was the view that administration costs would increase and the difficulties around MRV. Two coal organisations suggested that financial incentives would be a better way to encourage emissions reductions. These reasons were also cited by some of the ‘not sure’ respondents who considered that further research on these issues is needed²⁶.

Only a small number of organisations (5) suggested alternative ways to the Commission’s proposal. Apart from the coal organisations’ suggestion of direct financial incentives, an oil major suggested the IPPC as the appropriate regulatory mechanism and another suggested that coal companies participate in JI projects in the EU. One respondent commented that the potential role of other legislation should be fully explored before using the EU ETS.

Q7. Do you agree with the proposed method for including (Carbon Capture and Storage) CCS? If not, please provide your reasons and evidence.

Around 57% of respondents answered this question. Amongst those that did there was strong agreement that CCS should be included – the majority (51) agreed, and only a small number (3) were not sure – none of the respondents answered ‘no’.

Figure 13 Summary of responses to Question 7



The most frequently cited reason for answering yes was the abatement potential that CCS can deliver. However, some respondents were concerned that this potential has not yet been demonstrated on a commercial scale and that it is important to gain experience first. It was also argued that this will help to drive down the costs of deployment. A less common reason in support was that it will enhance equity and consistency with other sectors.

In terms of the methodology used to include CCS, a number of respondents (14) commented that some kind of financial incentives are crucial to help the CCS sector establish itself and reach maturity²⁷. The nature of incentive suggested ranged from

26 This included the need for research around the potential risk of carbon leakage outside the EU if coal mines are included.

27 For instance, there was a view in the lime sector and cement sectors that the technology/ infrastructure will not be sufficiently developed to deliver savings in Phase III or yet to define what ‘capture ready’ means. These sectors and others highlighted the need not to focus purely on CCS around electricity generation. One generator commented it is important that all carbon capture and power generation be treated equally and asked ‘how would a hydrogen production facility which could supply the power sector be treated under allocation rules?’



free allowances to redistribution of auctioning revenues or part of the new entrant reserve (NER), contracts for differences on the carbon price or capital grants/allowances. Some supported the EU commitment to a trial of demonstration projects but a similar number did not. Although some called for free allocation, others consider that the carbon price should be sufficient incentive.

There was some agreement amongst those that commented that 1 tonne stored should be equal to 1 tonne abated. They emphasised the importance of clarity on the legal ownership of captured CO₂ and also of responsibility in case there are major leakages from the storage facility. It was also argued that a clear legal framework is essential for long-term investment in the CCS technology. One respondent emphasised the risk that some companies may choose CCS instead of making a true effort for reduction in actual GHG emissions.

Q8. What are the key issues to consider in any cost benefit analysis of whether and how surface transport (road and rail transportation, and inland shipping) may be included in the EU ETS?

More than half of respondents (around 56%) provided an answer to this question. Although the question did not specifically ask for a view on whether surface transport should be included at all, the prevailing view was concern around whether the EU ETS is the right instrument for transport. The main concerns were around the difficulty of monitoring emissions, the lack of price elasticity and the fact that it is very different to other activities currently included. Although there was a view that (rising) emissions from this sector need to be addressed, respondents were not clear that the EU ETS is the appropriate mechanism (a number stated that rail and shipping are more suitable candidates). Some respondents commented that it is more important to focus on existing participants in the scheme.

In terms of the questions posed, there was support for further analysis, particularly around MRV.

Figure 14 Summary of responses to Question 8

Q8 What are the key issues to consider in any cost benefit analysis of whether and how surface transport (road and rail transportation, and inland shipping) may be included in the EU ETS?

	Number of respondents	% of all respondents	% of respondents to this question	Number of respondents
No answer	41	44%		
These sectors can/ should abate...	12	13%	23%	
...but EU ETS not right mechanism	16	17%	30%	
Consider...feasibility/ cost of accurate MRV	18	19%	34%	
...overlap with/ impact of existing taxes/ measures	11	12%	21%	
...international competitiveness/ leakage/ consistency	8	9%	15%	
...price sensitivity/ influence of carbon price/ abatement p	9	10%	17%	
...impact on market/ price	8	9%	15%	
...ownership of emissions	6	6%	11%	
Total number of respondents to this question	53	56%		

Note: each row is a separate category rather than being a subset of the others above it. i.e. 28 respondents agreed that these sectors should abate but only 16 were categorised as saying that the EU ETS is not the right mechanism. Some of these respondents also commented on factors that should be considered, and are counted alongside any other respondents that made the same point in the lower rows.



The key areas recommended for further analysis²⁸, in approximate order of support (see chart above for most popular points), are listed below. The table that follows lists some specific comments

- ◆ The feasibility of robustly and consistently measuring, verifying and reporting emissions from this sector and the cost effectiveness of the associated administration of it.
- ◆ Interaction with existing taxes and other measures (e.g. fuel duty, vehicle excise duty, congestion charging, EU ETS costs on electric rail) and whether additional charges are justifiable.
- ◆ The risk of carbon leakage, and market distortion in relation to international competition. Also, the treatment of journeys that start/end outside the EU.
- ◆ Price sensitivity and the abatement potential that EU ETS inclusion has on emissions in this sector. For example, some respondents pointed out that road transport appears relatively insensitive to fuel prices.
- ◆ The potential impact on existing EU ETS participants, the carbon market and the carbon price.
- ◆ Ownership of emissions, and correspondingly the ability to regulate. For example, individual drivers hold much of the responsibility for reducing emissions in road transport, but to be feasible the regulation would probably need to be on the fuel suppliers or vehicle manufacturers²⁹.

Table 2 Specific Issues mentioned by an individual respondents/sector

Comment

How should participants in this sector be benchmarked?

How could the emissions threshold be applied to the sector?

An open trading scheme could be acceptable, a closed scheme would not.

Inclusion within the EU ETS would not lead to engine efficiency improvements.

Clearer incentives are needed to promote more efficient vehicle technology.

Any inclusion of surface transport should target actual vehicle usage.

Impact on UK manufacturing competitiveness.

Would the EU ETS impact on medical transport?

If a modal shift to more efficient transport methods is to be encouraged (e.g. freight from road to rail), then a cap would need to cover all sectors. Otherwise, for example, the rail industry's emissions would increase, while total emissions decrease.

What are the implications for Member State effort?

Rail

The train operators' association provided a very detailed response to this question, outlining the work already being done by the sector to increase efficiency, and relative environmental benefits compared to road transport. The following points are of particular relevance to this question:

²⁸ Respondents did not tend to express their answers in terms of costs and benefits, but more in terms of general points to consider.

²⁹ Several respondents cited this as a reason why the EU ETS is not suitable for road transport, but that it may be for public transport and freight.



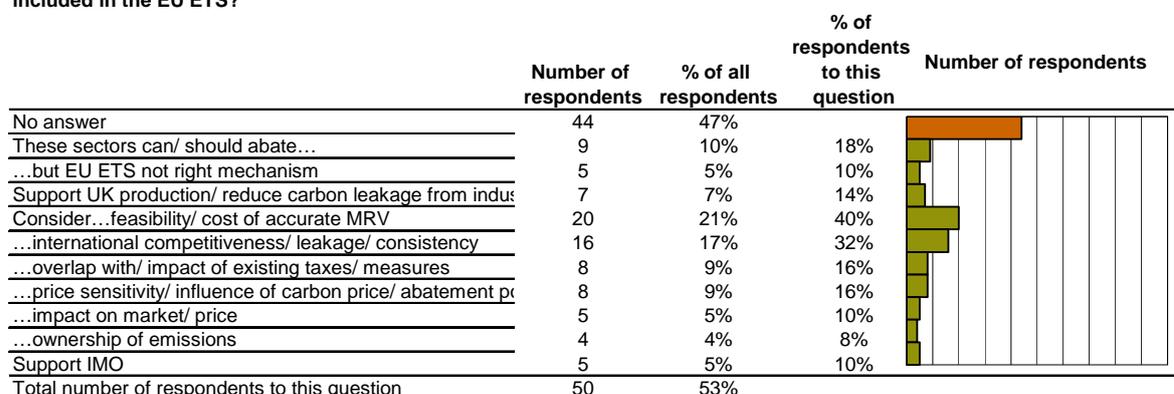
- ◆ due to franchise arrangements, the longer term costs of investments will transfer to DfT;
- ◆ the role of “free” allocations needs to be particularly carefully examined to ensure that these do not simply lead to windfall gains to suppliers – savings should be passed on to funders;
- ◆ any approach that led to an overlap on electricity used for rail, above that arising from the generators’ ongoing participation in the current EU ETS, would be opposed; and
- ◆ policy design must account for the long term (20-40 year) lifespan of railway assets, and therefore the limited scope for short term change.

Q9. What are the key issues for consideration in a cost benefit analysis of whether and how international shipping may be included in the EU ETS?

More than half of the respondents (around 53%) expressed an opinion on this question. As with other modes of surface transport, there was general support for a scheme to cap and reduce emissions from the shipping sector. However, there was not a firm consensus on whether it should be incorporated into the EU ETS (5 respondents stated specifically that emissions from shipping should be dealt with outside the EU ETS). However, others argued that shipping emissions can practicably be included in the EU ETS³⁰.

Figure 15 Summary of responses to Question 9

Q9 What are the key issues for consideration in a cost benefit analysis of whether and how international shipping may be included in the EU ETS?



Responses focused on potential problems and considerations if the sector is to be included in the EU ETS. The points raised (some of which are similar to those for land transport)³¹ are summarised below and their support highlighted in the chart above. Some more detailed points are highlighted in the table that follows.

- ◆ It is important (and likely to be difficult) to be able to accurately monitor, report and verify emissions from this sector. For instance some asked whether sufficient baseline data are available.

30 This respondent and suggested a methodology that incorporates a ‘port to port’ emissions factor for each voyage and that ship tracking services could be used to improve data verification.

31 Several respondents repeated their answers to Question 8 so many of the generic issues also apply here.



- ◆ There were several concerns relating to international co-operation, distortion and evasion, in simple terms respondents consider there to be significant risk of carbon leakage.
- ◆ For shipping to be comprehensively covered, a scheme should work internationally otherwise there are risks that shipping companies will avoid/stop just outside Europe or operate under a flag of convenience.
- ◆ Several respondents expressed support for IMO involvement and some commented that, as with aviation, specific rules will need to be developed. There was a view that, in any scheme, the scope for evasion should be well understood.
- ◆ Respondents from the cement sector highlighted the potential for the inclusion of shipping in the EU ETS to increase shipping (and hence import) costs which would improve the competitive situation of UK manufacturers for the UK market. It was also argued that the exclusion of shipping from the EU ETS would contribute to carbon leakage. However, some were wary of the risk of its inclusion affecting exports. Several respondents stated strongly that there is a need for further investigation of this matter.
- ◆ The cost effectiveness of reducing shipping emissions via the EU ETS and the actual impact that a carbon cost will have on shipping emissions (there was a view that the development of a marginal abatement cost (MAC) curve could help inform this). Therefore, the options for abatement in this sector must be understood.
- ◆ Reconciliation with existing taxation and other climate change measures on shipping.
- ◆ The potential impact on carbon prices and existing EU ETS participants.
- ◆ Who should comply with the caps – countries, companies or individual ships? Where is the point of compliance?

Table 3 Specific Issues mentioned by an individual respondents/sector

Comment

Emissions of other gases from shipping are also significant (NOX and SO2).

Clarification may be needed on whether international inland and domestic sea shipping would be covered.

How would benchmarks be set for this sector?

A trading scheme for shipping should run in parallel with the EU ETS until proven to work.

An LPG business provided a detailed description of how it is already making efficiency gains in their large shipping fleet. It also provided a briefing note on the 'rating system' and a comparison with the IMO scheme.

Two coal industry groups suggested a carbon import tax as an alternative to including shipping in the EU ETS.

An NGO has commissioned a study on global climate policies for international transport.

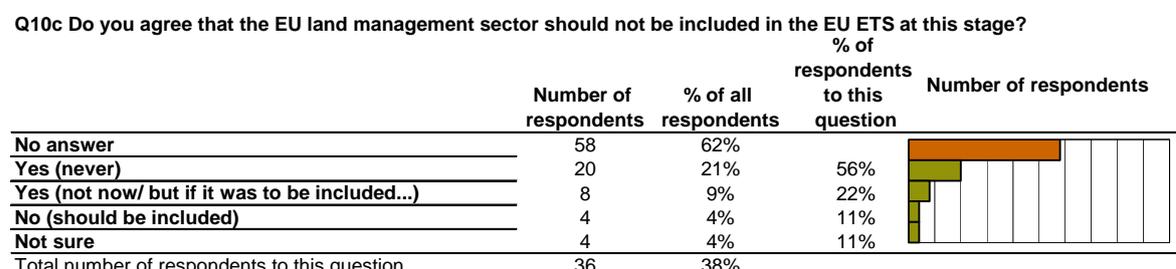
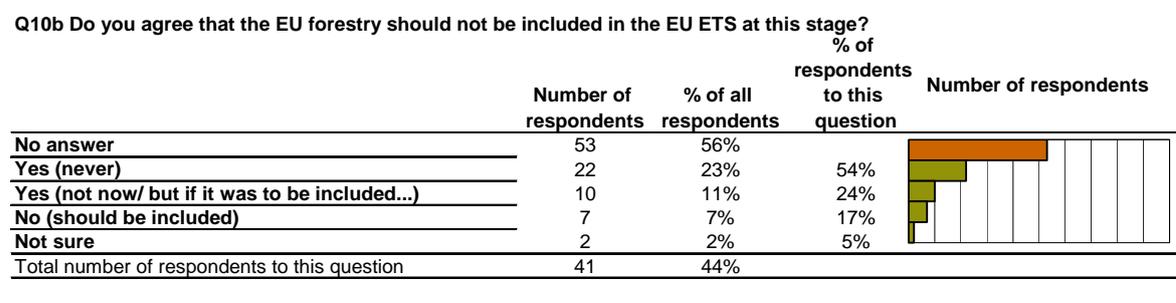
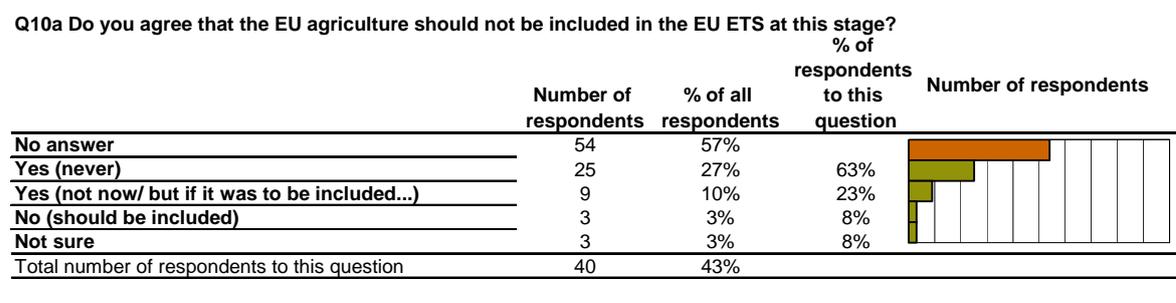
Q10. Do you agree that the EU agriculture, forestry and land management sectors should not be included in the EU ETS at this stage?

The majority of respondents did not answer this question (only 43% provided any answer at all and not all commented on all three of the activities listed). Of the respondents who answered, the majority (34) agreed that these sectors should not



be included in the EU ETS at this time and of these a number (25) were strongly against its inclusion. A number (6) stated their support for further analysis of this sector³². Several respondents commented that while emissions from this sector are significant, there are better methods for reducing them outside the EU ETS.

Figure 16 Summary of responses to Question 10



The most common reasons given for excluding the sectors were around the cost and complexity of administration, the risks and complexity associated with MRV, and the impact of natural variability on emissions. Of the respondents who agreed with the Government on this question, several mentioned that they would not necessarily be against including these sectors, if these problems could be overcome. Concerns around adding more financial burden on to farmers were also expressed³³, as was the impact of the scheme on biomass & biofuel production (although details were not discussed).

A smaller number of respondents considered that there are strong arguments for (at least some of) these sectors to be included in the EU ETS. This was typically driven by the significant impact that these sectors have on emissions and the view that problems around verification could be overcome. It is notable that more

³² Either supporting Defra’s proposal for further analysis for commenting that the work of the UNFCCC afforestation and reforestation working group should also be consulted when considering proposals.

³³ The same respondent commented that changes to the common agricultural policy (CAP) should be made, if agriculture were to be covered.



respondents called for forestry alone to be included than for agriculture and land management, for carbon sequestration purposes³⁴. For instance, a trade association called specifically for forestry to be covered by the EU ETS.

Q11. Do you agree with the Commission that installations exclusively burning biomass should not be covered by the EU ETS Directive from 2013?

Over 60% of respondents answered this question and of those respondents, around 34 agreed with the proposal, with a caveat around small uses of fossil fuels at biomass plant (see below). The fact that fossil fuels are used for start-up/ back up was one of the reasons given by the (16 or so) respondents that disagreed with, or were not sure about, the proposals i.e. categorisation as 'no' does not necessarily mean that installations predominantly burning biomass should be included.

Figure 17 Summary of responses to Question 11

	Number of respondents	% of all respondents	% of respondents to this question	Number of respondents
No answer	36	38%		
Yes	34	36%	59%	
No	16	17%	28%	
Not sure/ yes and no/ no direct answer	8	9%	14%	
Startup fuels/ still some fossil fuel	15	16%	26%	
Yes...but still report biomass emissions	6	6%	10%	
Biomass sustainability requirement	8	9%	14%	
No...still need verification to ensure burning biomass	1	1%	2%	
No...biomass not zero carbon/ still emissions to report	6	6%	10%	
Total number of respondents to this question	58	62%		

Of those that agreed, the most common reason given was that it will remove the administrative burden, and is in keeping with the zero rating of biomass. It was suggested that the other regulatory issues with biomass can be dealt with outside the EU ETS.

A considerable number of respondents (15) brought up the issue of fossil fuel use within biomass plants (several commented that a 100% biomass plant does not exist, due to use of fossil fuel for start-up)³⁵. A regulator mentioned that clarification is needed over the % fossil fuel permissible in biomass. One suggestion to overcome this was that plants using more than the small emitter threshold for start up fuels should not be exempt and must buy allowances. A power generator suggested a de-minimis level beyond which allowances are required/ allocated. Examples given included 90%, 95% and 97%, instead of 100% biomass; a power generator suggested 90%, in line with the RO.

Several respondents (e.g. the cement sector) commented that while these plants should be exempt from the EU ETS, they should still be required to report their emissions using standard emissions factors/ simplified monitoring and reporting guidance. The need for sustainability standards was brought up (8), with this being a requirement for agreeing in some instances.

³⁴ In addition, a cement manufacturer argued that forestry, a competitor to cement, should be covered by the scheme.

³⁵ One respondent argued that only gaseous and liquid biofuels should be exempt from the EU ETS, as fossil fuels are not normally required for start-up and other purposes. This would require amendment of the biomass definition as currently proposed.



A trade association called for stations that have the capacity to burn both fossil fuels and biomass to be included in the EU ETS. Several respondents argued that biomass fuels cannot be considered carbon neutral or sustainable so should not be exempt from the EU ETS at all. The other main reason for disagreement was the risk of biomass stations not reporting significant use of fossil fuels.

Three respondents argued that removing 100% biomass plants from the EU ETS removes equal treatment for part-biomass installations. A biomass CHP generator called for the option to participate in EU ETS, as it would qualify for new entrant allocation which is another incentive to use biomass. Another respondent commented that generators benefit from the flexibility of being able to use less than 100% biomass if necessary.

One respondent expressed concerns that removing 100% biomass plants from the EU ETS would provide additional incentives to co-firers, further affecting the wood market.

A water company questioned how this would affect site aggregate capacities, and whether excluding biomass installations would be a deciding factor determining whether sites are captured by the scheme.

Cap-setting

Q12. Do you agree with the level of the central cap proposed by the Commission for meeting a 20 per cent EU GHG reduction target? If not, why not?

This question was answered by the majority of the respondents. The majority of respondents agreed with the concept of an EU-wide cap (only one respondent stated explicitly that they did not³⁶) however opinion was more divided over its level.

Figure 18 Summary of responses to Question 12

Q12 Do you agree with the level of the central cap proposed by the Commission for meeting a 20 per cent EU GHG reduction target? If not, why not?

	Number of respondents	% of all respondents	% of respondents to this question	Number of respondents
No answer	30	32%		
Yes agree with cap and 20% target	24	26%	38%	
No, not enough allowances	23	24%	36%	
No, too many allowances	7	7%	11%	
No, should not be central cap	1	1%	2%	
Not sure	9	10%	14%	
No...insufficient account of action to date	18	19%	28%	
No...inequitable traded/ non traded	20	21%	31%	
No...should be 30%	8	9%	13%	
Total number of respondents to this question	64	68%		

Of those that answered and agree with a central cap, over a third agreed with the cap and its level, a further third or so considered it was set too low (i.e. too tight), around 14% were not sure and the remaining 7% considered that it was too high (i.e. was not ambitious enough).

The main reason that the cap level was objected to was that respondents consider it places too great a burden on the traded sector (20). Some commented that

³⁶ This respondent commented that a national administration was in a better position to reflect sector wide conditions specific to their country.



insufficient information was available to conclusively demonstrate that the relative abatement costs had been properly considered/ that further research is needed. Respondents from a range of industries (18) commented that the emissions reductions already made by the traded sector must be taken into account and that further cuts would require higher abatement costs, and may be limited by technical innovation.

All of those respondents that consider the cap too low (7) were NGOs, charities or trade associations. Comments included that it should be set at the 30% level or at an even more ambitious level, in order to be in line with IPCC recommendations, whether by unilateral decision or part of an international agreement.

There were some questions on the details proposed rather than necessarily the level, in particular whether the data used to calculate the level would be consistent with the current coverage/ scope (e.g. cement, oil and gas). Some respondents were supportive of developing a verifiable snapshot of emissions however some concerns were raised that this baseline would not take account of previous abatement action or any significant structural changes to a sector between 2005 and 2013.

Q13. Do you agree with the Commission's proposal for a linear emission reduction trajectory of 1.74 per cent per year to be reviewed by 2025? If not, why not?

The majority of respondents (65%) provided views to this question. There was some agreement over the use of a linear emissions reduction trajectory (30) or of the proposals more generally (22). However, there was less agreement around the idea and timing of a review (only a handful stated explicitly that they agreed with the idea of 'by 2025', others commented that the review date should be fixed/ in advance of Phase IV/ on reaching an international agreement. The primary concern was the uncertainty the absence of a firm date could create. Respondents underlined the requirement for early clarity on any changes³⁷ and avoiding amendments that resulted in the trajectory becoming too steep

Figure 19 Summary of responses to Question 13

Q13 Do you agree with the Commission's proposal for a linear emission reduction trajectory of 1.74 per cent per year to be reviewed by 2025? If not, why not?

	Number of respondents	% of all respondents	% of respondents to this question	Number of respondents
No answer	33	35%		
Yes (completely)	13	14%	21%	
Yes (linear trajectory)	30	32%	49%	
Yes (review date ok)	4	4%	7%	
No	11	12%	18%	
Not sure	3	3%	5%	
Yes ...provides certainty to plan ahead	16	17%	26%	
Review rate before Phase IV	8	9%	13%	
Fix date for review/ criteria that will prompt it	5	5%	8%	
Concern about uncertainty move to 30% would create	5	5%	8%	
No...should be higher to meet 30% target	5	5%	8%	
No...diff sectors have diff abatement potential/ history	4	4%	7%	
Total number of respondents to this question	61	65%		

The small number of respondents that disagreed with a linear reduction trajectory typically did so on the basis that it may not be practicable to follow a straight line

³⁷ For instance, two respondents commented that the criteria which might trigger an earlier review of the annual emission trajectory rate should be specified within the Directive to provide ongoing certainty for the market.



reduction. Some respondents from the aluminium, steel, and cement industries were of the view that different sectors should follow different emissions trajectories based on abatement potential within the sector. However one respondent considered that splitting trajectories by sector could lead to competitive distortions. One respondent commented either that the trajectory should decrease over time (to ensure emissions reductions are made) or increase (if it was shown that the target level was being achieved).

There was limited comment on whether 1.74% was the appropriate level (comments here are reflected in views around the cap level in response to the last question).

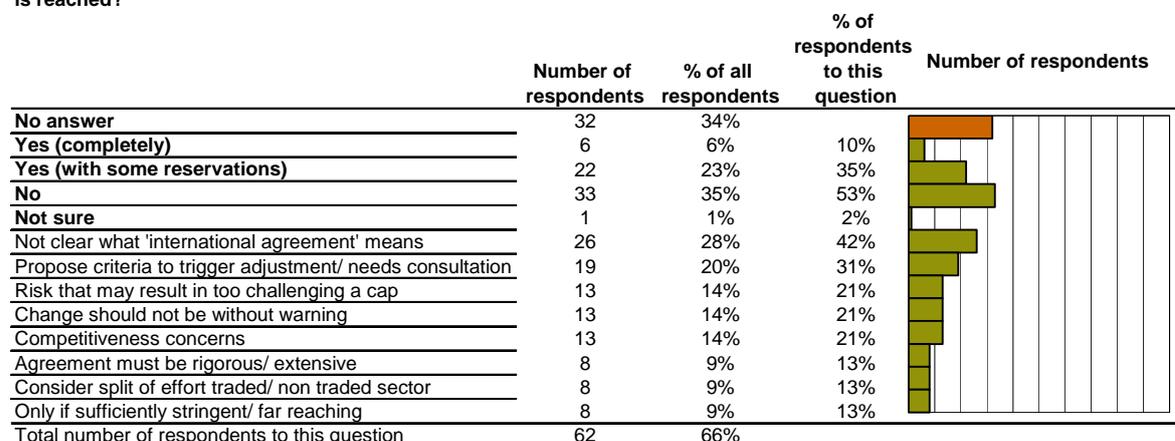
Q14. Do you agree with the Commission’s proposal for an automatic adjustment to a higher target when an international agreement is reached?

Over 65% of respondents answered this question. Responses were mixed and although fairly evenly balanced there were more concerns than outright agreement with the proposals (see chart below). A common message from those that raised concerns, was a recommendation that further criteria be developed to assess the strength, scope and timing of an agreement before any adjustment is made.

Some respondents did agree with the 30% adjustment. It was suggested that the cap should be set at this level from the outset or increased to a higher level in keeping with recommendations for industrialised nations in the latest IPCC report.

Figure 20 Summary of responses to Question 14

Q14 Do you agree with the Commission’s proposal for an automatic adjustment to a target when an international agreement is reached?



Amongst those that disagreed or agreed with caveats, a key concern was the definition and scope of an international treaty and when the adjustment would apply³⁸. A number of respondents (19) commented that criteria should be developed to assess any adjustment to ensure no disadvantage to European competitiveness/ carbon leakage. Common elements of this criteria included: incorporating a period of consultation or review on a new adjustment level (19); a re-assessment of the burden between the traded and non-traded sectors (8); a level or proportion of global emissions covered by the treaty; an assessment of potential carbon leakage resulting from the treaty; and that equivalent emission reductions are imposed on other countries and their respective industries.

38 For example a power generator stated that ‘it isn’t clear whether the adjustment applies once international agreement is reached, when it is ratified or once trading commences in non EU countries’.



Concerns were raised that if the treaty did not take effect and adjustments were not made before Phase III, potentially significant and unachievable targets would need to be set towards 2020. Furthermore respondents had concerns over the timing of the adjustment in the market once an international treaty had been agreed. Some respondents (13) noted that if an adjustment is implemented too quickly, a potential for 'market shock' exists. Some respondents recommended the market should therefore be given a period (2-5 years) to provide an opportunity to adjust to a new emission reduction trajectory.

Q15. Do you believe that there is a role for a European Carbon Bank and what functions should it perform?

This question was answered by the majority of respondents (61%). Although just over half of respondents to this question agreed that there is a role for a new body to assist in the running of the EU ETS, around a third of those that answered considered that the term 'bank' did not accurately describe the activities it should address; alternative terms offered are set out in the table below.

Table 4 Alternative names for the 'bank'

Name
Agency
Auction monitor; regulator
Central administrative agent
Committee on Climate Change
EU ETS Agency
European carbon regulator; watchdog
European Climate Change Committee
Independent consultative committee
Office of the European Carbon Ombudsman

Figure 21 Summary of responses to Question 15

Q15 Do you believe that there is a role for a European Carbon Bank? if yes, what functions should it perform? % of respondents to this question

	Number of respondents	% of all respondents	% of respondents to this question	Number of respondents
No answer	36	38%		
Yes (role for some kind of organisation)	32	34%	55%	
No (no new organisation)	15	16%	26%	
Not sure	11	12%	19%	
Wouldn't call it a 'bank'	20	21%	34%	
Administrative &/or harmonisation functions	15	16%	26%	
Should not make policy/ set cap	15	16%	26%	
Another layer of bureaucracy	10	11%	17%	
Body should...provide clarity/ indept advice/ review	10	11%	17%	
...set caps	3	3%	5%	
...advise on linking	4	4%	7%	
Total number of respondents to this question	58	62%		

A key concern was that without a clearly defined scope, a bank would add another layer of unnecessary bureaucracy and could be costly (10). There was also a view even amongst those that could see a role for some kind of new organisation that political decisions (e.g. the level of the cap) should remain with the Commission and/or Member States (15).



The most common view was that the new institution could provide: assistance in linking with other international trading systems (4); independent expertise and advice on the running of the market (10); administrative support e.g. running auctions and ensuring their harmonisation across the EU (15).

However, a small number of respondents could see a role for a 'bank' in the common sense of the word. These respondents in general considered that this would allow for longer term confidence in the carbon market without the risks of changes to long term commitments due to political pressures. Most respondents agreed with the consultation that the Bank should not have a role in determining the carbon price.

Q16. In terms of amending the rules of the system, do you favour a continuation of 5 year phases or a shift to 8 year phases? Please state the reasons for your view.

There was a relatively high response rate to this question – around 67% of respondents answered it. However, it was not always clear whether respondents' views were relating to the period up to 2020 (i.e. Phase III) or to the period after it, or both. A larger number of respondents favoured the longer (8 years at least) phase length than did the shorter (5 year) phase length (17 to 38). One respondent stated that it is too early to comment; others (7) had no strong view and could see the merits of either approach.

Figure 22 Summary of responses to Question 16

Q16 In terms of amending the rules of the system, do you favour a continuation of 5 year phases or a shift to 8 year phases? Please state the reasons for your view.

	Number of respondents	% of all respondents	% of respondents to this question	Number of respondents
No answer	31	33%		
5 years	17	18%	27%	
8 years	30	32%	48%	
At least 8 years (e.g. 10 years)	8	9%	13%	
Not sure	8	9%	13%	
Too early to tell	1	1%	2%	
Certainty for investment/ market stability	32	34%	51%	
Allow for flexibility/ review	19	20%	30%	
Aligns with 2020	8	9%	13%	
Total number of respondents to this question	63	67%		

The most common reasons for supporting the longer phase length were to provide industry with investment certainty and to facilitate a stable market. Some considered that this would be delivered by a phase shorter than eight years, particularly if allied with 15 year carbon budgets. Others commented that an eight year period fits well with the EU 2020 target. A small number of respondents stated explicitly that they would prefer an even longer phase length (e.g. 10 years)³⁹. Some commented that it was important to align phases with any future international agreement.

The most common reasons cited in favour of five years were to provide for flexibility and allow the rules to be modified if necessary. This included leaving room to tighten the cap if emissions were not in line with the necessary trajectory to meet the (UK and EU) targets. There was some concern that by deciding on the rules to 2020 in 2008, the phase is effectively 12 years which is too long (raised by the ceramics sector in particular). One respondent commented that a shorter phase

³⁹ Note that since the question asked for views on particular phase lengths, this should not necessarily be interpreted to mean that only a small number of respondents would support this option.

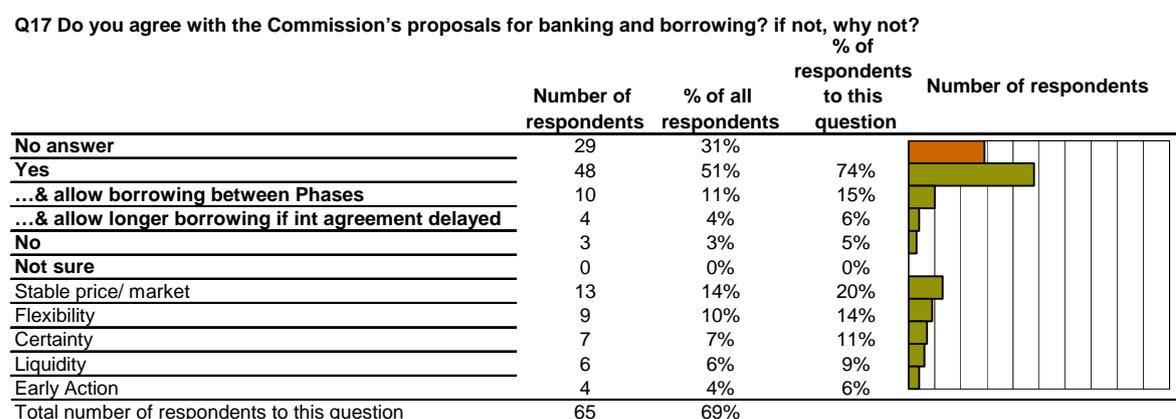


length would provide more ready access to the NER for small/ medium operators. One respondent noted that if a European Carbon Bank is established, it will be able to introduce corrective measures and hence phase length is less important.

Q17. Do you agree with the Commission’s proposals for banking and borrowing⁴⁰? If not, why not?"

Nearly 70% of respondents answered this question. The majority (95% of those that answered) agreed with the Commissions proposals, often without qualification. Where reasons were cited they included to provide flexibility, liquidity and a stable market/ carbon price. A number of respondents raised the view that as the market moves to full auctioning, (banking and) borrowing becomes less of an issue. However, the point was also made that in Phase III (where some are provided with allowances for free and others must buy them all) those subject to auctioning are disadvantaged by the rules for banking/ borrowing⁴¹.

Figure 23 Summary of responses to Question 17



A number of respondents (10) agreed with the proposals but also considered that borrowing between Phases should be allowed. One respondent described this option as being a ‘safety valve’ were the cap to be set lower than intended. Others highlighted that borrowing between phases may be particularly important if an international agreement is delayed (to avoid disruption to the market)⁴².

However, it should be noted that a small number of respondents did not agree with the proposals (3). One concern was that the provisions result in the differential treatment of organisations that are allocated free allowances and those that are allocated via full auctioning. Others supported neither banking nor borrowing, typically on the basis that it provides installations with opportunities to avoid making carbon savings. One respondent agreed with the proposals for borrowing but not for banking; this was on the basis that installations could carry forward allowances over a long period of time and so avoid making reductions and effectively raise the cap.

40 i.e. full banking between compliance years and between phases; borrowing to next compliance year within phase but not between phases.

41 In terms of process, one power generator commented that the timing of the auction/ the volume of allowances made available should not be manipulated in order to reduce the cap. They also stated that if borrowing between compliance periods is allowed, provision should be made for the closure of installations in order to avoid complicated cash out arrangements.

42 One respondent commented that the rules should be made consistent with any international agreement.



They and a number of other organisations suggested that some kind of limit on the volume of allowances to be banked/ borrowed may be appropriate to avoid abuse of the rules/ market distortion.

- ◆ Allow only a proportion (e.g. 10%) of allowances to be banked or borrowed between phases.
- ◆ Allow only compliance account holders to bank between phases. Restrict the level of banking to one year's emissions (to avoid the problem of large operators hedging exposure for many years forward).

Allocation methodology

Q18. Do you agree with the Government's position on harmonised minimum levels of auctioning across the EU?

There was a relatively high response rate to this question (around 70% of respondents commented on it). There was strong opposition to this proposal with 85% of those who commented disagreeing with the Government position, particularly those organisations that are (or represent) EU ETS participants. Only 8 respondents (9% of those that responded) agreed with the idea and a further 4 (6%) were not sure.

Figure 24 Summary of responses to Question 18

	Number of respondents	% of all respondents	% of respondents to this question	Number of respondents
Q18 Do you agree with the Government's position on harmonised minimum levels of auctioning across the EU?				
No answer	28	30%		
Yes	6	6%	9%	
No	56	60%	85%	
Not sure/ opinion not clear	4	4%	6%	
Equity/ market distortion/ competitiveness concerns	29	31%	44%	
Support EU harmonisation	21	22%	32%	
Against auctioning (for sector or at all)	10	11%	15%	
Total number of respondents to this question	66	70%		

There was a strong preference for harmonising auction levels⁴³, as per the Commission proposal. The main concern was the need for a level playing field in Europe, and the need to avoid the risk of unfair competition from industry within other Member States (29). The risk of 'intra-EU' leakage was also cited as a concern by a small number of respondents.

Some respondents disagreed with the justification that Government needs increased control over revenue streams, and that it could be open to exploitation by Government for tax raising purposes or otherwise. The point was made that it is difficult to support this proposal without knowing what the minimum auctioning level will be, and whether it would change during Phase III.

Several respondents were against auctioning at all (10 took the opportunity to state this explicitly here⁴⁴). These were all industrial businesses (or their representatives), including from the cement, coal and other mineral products sectors. Concerns included difficulty in passing on auction costs to customers, and the likelihood of

⁴³ For instance, some commented that the UK proposal goes against the original Directive's intent of pan-EU harmonisation.

⁴⁴ This is not to say that the remainder support auctioning.



carbon leakage if EU competitiveness is disadvantaged. Some companies, including a number in the cement industry, called for sector specific auction levels, to reduce this risk. Reference was made to information about the impact (e.g. to a study by NERA on the lime industry). A favoured option amongst some of these respondents was free allocation, with benchmarking to promote efficiency.

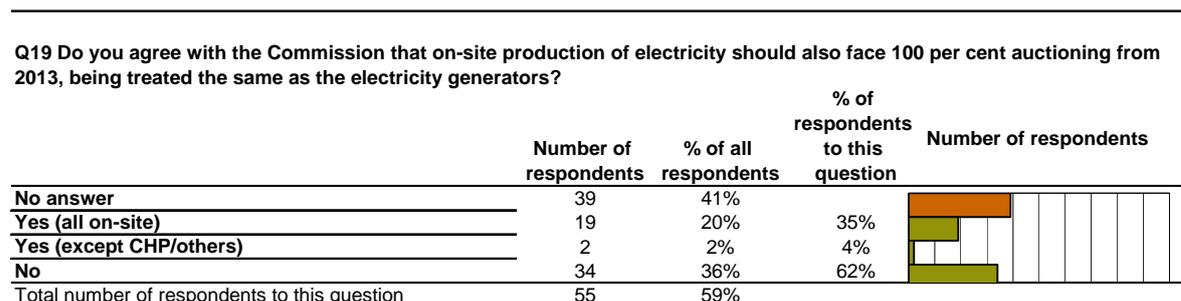
Those that supported a minimum level of auctioning were typically those that would prefer 100% auctioning.

Q19. Do you agree with the Commission that on-site production of electricity should also face 100 per cent auctioning from 2013, being treated the same as the electricity generators?

This was an important issue to many respondents, and opinion was notably divided. Respondents split broadly into two groups:

- ◆ large electricity producers and independent observers whose priority was equitable treatment with large power stations (19); and
- ◆ other respondents who were strongly against the proposal (including representatives from heavy industry, manufacturing and other organisations using CHP) (34).

Figure 25 Summary of responses to Question 19



The most common reasons for opposition with the proposals are listed below.

- ◆ It could discourage self generation, which avoids distribution and transmission losses, and is therefore more efficient than centralised generation (11). A number of respondents argued for free allowances for power generated and consumed on-site, potentially with auctioning for exported power.
- ◆ It does not incentivise CHP generation, and potentially encourages less efficient separate generation of heat and electricity/ purchase of grid power (17). Some respondents specifically called for free allocations for power and heat from CHP.
- ◆ On-site/ industrial generation does not compete with grid electricity (11)⁴⁵. Instead it is: used for business continuity (i.e. avoid power cuts); driven by heat demand (in the case of CHP); makes economical use of a by-product; or is used where there is no alternative (e.g. offshore).
- ◆ On-site power generation makes use of a waste product, such as steam or gas, which should be incentivised (e.g. in ceramics, cement, refineries, petrochemicals) (8). Several respondents called for free allocations for power generation from by-products.

45 A number of respondents commented that there is not a single electricity market. For instance one respondent referred to the “EU Commission DG Competition Sector Inquiry in 2007”.



In addition, a number of respondents commented there should not be any differentiation between power generated on-site by the consumer, or that generated on-site but sold by a third party e.g. an energy services company (ESCO).

Those that were supportive of this proposal consider that it would create a level playing field for all power generation and avoid market distortions/ perverse incentives for on-site generation (10). A large electricity producer stated that 100% auctioning from the outset may cause price volatilities and other risks, and that instead there should be a gradual move to full auction (for LEPs).

Suggested proposals to change the wording of the Directive are summarised in the table below. Specific requests from respondents that agreed with the approach included:

- ◆ waste gases (e.g. flaring) should not receive free allocations, nor should any power from CHP;
- ◆ benchmarks should be used for allocation, for heat, to incentivise efficient CHP and
- ◆ mechanical drives should also be included, to avoid the incentive to use them instead of electric motors.

Table 5 Suggested amendments to the definition(s)

Comment

Change 'electricity generator' to 'installation that produces electricity'

Clarify use of 'electricity production' and 'electricity generation'

Clarification is needed on how to separate emissions attributed to power from CHP

Apply auctioning only to installations that have the option of connecting to the grid

There seem to be distortions between sectors, relating to the definition of 'electricity generator' (the respondent provided examples and suggested solutions)

Q20. Do you agree that providing free allowances for electricity generators for heat produced under CHP is an adequate incentive for this technology? If not why not? How should emissions associated with heat be calculated?

Just under 60% of respondents answered this question. Even though not the direct question, the vast majority of respondents were in support of providing free allowances for CHP heat, generally for reasons of parity with stand alone heat generation, and to help encourage CHP installations. However, whether this alone is sufficient an incentive was an issue that divided opinion⁴⁶. The majority of respondents to this question (30) disagreed, around half as many agreed (16) and a further number (9) were not sure⁴⁷.

⁴⁶ Evidenced by the fact that an industry association commented that its members were unable to agree; it urged further consideration from the Government.

⁴⁷ A small number were against free allowances for heat at all.



Q20a Do you agree that providing free allowances for electricity generators for heat produced under CHP is an adequate incentive for this technology? If not why not?

	Number of respondents	% of all respondents	% of respondents to this question	Number of respondents
No answer	39	41%		
Yes	16	17%	29%	
No	30	32%	55%	
Not sure	9	10%	16%	
Also free allowances for (on-site) power from CHP	15	16%	27%	
Many CHP wouldn't be eligible for free allowances	11	12%	20%	
Change/ clarify/ question Directive	7	7%	13%	
No...not valuable enough	12	13%	22%	
Total number of respondents to this question	55	59%		

Many of the respondents that supported providing only free allowances for heat from CHP did not justify their position, stating simply that in their opinion it is sufficient, or agreeing with the reasons in the consultation. Two respondents stated that this should be sufficient incentive for CHP, and that other incentives for CHP should be abandoned.

The main reasons for disagreement and a requirement for additional measures inside or outside the EU ETS to incentivise CHP were as follows⁴⁸:

- ◆ Allocations for heat alone would not provide sufficient incentive over and above separate heat and power generation (15). Many respondents called additionally for free allowances for power from CHP.
- ◆ Many CHP installations would not qualify for the free allowances for their heat output, because of the wording of the Directive (see below) (11). It was argued that free allowances should be given for all heat output, regardless of whether from boilers or CHP; Good Quality or otherwise.

A significant concern was that CHP do not comply with the Cogen Directive's overall efficiency requirements. Respondents argued that this would act as a disincentive for CHP, given that boilers of any efficiency could qualify for free allowances. A small number of respondents also called for allowances for cooling output. The trade association for the technology made a number of detailed comments and requests⁴⁹.

Only a small number of respondents answered the second limb of the question. Alternative allocation methodologies proposed included:

- ◆ The most common suggestion was the CHPQA methodology (3).
- ◆ Dependent on the host organisation (provide free allowances if the host is open to international competition regardless of ownership or efficiency).
- ◆ Issue free allowances in line with incremental increases in emissions from on-site use of heat and power from CHP. Apply the allocation rules for the relevant sector for exported energy only.
- ◆ Require 100% auctioning for heat installations that compete with CHP.

⁴⁸ One CHP operator provided a detailed explanation of how their plant reduces emissions, but it argues is still penalised under the existing rules.

⁴⁹ Refer to response for details (including: carry out an IA to demonstrate the incentives; to consider the impact of the upfront costs of having to buy allowances for on-site generation; alter the allocation methodology for CHP heat; include a requirement for all EU states to model the impact of EU ETS and if disadvantaged then introduce further support schemes).



- ◆ One respondent suggested the EA guidelines⁵⁰.
- ◆ Another suggested apportioning the emissions based on all input energy, minus the proportion of energy output as electricity.
- ◆ Another suggested that the CHP industry should be consulted.

A water company stressed the need to incentivise the use, not just generation, of heat when calculating the emissions.

Q21. Do you agree with the Commission that all other sectors including aviation – with the exception of those demonstrably at significant risk from carbon leakage- should move to full auctioning with free allocation starting in 2013 at 80 per cent of their share of verified emissions for the period 2005-2007 and reducing by equal amounts each year? If not, why not?

Around 64% of respondents answered this question. A considerable number of respondents who answered this question did not agree with the proposed approach. For some (11) this was because they would prefer full auctioning for everyone. For the remainder that disagreed, the most common concern was around the potentially negative impact on competitiveness that could result from a move to full auctioning. Of those that did agree only a relatively small number (7) agreed without some form of caveat (11 more agreed with caveats) e.g. over the definition of exposure to carbon leakage or the timing of the proposed move to auctioning.

Figure 27 Summary of responses to Question 21

	Number of respondents	% of all respondents	% of respondents to this question	Number of respondents
No answer	34	36%		
100% auctioning preferred methodology	11	12%	18%	
Yes	7	7%	12%	
Yes but with caveats	11	12%	18%	
No	28	30%	47%	
Not sure	3	3%	5%	
80% for LEPs/ other sector go straight to 100% too	11	12%	18%	
Different timing	8	9%	13%	
Not all sectors	2	2%	3%	
Not aviation	3	3%	5%	
Comment on carbon leakage	36	38%	60%	
Can't pass costs through	10	11%	17%	
Cost too high / damage economy	16	17%	27%	
Total number of respondents to this question	60	64%		

The main point of concern (36) was the impact of carbon leakage on the competitiveness of the UK in the absence of international climate agreement. The majority were concerned over the cost of buying allowances and the ability to pass on costs even if their sector was not exposed to international competition. For

⁵⁰ Environment Agency has published guidelines for apportioning energy supplied from CHP units in Horizontal Guidance Note IPPC H2, Integrated Pollution Prevention and Control (IPPC), Energy Efficiency



example there was concern that certain public bodies cannot pass costs onto the 'customer' and should get special consideration⁵¹.

Some respondents were not entirely opposed to auctioning but set out various conditions that would have to be met before they would endorse the move such as a commensurate adjustment to other corporate taxes. There were also some concerns around the way that the auction would function. For instance, a sector organisation noted that care should be taken when selecting the auction design. Alternative approaches proposed included the use of benchmarking or the setting of a tighter cap.

Those in support of full auctioning were typically either not participants or from the electricity sector. In general they considered that the move to auctioning should be at the same rate across all sectors (except those exposed to significant carbon leakage) i.e. either the power sector should be given 80% like other sectors or that other sectors should also move straight to 100% auctioning⁵².

Other points raised were as follows:

- ◆ Timing: either that auctioning should be introduced slowly to allow industry to prepare and new technologies to be developed or that only after a formal international climate agreement had been developed.
- ◆ Readiness: there was some concern over whether the auction system would be set up in time given the delays experienced in Phase I and II. It was argued that any uncertainty may increase uncertainty for participants and delay investment decisions⁵³.

Q22. Do you agree with the Commission's and the Government's criteria for determining which sectors are at significant risk of carbon leakage? If not, why not and explain the rationale behind any alternative criteria you propose.

Around 68% of respondents answered this question. The majority (around 55% of those that answered) agreed with the criteria or agreed with a number of caveats. The answers given were detailed and showed strong views on the subject. A number of respondents noted the complexity of carbon leakage and commented that further analysis was required. A number of respondents considered the Government's criteria to be more clearly defined than the Commission's and agreed with the Government's call for greater clarity.

⁵¹ However, some respondents commented that they were sceptical about the potential loss of competitiveness and consequent carbon leakage. They pointed towards studies that suggest the problem is not as significant as is claimed.

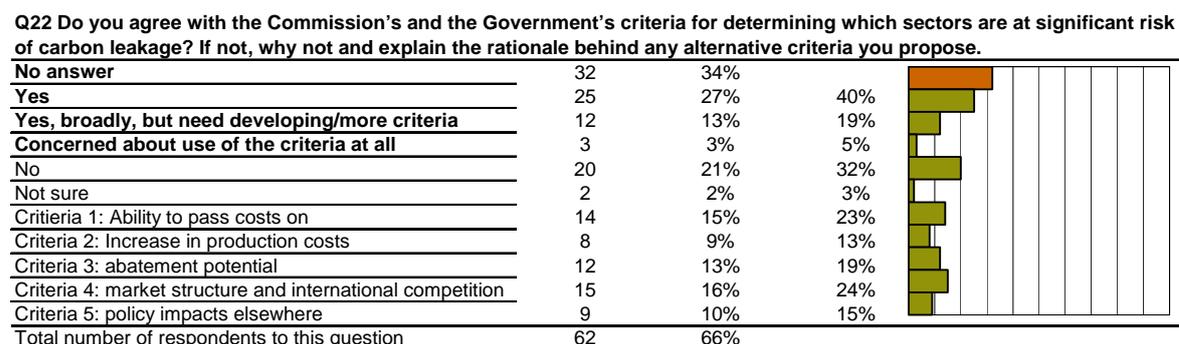
⁵² The power sector also commented that it was disappointed the allocation to LEPs was not a point of consultation.

⁵³ Two trade associations and an energy company.



Figure 28

Summary of responses to Question 22



Note: Bottom half of chart lists number of comments against particular criterion.

Carbon leakage

A number of respondents from the ceramics sector stressed that the definition of exposure to carbon leakage should not just consider international competition for the similar materials, but should look at substitute materials too. A trade body considered that assessments should be made at a detailed (product) level.

Respondents from the electricity sector broadly agreed with the criteria to assess carbon leakage as long as all sectors move to 100% auctioning following international agreement.

A number of respondents stressed that the analysis of exposure to carbon leakage should be based on consistent criteria set out by the Commission to ensure that the approach taken is consistent across all Member States. A power producer discussed the limitations of a number of studies which have assessed exposure to carbon leakage in some detail⁵⁴.

A small number of respondents considered that the impact of carbon leakage has been overplayed.

Other points

- ◆ Respondents from the chemicals sector were concerned that the proposed analysis only focussed on energy intensive activities and did not assess the whole sector or sub-sector manufacturing chain⁵⁵.
- ◆ Several respondents commented on the need for quick resolution on the list of criteria to be used to assess carbon leakage to increase certainty and allow for early investment decisions to be made. An aluminium producer considered that the timescales outlined in the Directive need to be brought forward.
- ◆ An oil and gas company considered that both the definition of 'energy intensive' and 'substantial' needs developing and that 'sectors' should be changed to 'sector or sub-sectors'.

⁵⁴ "Industry does not believe that these studies accurately reflect reality and there are a number of reasons for this including the data that the studies have used, the nature of the modelling, and the degree of consultation in the process. In the absence of an agreement much more work is needed to establish the true impact on selected sectors."

⁵⁵ A chemical company said "the criteria should also provide for recognition of the integrated nature of activities rather than purely focus on the energy-intensive stages. For example, chlorine itself is not actively traded, but much chlorine is immediately converted to PVC which is highly exposed."



- ◆ A trade body questioned whether the concept of carbon leakage should be defined in the Directive.
- ◆ A trade body commented that “the Commission would be unable to determine which foreign installations were “less carbon efficient” without detailed co-operation from those installations, which is highly unlikely to be forthcoming”.

The comments made on each of the five criteria proposed are summarised below.

Table 6 **Comments on specific criteria**

Criteria	Overview of comments
Criteria 1: Ability to pass costs on	<p>Respondents typically considered that the ability to pass costs on was an important indicator of risk of carbon leakage. However several provided explanations on the limitations of using the ability to pass on costs as an indicator. A number of respondents considered that a sector’s ability to continue to attract international investment should be considered.</p> <p>With regards to profitability, respondents commented that the use of GVA or GDP to determine cost impact was not suitable as it fails to consider the need to cover direct fixed costs. They suggested that the analysis should focus on the impact on profitability (which is more likely to steer investment decisions). Several respondents suggested that EBITDA would be a more appropriate metric⁵⁶.</p>
Criteria 2: Increase in production costs	<p>The majority of respondents who answered this viewed consideration of increases in production costs through auctioning important. Respondents, particularly those in energy intensive manufacturing, stressed the need to consider the indirect impact of increased electricity prices.</p> <p>A number of respondents considered that a clearer definition, based on variable costs of production should be developed. However an energy company disagreed as it considered that increased production costs due to the internalisation of the carbon cost are “precisely what the EU ETS aims to ensure”.</p>
Criteria 3: Abatement Potential	<p>The ability for a sector to reduce emissions was also seen as an important issue when assessing risk of carbon leakage. Respondents from the lime and cement sectors noted the limited abatement potential due to technical issues around process emissions and the high uptake of energy efficiency measures as a result of high energy prices⁵⁷.</p> <p>Several respondents considered that any assessment of potential should involve industry experts. Respondents from the chemical sector considered that the analysis should only reference cost effective technologies and take account of plant life cycles.</p> <p>However, two respondents considered that abatement potential within a specific sector should not be a major consideration as the emission reductions will occur in the sector where it is most cost effective to abate.</p>
Criteria 4: Market structure and international competition	<p>Only one respondent did not consider that the analysis of carbon leakage risk should look at international market structure and international competition. Other respondents commented on the limitation of the current analysis as it is based on historic data and does not consider future international markets.</p>

⁵⁶ A trade body noted that “GVA data for the lime sector is scarce and the only available UK data is about 10 years old.”

⁵⁷ A cement company noted that CCS may be a long term abatement option for the cement industry.



Criteria	Overview of comments
Criteria 5: Policy impacts elsewhere	<p>Respondents from the cement sector expressed concern over potential increases in imports of cement if the cost of carbon outweighed the shipping costs.</p> <p>Fewer respondents commented on this criterion than the other four. However, there was general agreement (where it was discussed) that it should be included in the analysis.</p> <p>Several respondents from the lime/cement sector stressed the need to compare like with like and accurately reflect the existing legislative framework and climate change instruments already operating in the UK.</p> <p>A chemical company considered that only implemented policies should be considered.</p>

The criteria set out in the table below were considered missing from the current analysis.

Table 7 Additional Criteria proposed

Respondent	Additional criteria to be considered
Cement sector	<ul style="list-style-type: none"> - The extent to which a substitution product with a lower carbon footprint during its lifecycle is currently or likely to be available in the foreseeable future - The carbon intensity of production in relation to profit - The projected import intensity from non-carbon constrained countries under Phase III auctioning conditions.
Energy company	<ul style="list-style-type: none"> - Relative size of carbon cost of profitability and cost of importing alternatives from competitors that are not burdened with similar carbon costs - Impact on other policies – security of supply and loss of indigenous resources
Energy Company	<ul style="list-style-type: none"> - Transport costs of importing into EU - Current level of production surplus capacity in ex-EU supply jurisdictions - Capital expenditure required to establish any necessary additional capacity in ex-EU markets
Trade body	<ul style="list-style-type: none"> - Direct & indirect costs at a range of plausible carbon prices, as a proportion both of GVA and profit margins - Non-EU trade intensity at subsector level - Ability to attract investment to EU
Trade body	<ul style="list-style-type: none"> - Impact of loss of export markets - Impact of substitution from the non traded sector - Possible intra EU leakage

Q23. Do you agree that free allocation helps to significantly reduce the risk of carbon leakage? If not, why not?

Around 65% of respondents answered this question. Around 64% of those that did (39) broadly agreed that free allocation would significantly reduce the risk of carbon leakage, or agreed with some caveats/ exception (12). Only a small number (4) commented that they disagreed and a further group (6) suggested that they were not sure.



Q23 Do you agree that free allocation helps to significantly reduce the risk of carbon leakage? If not, why not?

	Number of respondents	% of all respondents	% of respondents to this question	Number of respondents
No answer	33	35%		
Yes	39	41%	64%	
Yes with caveats	12	13%	20%	
No	4	4%	7%	
Not sure	6	6%	10%	
Yes...interim solution/absence of global agreement	11	12%	18%	
...improves competitiveness	4	4%	7%	
...but extra allowances for electricity intensive sectors	7	7%	11%	
...but only if genuinely/ critically exposed	3	3%	5%	
Total number of respondents to this question	61	65%		

Whilst many respondents agreed outright (and often did not provide a rationale) some respondents had a number of caveats or exceptions including:

- ◆ only interim solution until global agreement could be reached (cross-sector);
- ◆ in partnership with progress-fostering benchmarks (lime & cement); and
- ◆ only in exceptional circumstances (power sector).

Some respondents considered that free allocation would go some way towards preventing carbon leakage but were not sure it would prevent it entirely. For instance, there were concerns about the impact of the pass-through of carbon costs to the electricity price (e.g. aluminium and chlor-alkali). A number of respondents (7) consider that free allocation should reflect both direct and indirect carbon costs. However one trade association commented that this would add further complexity/distortion and potentially raise State Aid issues. One respondent was concerned that off-site separately owned CHP units should not be penalised if the installation using its heat or electricity is deemed to be exposed to carbon leakage.

Amongst those that disagreed with the question, there was concern that free allocation would affect profitability rather than carbon leakage⁵⁸ or that it amounts to state support. The point that carbon leakage claims may be exaggerated was reiterated here. It is worth noting that some commented explicitly that free allocation is a more appropriate method than e.g. a border tax while others would support the alternative (discussed in more detail under Q24).

Q24. Are there any alternative methods for addressing carbon leakage that you favour?

Under 60% of respondents answered this question. A number of alternatives were suggested, with a particular focus on the idea of placing requirements on importers (21), although a number of respondents (7) stated explicitly that they did not support such an approach⁵⁹.

⁵⁸ Since there is no requirement to surrender the allowances against emissions, they could just be sold.

⁵⁹ Note that, even where an alternative method to prevent carbon leakage was suggested, it was not necessarily the approach that respondents favoured (e.g. free allocation/ full auctioning were still their preferred approach as evidenced by the responses to previous questions).



Q24 Are there any alternative methods for addressing carbon leakage that you favour?

	Number of respondents	% of all respondents	% of respondents to this question	Number of respondents
No answer	40	43%		
Yes	35	37%	65%	
No	15	16%	28%	
Not sure/ give careful consideration/ research	4	4%	7%	
Yes...trade agreements and/or border tariffs	21	22%	39%	
...global agreement	10	11%	19%	
No to import taxes/tariff	7	7%	13%	
Sectoral agreement	4	4%	7%	
Total number of respondents to this question	54	57%		

A number of respondents (10) stressed the need for international agreement as the only real solution while others (4) discussed the use of sectoral agreements as an interim measure before global climate agreements can be made.

However, the most common alternative method supported was some sort of trade agreement or border adjustment mechanism e.g. a border tax (21)⁶⁰. Others commented that a global agreement is the best option (10) and a smaller number (4) supported sectoral agreements. Others preferred the use of free allocations over border adjustment mechanisms due to the complexities involved with the later, risk of retaliation by other trading blocs and potential legal issues relating to the world trade organisation (WTO).

Other alternatives were proposed, summarised below.

- ◆ A trade body suggested requiring non-EU imports to purchase and surrender equivalent allowances from the market.
- ◆ An oil and gas company suggested various alternatives, including the development of a programme of carbon reduction projects similar to the clean development mechanism (CDM).
- ◆ A chemical company suggested that the recycling of auction revenues could be used to address the impact of indirect emissions.
- ◆ An NGO suggested that a 'more open and transparent means of direct subsidy' would be preferable

Q25. Do you agree with the Commission's proposals to undertake a thorough evidence-based review of sectors which may be at risk of carbon leakage in time to propose solutions in 2011?

This was a popular question (70% of organisations responded). There was a strong view that there should be a review (only 2 respondents answered 'no'⁶¹). The overriding concern was around its timing and that it needs to be thorough.

⁶⁰ Note that others (7) commented explicitly that they did not agree with this approach. Others only support the use of such an approach if attempts to reach international agreement fail.

⁶¹ One to say that the NHS and MOD cannot pass costs through and that the threat of carbon leakage is not an appropriate reason for differential treatment. The second commented that the timetable was too slow (note that other respondents like this typically answered 'yes, but').



Figure 31 Summary of responses to Question 25

Q25 Do you agree with the Commission's proposals to undertake a thorough evidence-based review of sectors which may be at risk of carbon leakage in time to propose solutions in 2011?

	Number of respondents	% of all respondents	% of respondents to this question	Number of respondents
No answer	28	30%		
Yes	18	19%	27%	
Yes with caveats	46	49%	70%	
No	2	2%	3%	
Not sure	0	0%	0%	
Review needs to be brought forward/2011 too late	31	33%	47%	
Need input from industry sectors/ trade bodies	12	13%	18%	
Comment on interaction with global agreement	10	11%	15%	
Total number of respondents to this question	66	70%		

The most common caveat (31) was that the analysis should be brought forward and that the proposed completion date of 2011 would prevent effective business planning and delay operational/ strategic decisions. Where an alternative date was suggested, this was as early as 2009 or 2010. A key concern was that its timing should not delay the decisions necessary to facilitate a timely start to the auction process by 30 June 2011 (a common view amongst LEPs).

Some commented that there is a balance between ensuring it is in-depth and thorough, whilst avoiding creating uncertainty. Although some considered that the Commission should wait until after the Copenhagen conference to undertake the review, others were keen that the review should not be delayed.

General comments around how the review should be undertaken included:

- ◆ Consider all sectors – rather than make decisions in advance without discussion with stakeholders. Comment was also made that the public sector should be included.
- ◆ Transparent – a number of respondents highlighted the need for the review to be transparent and open to public scrutiny.
- ◆ Independent – the review must be independent and resilient to industrial lobbying.
- ◆ Based on real evidence – there was concern that ‘evidence’ used in similar studies is actually assertion.
- ◆ Consult with industry – several respondents stressed that the review must not be theoretical and conducted in isolation but should involve extensive consultation with industry sectors and their trade bodies.
- ◆ Regularly updated – a number of respondents commented on the need for regular updates to the analysis of carbon leakage as the position of industries at risk could alter over time.
- ◆ Detailed – take into account regional and MS-specific constraints (e.g. fuel and raw material availability).

A number of respondents considered the sectors identified as being exposed to carbon leakage and their treatment should be set out in the amended Directive to prevent uncertainty⁶².

62 An oil and gas company suggested amendments to the wording in the Directive.



Q26. Do you believe that sectoral agreements are a plausible solution to the risk of carbon leakage? If so, for which sectors and in what form and to what timescale do you believe they might be achieved?

Around 55% of respondents answered this question. Of those that did, responses were very mixed with a similar percentage agreeing as disagreeing with sectoral agreements as a plausible solution to risk of carbon leakage (16 versus 15). A larger number (21) were not sure or did not give a definitive answer.

Figure 32 Summary of responses to Question 26

Q26a Do you believe that sectoral agreements are a plausible solution to the risk of carbon leakage?

	Number of respondents	% of all respondents	% of respondents to this question	Number of respondents
No answer	42	45%		
Yes	16	17%	31%	
No	15	16%	29%	
Not sure	21	22%	40%	
Possibly	7	7%	13%	
Not for our sector	6	6%	12%	
Total number of respondents to this question	52	55%		

Of those that did not agree, some organisations (6) from the Offshore, Refineries and LEP sectors stated that they did not agree this was a solution for their sector in particular. Others, predominantly from the Cement and Lime sectors (5) stated that there was little incentive or that it was difficult to see the benefits for organisations from other countries outside the EU to enter into them. Organisations from various sectors (5 respondents in total) stated that there needed to be a legally binding agreement for sectoral agreements to work.

There were substantial concerns with/ barriers to international sectoral agreements. For instance, some commented that there is no guarantee that sectoral agreements will reduce carbon emissions and that they would be difficult to enforce. Others were of the view that any global agreement must be based on national commitments to substantial, absolute emission reductions in developed countries. A small number of respondents stated that they would prefer an international climate change agreement (4) and that any agreements need to involve governments (3).

A number of respondents (3) commented that further research is required to take this forward and that the Government's view that only a small number of sectors are at significant risk of carbon leakage should not be made without evidence-based assessment (1)

If so, for which sectors?

The table below lists those sectors where agreement was considered plausible. Some respondents commented that they have already started this process (e.g. chemicals).

Table 8 Sectors for which sectoral agreement may be plausible

Sector	Number of respondents	Sector	Number of respondents
All sectors	1	Chemicals, inc petrochemicals	1
Aluminium	3	Iron and steel	3
Aviation	1	Wood industry	1



If so, in what form?

Only a small number of respondents described the form that such an agreement could take. They included: market approaches; regulatory approaches; information sharing; common reporting/ monitoring; building on experience from UK CCAs and the Dutch Covenant⁶³.

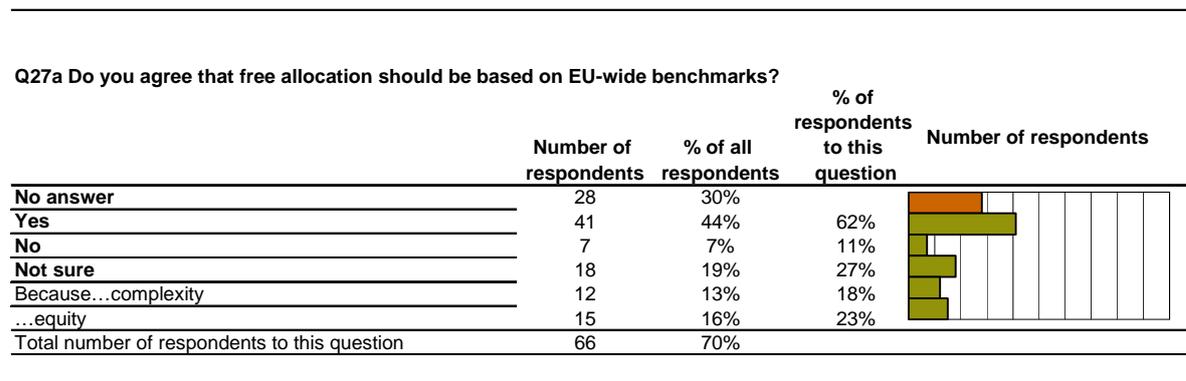
If so, to what timescale?

Only a small number of respondents (9) commented on the last part of the question; the majority (7) simply commented that it would be a lengthy process. Only one considered that agreements could be in place before the end of Phase II.

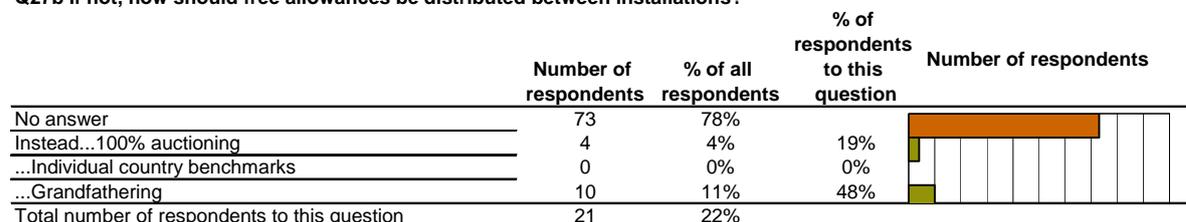
Q27. Do you agree that free allocation should be based on EU-wide benchmarks? If not, how should free allowances be distributed between installations?

About 70% of respondents answered this question. Just over 62% of respondents to the question agreed, a further 27% commented that they were not sure while only 11% of those that answered did not agree.

Figure 33 Summary of responses to Question 27



Q27b If not, how should free allowances be distributed between installations?



The most common concern about the use of benchmarking was its complexity and the difficulties around ensuring that they are equitable. Around 70% of those that agreed with this methodology stated that it was on the proviso that benchmarks were harmonised, equitable for all sectors, do not affect competitive positioning, and take national circumstances into account.

There were strong as well as mixed comments about how benchmarks should be set. Examples given included: based on combustion capacity, based on historic

63 Each of these was only mentioned in one or two responses



levels or production/ output or according to sub-sector. There was a view that trade associations/ sector representatives should be consulted before finalising a benchmarking methodology.

The most commonly suggested alternative was grandfathering (10) from respondents in the offshore, engineering and vehicles and chemicals sectors. One respondent stated that allowances should be sub-divided to MS (based on three most recent years' verified annual emissions) and that each should decide on further sub-division of these allowances. Five respondents from the ceramics and oil and gas industry⁶⁴ supported the approach in a UK non-paper that uses sector caps combined with benchmarks. Respondents (8), mainly NGOs stated that they disagreed with free allocation and that there should be 100% auctioning.

Q28. Do you agree with the Commission proposal that there will be no sector caps with harmonised bottom-up benchmarks being used to divide up the sub-cap for free allocation?

Around 56% of organisations answered this question. About 60% of those respondents that answered did not agree, 21% did agree and about 19% were not sure.

Figure 34 Summary of responses to Question 28

Q28 Do you agree with the Commission proposal that there will be no sector caps with harmonised bottom-up benchmarks being used to divide up the sub-cap for free allocation?

	Number of respondents	% of all respondents	% of respondents to this question	Number of respondents
No answer	41	44%		
Yes	11	12%	21%	
No	32	34%	60%	
Not sure	10	11%	19%	
Total number of respondents to this question	53	56%		

Those that agreed commented that: there should be cross-sector harmonisation; the result should not act as a brake for economic growth; and grandfathering should be used where it is difficult to benchmark.

One of the most common reasons for disagreement is that sector caps are needed (19) (see reference to UK non-paper under Q27) e.g. to ensure consistent treatment. Nine respondents from various sectors expressed a preference for a method where sector caps are set and then allocations between each sector are calculated using benchmarking within each sector. There was a view that as it stands, the Commission proposal is not equitable, is complex and may lead to disputes between sectors⁶⁵.

For some respondents, there was also a concern that the benchmarks would not be representative. For instance, the food and drink sector was in favour of sub-sector benchmarks to make the methodology more equitable⁶⁶.

Other points raised included that:

- ◆ there should be a harmonised benchmarking system for large emitters and more discretion for each MS in free allocation for small emitters;

⁶⁴ 'Free allocation: can sector caps help?' 4 April 2008

⁶⁵ As noted in response to questions above, around eight respondents support full auctioning and so do not support the approach proposed.

⁶⁶ They gave examples where benchmarks vary substantially within their sector.



- ◆ allowances should be allocated pro-rata where it is difficult to benchmark;
- ◆ the accuracy and robustness of MRV must be consistent across MS; and
- ◆ support for the proposals will depend on the benchmarks used – the approach does not overcome the need to ensure that competitiveness is reflected between sectors.

Q29. Do you agree that there should be an EU-wide new entrant reserve, based on a percentage of the overall cap?

Around 65% of respondents answered this question. The majority of those that did (64%) agreed with the approach while around 28% did not agree. Only a small percentage of those that answered (8%) did not give a definitive answer or were not sure.

Figure 35 Summary of responses to Question 29

	Number of respondents	% of all respondents	% of respondents to this question	Number of respondents
Q29 Do you agree that there should be an EU wide new entrant reserve, based on a percentage of the overall cap?				
No answer	33	35%		
Yes	39	41%	64%	
No	17	18%	28%	
Not sure	5	5%	8%	
No...inequitable	8	9%	13%	
...based on % of free allowances	8	9%	13%	
...should be based on % of auctioned allowances	6	6%	10%	
Total number of respondents to this question	61	65%		

The most commonly stated reason in agreement was that this is an equitable method. However, even amongst those that agreed, there were some qualifications, predominantly around ensuring equitable treatment (of MS, sectors or of new and incumbent plant). There was a view that a harmonised method should be used to minimise distortion, including a common central method for eligibility (it was suggested that there is a need to provide guidance with regard to redevelopments or extensions to existing facilities).

Those that disagreed can be grouped as follows:

- ◆ the percentage for the NER should be taken from allowances allocated for free (electricity sector); or
- ◆ that the percentage for NER should be taken from allowances allocated for auctioning (cement and lime).

A comment common to the cement sector was that if this approach is progressed, any unused allowances should be fed back to industries that the allowances were originally earmarked for, in proportion to their free allocations. Comments on the percentage level are included under Q30 below.



Q30. Do you agree with the Commission proposed level for the new entrant reserve of 5 per cent of the overall EU cap or do you agree with the Government's position that it should be a lower percentage? What should the percentage be? Please give reasons for your answer.

Around 60% of respondents answered this question. There was a strong view that the proposed level is too high (75% of those that answered). Only 5% considered that it was the right level, a further 12% were not sure and suggested a further consultation (no respondents stated explicitly that it was too low)⁶⁷.

Figure 36 Summary of responses to Question 30

Q30a Do you agree with the Commission proposed level for the new entrant reserve of 5 per cent of the overall EU cap or do you agree with the Government's position that it should be a lower percentage? Please give reasons for your answer.

	Number of respondents	% of all respondents	% of respondents to this question	Number of respondents
No answer	38	40%		
Yes (5%)	3	3%	5%	
No (lower %)	42	45%	75%	
No (higher %)	0	0%	0%	
No (no NER)	0	0%	0%	
Not sure	11	12%	20%	
Total number of respondents to this question	56	60%		

One of the main reasons given for setting the NER at a lower percentage was that installations that were subject to 100% auctioning would not be eligible for access to the NER, so 5% would result in too large an NER. A small number of respondents (4) commented that having the NER set at 5% was not equitable for incumbents.

A considerable number of respondents (21) favoured the UK Government proposal to set the NER at 1.2%, but others (5) considered that the UK proposal lacked detail and supporting evidence (see table below). Others (6) were concerned this would be too small. Only a small number of respondents specified an alternative percentage (6 suggested 2% and 2 suggested 3%). Several respondents highlighted the need to take account of economic growth when sizing the NER (e.g. one respondent (TUC) commented that it should reflect the growth potential for a particular sector).

Table 9 Other comments that do not necessarily relate to the level

Comment	Number of respondents
There should be an explanation of how the 5% figure has been reached	1
Further analysis is required to determine the size of the NER (and this should include consultation with industry)	8 (1)
The size of the NER may change depending on whether carbon capture and storage (CCS) projects are eligible	8
Unused allowances from the NER: should be auctioned (in a transparent manner)	7
Unused allowances from the NER: could be distributed among Member States	5
Unused allowances from the NER: should be returned to the NER to leave allowances for those entering near the end of the phase	2
Auction revenue should be used to top up the NER if necessary	5

⁶⁷ Comments on the methodology rather than level are included under Q29. One respondent provided a detailed methodology for administering the NER, another commented on the queuing methodology and three respondents commented on access for CHP.



Q31. Do you agree with the Commission proposal that installations which close should not receive any further free allowances or that they should receive a longer period of free allocation? Please include why you support each approach.

Around 56% of respondents answered this question. Of those that did, the vast majority (42) agreed that installations which close should not receive further free allowances. Only a small number of organisations (5) considered installations that close should receive a longer period of free allowances. A further small number (6) were not sure.

Figure 37 Summary of responses to Question 31

Q31 Do you agree with the Commission proposal that installations which close should not receive any further free allowances or that they should receive a longer period of free allocation? Please include why you support each approach.

	Number of respondents	% of all respondents	% of respondents to this question	Number of respondents
No answer	41	44%		
No free allowances	42	45%	79%	
Longer period of free allowances	5	5%	9%	
Not sure	6	6%	11%	
Total number of respondents to this question	53	56%		

Most respondents did not provide a rationale for their view, but two reasons that were mentioned (by a small number of respondents) were that: providing free allowances could encourage early closure to generate profit; and stopping free allowances will make the process simpler. One respondent highlighted the need for symmetry between the new entry and closure rules and a small number (4) (mainly from the electricity sector) commented that a clear definition of closure should be included in the Directive.

One reason given for providing closed installations with a longer period of free allowances was it would avoid older, more carbon-intensive facilities being kept open unnecessarily. One organisation suggested that companies which have rationalised installations to improve efficiency, but have maintained net volumes should be entitled to a longer period of allowances. Three respondents suggested that if production transfers from a closed site, then the allowances should also transfer. One organisation proposed that newly reopened installations under new management should receive longer periods of free allocations⁶⁸. Two organisations suggested that extending the allocations period should be considered if employment and carbon emission reductions could be secured as a result. Another organisation proposed that allowances be retained until the end of the Phase.

Several organisations raised concerns around temporary closures. One suggested that failure to be flexible in allowing installations that temporarily close to retain their allowances could result in permanent closure and importation of products. Other comments on the detailed operation of the rule are provided in the table below.

Respondents provided views on what should happen to allowances from closure:

- ◆ returned to the NER (4 from chemicals);

⁶⁸ Similarly one respondent commented that if an installation closes due to bankruptcy, but is reopened by a new owner and if the installation's allowances have lapsed, it should be eligible for allowances from the NER. Two organisations proposed that the definition of a new entrant should include the reopening of closed plants providing that the plant was not owned by the same company or an associated company in response to the next question.

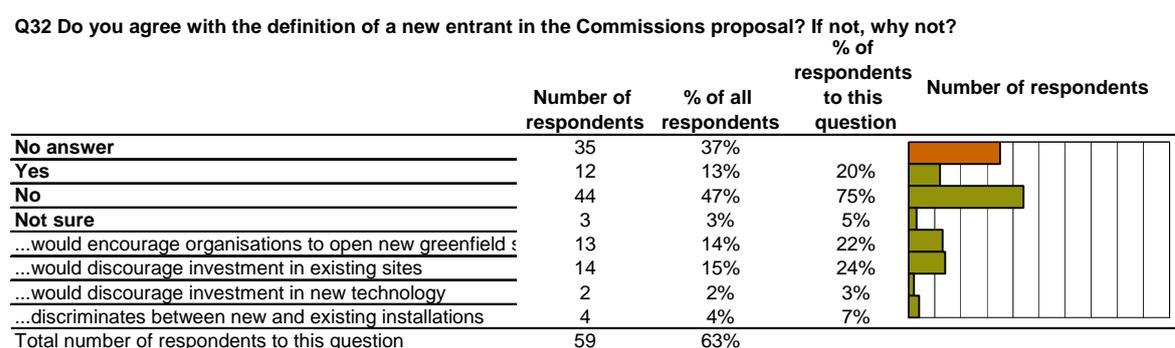


- ◆ auctioned (7 from the electricity sector);
- ◆ cancelled (1 NGO).

Q32. Do you agree with the definition of a new entrant in the Commissions proposal? If not, why not?

Around 63% of respondents answered this question. Approximately three quarters (43) of those who did, disagreed with the Commission's definition of a new entrant. However, 13% agreed and only 3% of those that answered were not sure.

Figure 38 Summary of responses to Question 32



Those that agreed did not always provide a rationale. The two most common reasons given by respondents that disagreed with the definition are listed below.

- ◆ It would encourage organisations to open new greenfield sites (13). Several organisations pointed out that expanding existing sites was preferable (economically and environmentally) to developing new greenfield sites. One suggested that the Commission's definition could encourage organisations to create artificial separations⁶⁹.
- ◆ It would discourage investment in existing sites (14). One organisation was concerned about the impact this would have on hospitals undertaking major redevelopment. Another pointed out that discouraging investment in existing sites was undesirable as such investment often reduces carbon emissions. Two stressed that most expansion in their sectors occurs through investment in existing facilities

Other concerns were that the definition would: discourage investment in the EU (6); discriminate between new and existing installations (4); discourage investment in new technology (2). There were various comments about the need for harmonisation to avoid inequalities across the EU, e.g. around the application of the new entrant definition and particularly permitting regimes. A small number of respondents provided this as their rationale for supporting the Commission's definition. Another requested that the process for applications to the NER be administratively simple.

⁶⁹ One organisation commented since allowances for growth will need to be purchased, except for new plants on greenfield sites, this effectively imposes full auctioning on economic growth, which is contrary to the objective for free allocation and the objectives of the Lisbon Strategy.



Q33. Do you agree with the UK position that there should not be a system of hypothecation or earmarking of auctioning revenues?

A relatively large proportion (72%) of respondents answered this question. Respondents to this question did not agree with the stated UK Government position. There was a strong view from a wide cross section of respondents (75% of respondents to the question) that revenues should be used to fund climate change measures and that they should not be transferred to the consolidated fund (which many respondents would view as a tax). Respondents typically considered that the funds generated should be put to use to tackle climate change and/ or to alleviate fuel poverty, in keeping with the objectives of the EU ETS. Views varied on whether the monies should be given back to participant organisations/ sectors⁷⁰ or to other funds⁷¹.

Figure 39 Summary of responses to Question 33

Q33 Do you agree with the UK position that there should not be a system of hypothecation or earmarking of auctioning revenues?

	Number of respondents	% of all respondents	% of respondents to this question	Number of respondents
No answer	26	28%		
Yes (no hypothecation)	7	7%	10%	
No (hypothecation ok)	51	54%	75%	
Not sure	10	11%	15%	
Support Cion proposal	7	7%	10%	
Go back to contributors/ be used to help them	11	12%	16%	
Use it to...help fuel poor/ energy users	9	10%	13%	
...support R&D/ emerging technologies	31	33%	46%	
...fund mitigation/ reduction techniques/ strategies/ EE	21	22%	31%	
...fund adaptation	10	11%	15%	
Total number of respondents to this question	68	72%		

A number (7) stated explicitly that they concurred with the European Commission proposal of at least 20% (reasons given included that it would provide for a harmonised approach across the EU). Some stated explicitly that the 20% level proposed would be too low. However, not all respondents considered that all revenues should be redistributed/ earmarked. One respondent cited other examples of hypothecation to emphasise its support of earmarking⁷².

Those that did not explicitly disagree with the UK position highlighted that some sort of long-term, reliable support to tackle climate change should be committed to, whether the funding for it is sourced from the consolidated fund or elsewhere. One respondent commented that even if hypothecation is not mandated by the EC it should be the subject of further debate in the UK.

A wide range of uses for the auction revenues was proposed, including measures to assist organisations, individuals and communities with climate change mitigation and adaptation plus, as noted above, fuel poverty. One of the most common

⁷⁰ For instance one respondent was of the view that funding should be used to reduce carbon emissions in the health care sector specifically. Others considered the monies should be returned to scheme participants.

⁷¹ Few actually named possible funds. One respondent commented that they had suggested a 'Just Transition fund supporting the rapid shift to low carbon economic growth'.

⁷² 'Current examples of hypothecation in the UK environmental legislative portfolio include landfill tax and the PRN system and they are not presumably "at odds with the sound management of public finances" as suggested in the consultation document.'



suggestions was to support R&D into emerging or pre-commercial technologies⁷³ like Carbon Capture and Storage⁷⁴. Another suggestion was that the revenues could be used to offset the electricity price impacts of the EU ETS for energy customers. The majority of responses appeared to assume that the revenues would be used to support organisations/ individuals in the UK (although very few stated this explicitly). However, one respondent suggested that the revenues could be used to support carbon reduction in developing countries too.

Q34. Do you agree with the Commission's proposals to make the basis for distributing auctioning allowances a Member State's share of 2005 emissions?

Around 56% of respondents answered this question. The predominant view was that a single year's data may not be representative and as a result, the majority preferred an alternative approach to the Commission's proposal (29). However, some respondents (17) did support the use of 2005 and others (7) were not sure. They often commented that no solution would be perfect/ there would be winners and losers under any approach.

Figure 40 Summary of responses to Question 34

Q34 Do you agree with the Commission's proposals to make the basis for distributing auctioning allowances a Member State's share of 2005 emissions?

	Number of respondents	% of all respondents	% of respondents to this question	Number of respondents
No answer	41	44%		
Yes	17	18%	32%	
No	29	31%	55%	
Not sure	7	7%	13%	
No...Support UK Government	3	3%	6%	
No...2005-7 instead	12	13%	23%	
Single year not representative	18	19%	34%	
Nothing's perfect	7	7%	13%	
Need to amend historic data (expansion/ scope changes)	5	5%	9%	
Total number of respondents to this question	53	56%		

A small number stated explicitly that they agreed with the UK's position. The most common alternative suggestion was that 2005-7 be used as the base year. A number of organisations commented that any historic data would need to be adjusted to ensure that the coverage matched the Phase III coverage (taking into account expansion/ any changes in scope).

Q35. Do you agree with the UK position that there should not be a system of redistribution of allowances to be auctioned? If not, why not?

Around 57% of respondents answered this question and amongst those that did there was strong agreement (85%) with the UK view. A small number of respondents (2) agreed with the Commission's proposal while a few others (4) neither agree nor disagree on UK's position but mentioned their concerns.

⁷³ A number of supporters of this approach commented that it was important that Government should not 'pick winners' and that such funding should not distort the carbon market or transgress State Aids rules.

⁷⁴ Illustrative example of a technology only; this was not the only technology suggested for support.



Figure 41 Summary of responses to Question 35

Q35 Do you agree with the UK position that there should not be a system of redistribution of allowances to be auctioned? If not, why not?

	Number of respondents	% of all respondents	% of respondents to this question	Number of respondents
No answer	40	43%		
Yes	46	49%	85%	
No	2	2%	4%	
Not sure	4	4%	7%	
Did Not Answer	2	2%	4%	
...use for fuel poverty/climate protection & tech devpt	23	24%	43%	
Total number of respondents to this question	54	57%		

The most common concern raised was that funds generated from an environmental policy should not be used for economic development or to bridge the economic differences between MS⁷⁵. A number of organisations (6) considered further clarification on how the 'auction pot' will be divided essential. The same number of respondents supported the redistribution of allowances for electrically intensive activities.

Other comments specific to this question included:

- ◆ concern over the lack of reporting requirements on the use of proceeds from the redistribution of allowances, which would not be a concern if the allowances were allocated; and
- ◆ that moves towards greater auctioning may direct emissions revenue outside the climate agenda, leaving low carbon initiatives under-resourced and exposed to conflicting investment signals.

Q36. Do you agree with the Commission's proposal for a Regulation to ensure auctions are open, transparent and non-discriminatory?

Around 62% of respondents answered this question. The overwhelming majority of those that did (97%) agreed with the need to ensure that auctions are open, transparent and non-discriminatory (although not all stated explicitly that they agreed with the Commission's proposal to achieve this). Very few respondents were not sure (2).

Figure 42 Summary of responses to Question 36

Q36 Do you agree with the Commission's proposal for a Regulation to ensure auctions are open, transparent and non-discriminatory?

	Number of respondents	% of all respondents	% of respondents to this question	Number of respondents
No answer	36	38%		
Yes	56	60%	97%	
No	0	0%	0%	
Not sure	2	2%	3%	
...open and transparent	19	20%	33%	
...accessible to small emitters	17	18%	29%	
...process predictability – timing, frequency & volumes	5	5%	9%	
Total number of respondents to this question	58	62%		

Respondents called for a regulation to ensure openness and transparency (19); ensuring that auctions to small emitters and SMEs was also a common concern

75 Various organisations commented on alternative uses for the auctioning revenue (see Q33).



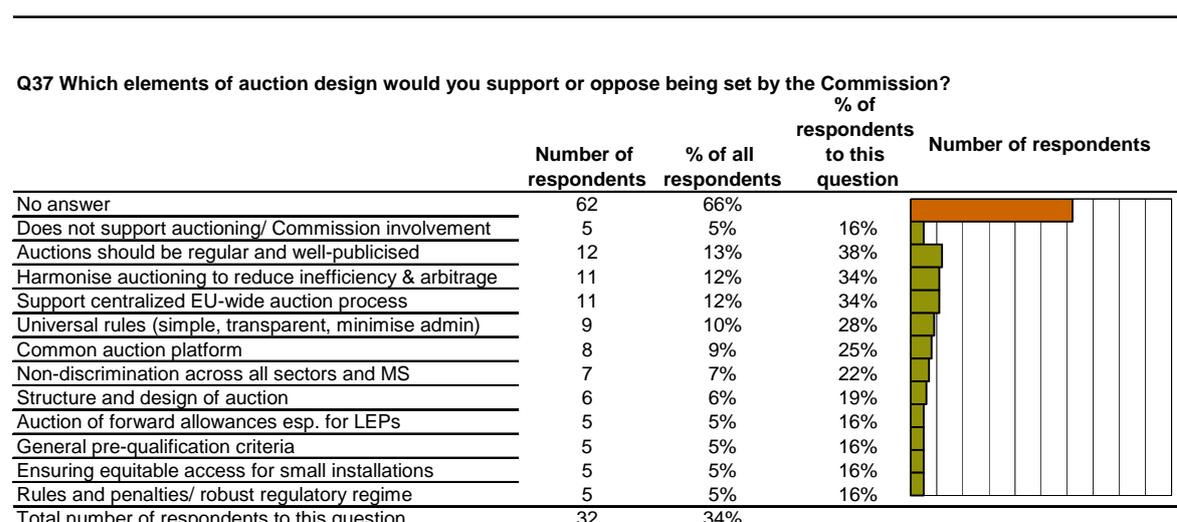
(17)⁷⁶. It was also considered that such a regulation could affect the predictability of the auctioning process (i.e. the timing, frequency and volumes available for auction). Other features of the proposals considered important (each supported by a small number of respondents) included:

- ◆ that it support the avoidance of collusion, market manipulation and abuse of dominant position;
- ◆ that national (UK) industry should not be disadvantaged;
- ◆ that the auctions should only be to EU ETS participants in order not to distort secondary market;
- ◆ that it must assist simple and efficient auction;
- ◆ that it must not impose unreasonable financial burdens (especially on small emitters); and
- ◆ that clear definitions of the terms such as 'non-discriminatory' are essential to avoid abuse of regulation.

Q37. Which elements of auction design would you support or oppose being set by the Commission?

Only around 34% of respondents provided an answer to this question. A small number of respondents (5) took this opportunity to reiterate that they did not agree with auctions at all. The remainder noted which areas they consider the Commission should be involved in (those areas that received the most support are listed in the chart below). There was some consensus (amongst those who considered there is a role for the Commission at all) that its key purpose should be to harmonise the rules and ensure an equitable approach (between participants and MS). There was also a view that it could play a co-ordinating role to avoid adverse impacts on the market and ensure predictability (there was some support for centralised auctioning).

Figure 43 Summary of responses to Question 37



Note: Member State (MS). Large Electricity Producer (LEP)

⁷⁶ A small number commented that there should be intermediaries to assist small emitters and also for data and information protection of buyers.



Q38. Do you agree with the Commission's proposed timetable for the auction design regulation of 31 December 2010?

Less than half (47%) of respondents answered this question and views were polarised; around 48% of those that answered agreed with the proposals but the remaining 52% did not (considering that the timescales were too long).

Figure 44 Summary of responses to Question 38

	Number of respondents	% of all respondents	% of respondents to this question	Number of respondents
No answer	50	53%		
Yes	21	22%	48%	
No (too short timetable)	0	0%	0%	
No (too long timetable/too late)	23	24%	52%	
Not sure	0	0%	0%	
No, auctioning should/ is planned to start earlier	20	21%	45%	
date given: auctions in 2011 at latest	12	13%	27%	
date given: regulation in 2009 at latest	10	11%	23%	
Total number of respondents to this question	44	47%		

Many of those that answered 'yes' did not justify their response; those that did commented that it appeared to leave sufficient time to fit with other decisions/ their needs for internal decision making.

The slight majority that disagreed had very clear and strong arguments for doing so. These organisations included: all but one of the LEPs that answered this question (9 in total)⁷⁷; a regulator; an industry body; and a number of other industrial businesses.

The central reason for disagreement was that this date would not provide sufficient time for the auctions to start well before 2013. Many respondents called for the auctions to start in 2010 or by the end of 2011 at the latest, and for the design regulation to be ready by the end of 2009 or sooner. The reasons given for this were:

- ◆ to support the operation of other commodity markets; including electricity, which is traded 1-2 years in advance and needs to be aligned with the carbon market;
- ◆ to reduce the financial risk of the carbon market i.e. improve carbon market liquidity and avoid volatility; and
- ◆ allow participants to gain experience in auctioning process.

An electricity industry body highlighted the need for a common market for EUAs, and supported a single market. They also called for an early review of the operation of the Commission Regulation and that, if anomalies arise in the market resulting from the process of individual Member States' auctions, the Directive should be amended. A large electricity producer called for Member States to be able to choose when they auction their first allowances, to allow the benefits of early auctioning to be made available.

⁷⁷ The electricity industry provided some detailed explanations including those listed in the bullets below. One company has undertaken an analysis of the financial exposure created by starting the auctioning too late which they offered to discuss in detail with Government. Some of these respondents agreed with the alternative timetable provided by the sector association.



Linking to other trading systems and project credits

Q39. Do you agree with the Commission proposal to include the possibility of linking to national, sub-federal or regional entities? If not, why not?

Just under 60% of respondents answered this question and the vast majority (55) agreed that the ETS should be linked to other trading schemes. A considerable number (33) cited a number of issues that would need to be considered and principles that other schemes would need to adhere to).

Most respondents supported linking to both national and regional schemes however one NGO had reservations about linking to sub-federal ones and another respondent considered there could be national sovereignty issues in linking with sub-federal or regional entities.

Figure 45 Summary of responses to Question 39

Q39 Do you agree with the Commission proposal to include the possibility of linking to national, sub-federal or regional entities? If not, why not?

	Number of respondents	% of all respondents	% of respondents to this question	Number of respondents
No answer	39	41%		
Yes	22	23%	40%	
Yes with caveats	33	35%	60%	
Not sure	0	0%	0%	
No	0	0%	0%	
Equivalence	21	22%	38%	
Credibility/ confidence / integrity	9	10%	16%	
Price impact	6	6%	11%	
Feasibility/ practicality	4	4%	7%	
Fungibility/ verifiability	4	4%	7%	
Total number of respondents to this question	55	59%		

The benefits of linking that were cited included: increased flexibility and market liquidity; stabilising investor expectations and ensuring that reductions are made at the lowest cost. One trade association considered that maximum access to third country project credits is essential if the European economy is not to be disadvantaged.

Common issues included the need for: equivalence of schemes (21); linking with schemes that have (environmental) integrity (9); compatible rules and boundaries (including a consistent basis for setting caps) (4); alignment in design and structure including fungibility and mutual recognition of units (4). Respondents also commented that similar MRV requirements and compliance/ enforcement requirements would also be necessary.

In addition to considering practicalities, there was also a concern that care must be taken to avoid a detrimental impact on the EU ETS market/ prices (6). There was a common theme that there must be sufficient market transparency to avoid price shocks and that EU ETS participants must be provided with adequate notification and information before any changes were made.

Several respondents considered it was preferable to link with other Schemes that are covered by an international climate agreement post-2012. Although there was also a view that it would be important to allow some linking in the absence of such an agreement or even with parties that have not ratified an agreement.



A number of respondents considered that criteria would need to be developed against which other trading schemes could be assessed prior to linking (see also Q40). In addition to those listed above, some additional considerations for linking are set out in the table below.

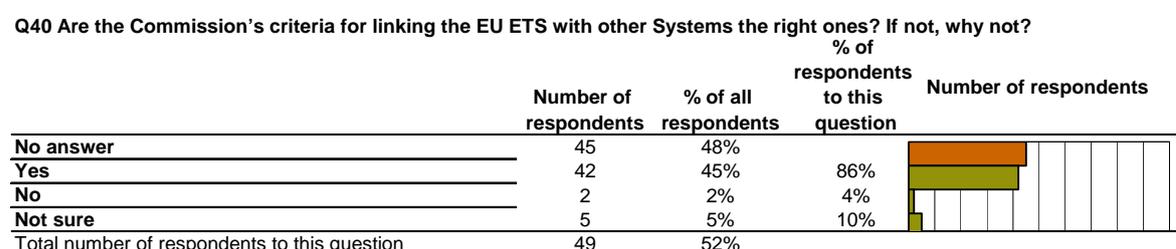
Table 10 Additional considerations prior to linking

Respondent	Additional consideration
Power company	- Only link to schemes which have already been through introductory stage - Only link at the start of an ETS “period” (allocation or compliance period)
Trade Association	Provided access works both ways
Regulator	Preference should be given to linking with schemes that operate within a Kyoto Protocol successor framework.
Energy company	Mandatory, regulated markets only

Q40. Are the Commission’s criteria for linking the EU ETS with other Systems the right ones? If not, why not?

Just under half of respondents did not answer the question. Of those that did, around 45% (42) agreed that the Commission’s criteria for linking the EU ETS with other systems were the correct criteria. A small number (2) did not agree that the Commission’s criteria for linking were the right ones and a further (5) were not sure.

Figure 46 Summary of responses to Question 40



There was a general view that it is important to maintain the integrity of the EU ETS by linking only with similarly robust and competitive (i.e. comparable) systems (several respondents, across sectors). There was some support for the general premise of using criteria to ensure this, in order to facilitate linking (seen as a bridge to a global scheme and a step towards an international agreement).

Some respondents did not agree with all criteria, just some of them. For instance, (similar) MRV⁷⁸ was supported by a small number (6); intervention measures also had some support (8)⁷⁹; and others suggested the type and level of credits from domestic and international projects and systems.

Just under half of respondents answering the question agreed with the criteria at a high level but disagreed with specific criteria or made suggestions. A common area of disagreement was around banking and borrowing (10). Respondents requested that there be further consultation around the criteria; other suggestions included:

⁷⁸ For instance, one respondent commented that a linked scheme must provide access to data (historic emissions, allocations, and verified emissions) at a similar level to that provided about the EU ETS.

⁷⁹ One respondent commented that there should not be linking with those with price caps.



- ◆ a transparency test for equivalence (several respondents, across sectors);
- ◆ allowance price;
- ◆ relative effort required between EU ETS and potential linked scheme; and
- ◆ demonstration of price stability;

One respondent commented that the criteria should comprise the minimum level of desirability. Another suggested that any IA should be entrusted to an independent body (rather than the EC). It was suggested that the EU engages with third countries developing national emissions trading systems, e.g. via the International Carbon Action Partnership.

Respondents raised a number of questions including those listed below.

- ◆ Who will be responsible for solving issues of equity quickly?
- ◆ Will the decision to link be taken on political rather than technical grounds?
- ◆ How will linked scheme compliance periods/phase lengths impact on the EU ETS market?

Q41. Do you agree that consideration should also be given to the type and limits allowed on credits from baseline and credit Systems?

Around half of respondents answered this question. In total 85% of organisations that did (39) argued that some consideration should be given to the type of credits and/ or that limits on them should be allowed. Only a small number (3) commented that they should not be and several more (4) were not sure or requested further information.

Figure 47 Summary of responses to Question 41

Q41 Do you agree that consideration should also be given to the type and limits allowed on credits from baseline and credit Systems.

	Number of respondents	% of all respondents	% of respondents to this question	Number of respondents
No answer	48	51%		
Yes	24	26%	52%	
Yes with caveats	15	16%	33%	
No	3	3%	7%	
Not sure	4	4%	9%	
Limits...set as %	5	5%	11%	
UNFCCC style scrutiny of credits/ guidance	5	5%	11%	
Type limited	4	4%	9%	
Only established/ comparable schemes	3	3%	7%	
EU ETS not compatible w/ baseline & credit schemes	2	2%	4%	
Total number of respondents to this question	46	49%		

Respondents commented that credits should only be permitted if they are from similarly rigorous (i.e. similarly assessed) systems that are comparable and established like the EU ETS. There was a view that, particularly given the vast array of emissions trading systems being proposed (e.g. even just within the US) it was necessary to consider the type of credit and limits. A petrochemicals company suggested making sure that credits were assessed and verified rather than prohibiting the use of credits from baseline and credit systems. Several respondents noted their preference for restricting the use of credits from developing countries and one respondent preferred credits from domestic action only.



An LEP considered that there should be limits to the type and volume of credits coming from baseline and credit systems, another two utility companies echoed this sentiment. A large oil and gas company considered that there wouldn't need to be a limit to volume if credits were UN approved/ accredited.

A couple of respondents were sceptical that allowing credits into the EU ETS from outside of the system would not favour meeting a stringent cap. One of these respondents went to the extent of recommending varying limits for credits dependent on the cap or reductions targets and domestic contribution to meeting this.

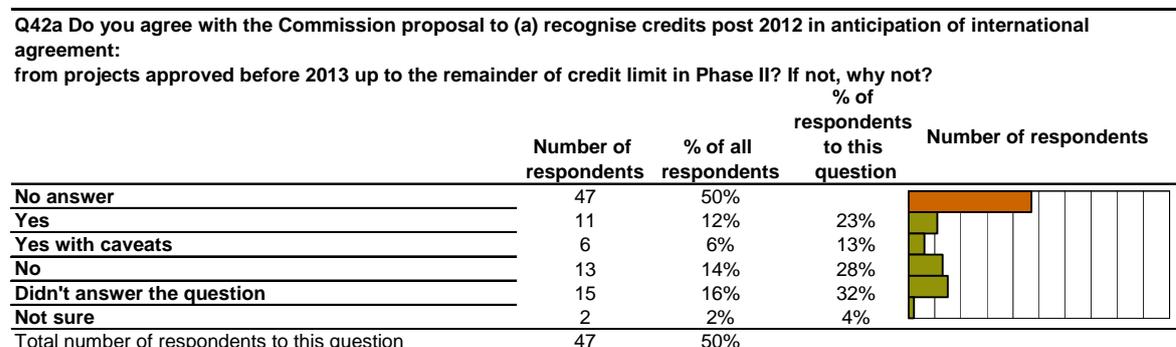
The real concern seemed to be that allowing inappropriate credits into the EU ETS (and linking with inappropriate systems) could jeopardise EU ETS market certainty, integrity and carbon price. With this in mind there was a feeling that there is a trade-off between cost effective reductions and robustness. Some also consider there to be a balance between moving towards international agreement and ensuring EU ETS integrity.

Q42. Do you agree with the Commission proposal to recognise credits post 2012 in anticipation of international agreement:

Half of respondents answered this question. 36% of the respondents that answered broadly agreed with the proposal (this includes those who agreed with various provisions). 28% disagreed, 4% were not sure and 32% did not answer the question directly but provided feedback at a general level. The strength of feeling was relatively evenly mixed.

a. From projects approved before 2013 up to the remainder of credit limit in Phase II

Figure 48 Summary of responses to Question 42a



Few respondents provided reasons (many just provided a straight 'yes'). However, reasons given included that:

- ◆ Maximum flexibility should be encouraged to reward environmental improvements in non-annex countries and to ensure reasonable compliance costs for EU ETS participants;
- ◆ It is an effective way of balancing investment without undermining the EU's international negotiating position.

There was some concern around the credit limits proposed, in particular that they are not set at the right level, that they are too low or should 'go further than this' (by allowing limited use of project credits from projects approved after 2013 beyond the Phase II credit limit). There were also some concerns around CDM in the absence of international agreement post-2012.



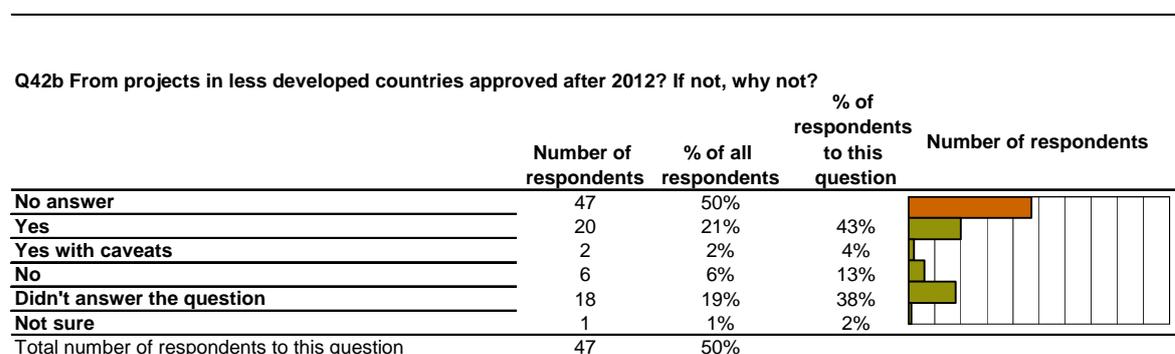
- ◆ Several respondents made similarly themed arguments for disagreeing with the proposal (rather than just qualifying their agreement). Some argued that reduced credit scope reduces world reduction outcome and discourages international company-wide reductions. There was also concern that it will stall CDM and other international projects, and so, it is argued, deprive developing countries of technology transfer and investment. The adverse impact on the carbon price was also noted (by similar respondents).

There was some concern that the carry over of Phase II credits and the perpetuation of different surrender limits runs counter to creating a level playing field.

b. From projects in less developed countries approved after 2012?

A larger number of respondents broadly agreed with 42b than 42c; around 13% disagreed with the proposal and 38% did not directly answer (a small number were unsure). The strength of opinion was pretty mixed amongst respondents. There was much less specific comment about this limb of the question in comparison to the first part of the question.

Figure 49 Summary of responses to Question 42b



Some respondents see CDM projects as a transition mechanism to engage least developing countries in the mitigation of the climate change (they consider it unlikely that these countries will be involved in negotiating absolute emission reduction targets during Phase III).

There was some agreement with the provisions, subject to getting credit limits correct in view of the possible compliance burden on European business. One respondent commented that the Commission should clearly define “least developing countries”.

c. Subject to the potential exclusion of CERs from particular projects established before 2013 by individual Member States? If not, why not?

There was a clear view amongst respondents that this part of the proposal was not acceptable (17% agreed compared to 49% that disagreed). A common view was that ‘the ability for a single Member State to veto certain types of credits needs to be removed’ 34% did not respond directly about this part of the proposal but made some useful points which are covered earlier.



Figure 50 Summary of responses to Question 42c

Q42c Subject to the potential exclusion of CERS from particular projects established before 2013 by individual member states? If not, why not?

	Number of respondents	% of all respondents	% of respondents to this question	Number of respondents
No answer	47	50%		
Yes	8	9%	17%	
No	23	24%	49%	
Didn't answer the question	16	17%	34%	
Not sure	0	0%	0%	
Total number of respondents to this question	47	50%		

Where respondents cited reasons for disagreeing with this part, four key reasons were reiterated by several respondents across sectors.

- ◆ It creates uncertainty for project developers and investors.
- ◆ This should be tackled multilaterally through the UNFCCC and/ or the CDM Executive Board. There was a view that If projects are approved by the EB these CERs should be accepted into the EU ETS, particularly given that the UK/ EU has formally agreed to that type of project being used in the international process.
- ◆ It runs counter to a level playing field. The exclusion of CERs from certain projects by individual Member States should be harmonised to avoid one Member State accepting a project type.
- ◆ 'Gold standards' are inappropriate either by third parties or Member States. If one Member State chooses to impose additional constraints then this should not be allowed to impact on all other MS.

Other reasons included that this would reduce the number of certified emissions reductions (CERs) on the market, and would increase costs. An energy producer noted that accepting only project types that were accepted by all Member States during 2008 is ambiguous and could lead to a two-tier CER market.

Q43. Do you agree with the Commission proposal that once an international agreement is reached:

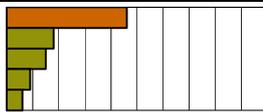
a. Access to project credits to increase by 50 per cent of the increase in absolute emissions reductions (i.e. half of the shift from the 20 per cent to the 30 per cent greenhouse gas emissions reduction target). If not, why not?

Around half of respondents answered this question. Amongst those that did opinion was split, with slightly more agreeing with the Commission's proposal to increase access by 50% of the increase in absolute emissions reductions.



Figure 51 Summary of responses to Question 43a

Q43a Do you agree that once an intl agreement is reached: a Access to project credits to increase by 50% of the increase in absolute emissions reductions. If not, why not?

	Number of respondents	% of all respondents	% of respondents to this question	Number of respondents
No answer	46	49%		
Yes	18	19%	38%	
No	15	16%	31%	
Didn't answer the question	9	10%	19%	
Not sure	6	6%	13%	
Total number of respondents to this question	48	51%		

A number of respondents from the cement and lime sector considered that the proposed approach was far too complicated. One trade association stressed the need for independent auditing of projects to avoid double counting and delivery of carbon savings.

Although a relatively large number of respondents agreed that access to project credits should increase following international agreement, views differed on the appropriate limits. Respondents from the power sector considered that access to project credits should increase even if international agreement is not reached to protect industry. Views could be grouped into three as follows.

- ◆ *No limit* – Several respondents considered that there should be no limit to the number of project credits that could be used to meet the reduction target once international agreement had been achieved.
- ◆ *Different limits* – Some respondents considered that the limit should not be 50% of the increase in emission reduction (half of 10% – 5%) but 50% of the total emissions reductions (i.e. half of the 30% – 15%). One power company considered that it should be half of the total emissions reduction whether it was 30% (with international agreement) or 20% (without).
- ◆ *No access to project credits* – One NGO gave a detailed response on why there should be a 30% economy wide reduction target even in the absence of international agreement to be delivered entirely within the EU.

The rationale for these views was as follows.

- ◆ *Impact on CDM/JI markets* – A trade association was concerned that the proposed approach could reduce demand for CERs and Emission Reduction Units (ERUs).⁸⁰
- ◆ *Definition of international agreement* – Several respondents considered that the definition of international agreement needs further clarification.
- ◆ *Sharing between installations* – A power company considered that there needs to be a mechanism that shares the increased use of credits between all installations. An oil major were concerned about the distribution between installations and considered that detailed implementation proposals should be published.

80 “The 20 per cent scenario could lead to a situation whereby operators chose to use their full quota of CDM/JI credits in Phase II to meet their cap and bank their EU allowances to Phase III where stricter emissions limitations apply. This could mean that projects developers will have no market post-2012.” The association also points out that if international agreement is reached “the total expected CER/ERU demand for Phase III will be 128 Mt, with an average of 79 MT/year. This is less than half of the current demand in Phase II.”

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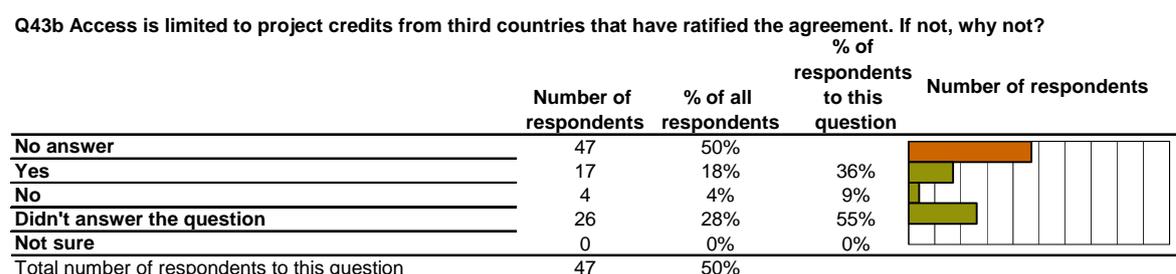


- ◆ *Impact on market liquidity* – One trade association considered that increased access to project credits would increase market liquidity whilst another considered the proposed increase in access would not be sufficient to improve liquidity.

b. Access is limited to project credits from third countries that have ratified the agreement. If not, why not?

A smaller number of respondents answered this question. Of those that did, the majority (17) agreed that project credits from countries that have ratified the agreement should be preferred compared to a smaller number that did not (4).

Figure 52 Summary of responses to Question 43b



The following reasons were given in support:

- ◆ improves environmental integrity of scheme;
- ◆ consistent with current approach under Kyoto Protocol; and
- ◆ provides incentive for third party countries to ratify.

One NGO agreed in the interests of the international harmonisation of rules.

Respondents from the cement and lime sector were opposed as they considered the ratification process takes too long and could have a negative impact on international trade. They consider that project developers should be set a deadline instead. An oil and gas company considered that the definition of eligible project developers was too restrictive (details provided in response).

Q44. Do you agree with the Commission proposal that if an international agreement is delayed beyond 2013, the European Community should seek bilateral agreements with third countries to enable access to project credits to the extent that the limits from Phase II have not been used up? If not, why not?

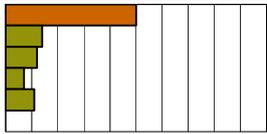
Around half of respondents (47%) answered the question. Around half of respondents that did were broadly in agreement with the proposal. A further 16% of respondents disagreed with the proposal and 25% did not directly answer the question. Overall, responses were quite mixed and there was no particularly strong view.



Figure 53

Summary of responses to Question 44

Q44 Do you agree that if an int agreement is delayed beyond 2013, the EC should seek bilateral agreements with third countries to enable access to project credits to the extent that the limits from Phase II have not been used up? If not, why not?

	Number of respondents	% of all respondents	% of respondents to this question	Number of respondents
No answer	50	53%		
Yes	14	15%	32%	
Yes with caveats	12	13%	27%	
No	7	7%	16%	
Didn't answer the question	11	12%	25%	
Not sure	0	0%	0%	
Total number of respondents to this question	44	47%		

Where respondents explained why they agreed with the Commission's proposal, it was on the grounds below.

- ◆ Bilateral agreements – important for bridging the gap between the end of Phase II and continuing to incentivise Developing Nations to continue to reduce emissions. Failure to engage key Developing Nations on any level will jeopardise the global carbon market and make achieving an international agreement even more difficult.
- ◆ Flexibility: the proposal provides flexibility for compliance.

Access and limits. There was a view that bilateral agreements with third countries should enable access to project credits up to an overall level of 50% of the Phase III reduction effort. Some considered that there should be a more liberal process for CCS projects. Others argued that the Commission should seek bilateral agreements even if the limits have been used up. Another respondent suggested that there could be a framework with criteria on the nature of agreement required for each kind of credit.

Credit quality. There were a considerable number of comments on credit quality. A range of respondents (6) argued that the quality/integrity of credits should be maintained in line with UNFCCC standards. There was a view that they must be genuine, sustainable and fully verifiable to a standard comparable to that agreed by the CDM Executive Board.

The main concerns about the proposals are listed below.

- ◆ Cap and leakage: if the cap is set at 20%, this is too low to allow any use of external credits; employing 'unused' credits from Phase II would cause a large leak from the already inadequate cap.
- ◆ Access to credits: this should be determined at harmonised EU-wide levels to avoid intra-EU competitive distortions and/ or ensure level playing field (4).
- ◆ No need for bilateral agreements: CDM credits meeting the Linking Directive criteria and generated after 2013 should be accepted regardless of the progress on an international agreement – so there is no need to establish bilateral agreements with third countries – a large energy producer.
- ◆ On principle: the proposal adds complexity, causes distortion, and weakens the EU's international negotiating position.
- ◆ Respondents not answering the question directly made the following points or suggestions:
- ◆ On bilateral agreement criteria: Further details required on the criteria for selecting partner countries and the likely structure of these agreements – 2



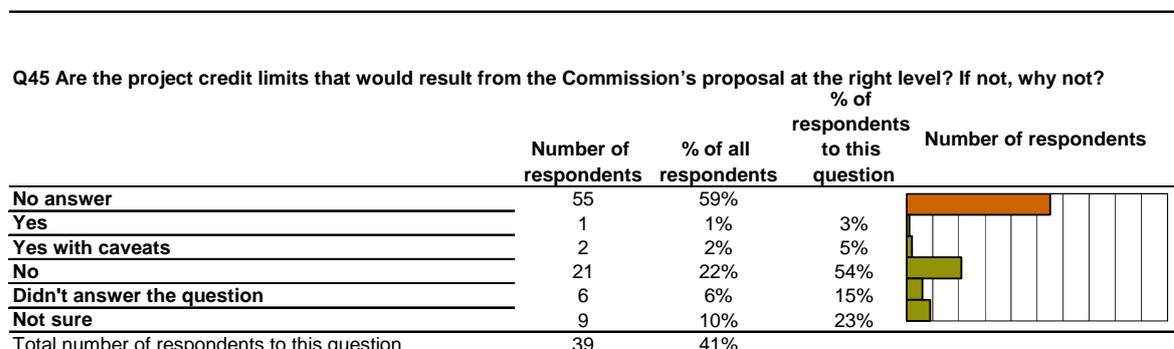
trade bodies; and greater certainty on the types of projects allowed under bilateral arrangements – 2 trade bodies.

- ◆ On access to project credits and limits: limits are not required; CDM credits should continue to be accepted (approved prior to 2012) which are capable of meeting the market demand for the limits proposed – 2 from the chemical industry.
- ◆ 2013 is too late for action: ‘The Commission cannot let the CDM market fail and then negotiate bilateral agreements’ – a large energy producer. Certainty to long-term investments should be provided now or action taken now to provide this.
- ◆ Further work identified: Further debate is necessary on any limit; Whether (or not) bilateral agreements undermine the original intent to limit credits to projects established prior to 2013.

Q45. Are the project credit limits that would result from the Commission’s proposal at the right level? If not, why not?

Only 41% of respondents responded to this question. Of those that did respond, the majority disagreed with the project credit limits – the general feeling is that they are too restrictive and a number suggested there should be no limits at all. One respondent commented that the proposed limits “are too restrictive and are not in keeping with the scheme’s aim to reduce CO₂ at the lowest price. The overall objective of reducing CO₂ should be adhered to; it doesn’t matter where this occurs.”

Figure 54 Summary of responses to Question 45



A small number of respondents reiterated that the limit should be 50% of the total reduction effort not 50% of the increase in reductions regardless of the level of use in Phase II. Other respondents considered that the proposed approach would penalise UK industry given that the use of project credits in Phase II was low in the UK. One energy company considered that there needed to be a separate cap for Phase III irrespective of whether there is international agreement⁸¹.

As discussed in question 43a above, a trade body commented that the limit was too restrictive and may have a negative impact on the CDM/JI market. A respondent from the aviation sector did not agree with the limit as “the limits set for Phase II are insignificant in comparison to the exposure.”

81 Which can then be increased following conclusion of an acceptable international agreement.

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A number of respondents had been unable to undertake an analysis of the proposed limit and could not comment on whether the limit was appropriate. One trade body commented that the proposals are complex and further study may be necessary. A regulator was unable to say whether the level was correct but commented they “support restrictions on the use of project credits in order to encourage domestic reductions to help achieve the EU’s overall 2020 reduction targets.” An oil major considered the appropriate limit would depend on the negotiations and final agreement struck in Copenhagen in 2009.

Only one respondent (an electricity company) agreed with the limit for the reasons that it: ensures domestic abatement; assists in the environmental integrity of the scheme and assists in providing a stable carbon price.

Some respondents agreed but with caveats. One charity was unsure how to interpret the Commission’s approach and would only agree with the limit if it were 5% (half of the 10% difference). A power company considered that the limit seems correct but may need to change if international agreement is reached.

Q46. Do you agree that the project credit limits in Phase III should be harmonised? If so, how can this be best achieved?

This question was answered by about 43% of respondents. In general there was agreement with the Government that project credit limits in Phase III should be harmonised between Member States (70% of those that responded). The most common reason in support was that the current system of allocation could lead to market distortions.

Figure 55 Summary of responses to Question 46

	Number of respondents	% of all respondents	% of respondents to this question	Number of respondents
No answer	54	57%		
Yes	28	30%	70%	
No	1	1%	3%	
Yes with caveats	9	10%	23%	
Not sure	2	2%	5%	
Total number of respondents to this question	40	43%		

A range of methodologies to harmonise the limits were proposed.

- ◆ Some respondents agreed with the Government suggestion that a new limit could be developed from 50% of the reduction between Phase II allocations and the level of the cap in future years. There was a view that this method would be more in line with the approach taken to set a central EU cap.
- ◆ One respondent suggested following the method undertaken by Norway during Phase II of the EU ETS⁸².
- ◆ Another suggested that the limit could be set to 100% of the reduction between Phase II and the level of the new cap in each year.

⁸² The Norwegian project credit limit is 20% of the total allocation. As issued allowances do not cover certain installations, as there are installations that receive no free allowances, each installation is permitted to submit a lower limit, 13%, of its emissions in CERs or ERUs. This lower limit is adjusted during the Phase in order to approach the 20% of issued allowances over the Phase.



- ◆ A few respondents (3) recommended that installations should be allowed to submit a maximum proportion of their verified emissions as project credits, with the proportion set to the maximum use of project credits for the scheme as whole⁸³.

There was a view that a clear methodology for determining credit usage should be included in the Directive.

Q47. What provisions should be made in respect of the scope of recognition of credits in advance of international agreement, in particular should particular sectors be included or excluded in advance, and if not what provisions should be made for inclusion and exclusion of sectors upon international agreement.

Only a third of respondents answered this question. There were a range of views and no clear consensus, but some agreement that no provisions should be made with respect of the scope of recognition of credits in advance of an international agreement, at least not at an EU level. Views were also mixed about the provisions that should be made to include or exclude sectors once an agreement has been reached.

Figure 56 Summary of responses to Question 47a and b

Q47a What provisions should be made in respect of the scope of recognition of credits in advance of international agreement, in particular should particular sectors be included or excluded in advance,

	Number of respondents	% of all respondents	% of respondents to this question	Number of respondents
No answer	65	69%		
No restrictions in advance of int agreement	7	7%	24%	
Not sure	10	11%	34%	
Provisions decided at UN not EU level	6	6%	21%	
Mechanism to oversee/ harmonise project approval	4	4%	14%	
Specific sector identified for excl/inclusion	2	2%	7%	
Single state should not have veto	10	11%	34%	
Total number of respondents to this question	29	31%		

Q47b and if not what provisions should be made for inclusion and exclusion of sectors upon international agreement.

	Number of respondents	% of all respondents	% of respondents to this question	Number of respondents
No answer	64	68%		
Didn't answer the question	15	16%	50%	
Wait for structure of int agreement to be finalised	4	4%	13%	
Should be determined at UNFCCC level	5	5%	17%	
Include all sectors to maximise cost effectiveness	3	3%	10%	
Refers to inclusion/ exclusion of specific sector	1	1%	3%	
Total number of respondents to this question	30	32%		

Reasons in agreement with the UK Government included the view that as new evidence emerges and verification procedures are developed it may be feasible to include new sectors, such as from Reducing Emissions from Deforestation and Degradation (REDD). Another NGO took a similar view and provided the additional example that it may be feasible to include Afforestation and Reforestation (A/R) CDM credits. It also recommended that the feasibility of including these sectors

⁸³ These respondents considered that this would be a simple approach and giving certainty to operators/installations over the number of credits available and developers clarity over the size of the market.



should be reviewed once the structure of a new international agreement was finalised.

Some respondents considered that decisions should be left to the UN to determine on the basis that the review process at the EU level created unnecessary duplication of work. One respondent recommended that all CDM credits that meet the criteria set out in of the Linking Directive and are generated after 2013 should be accepted, regardless of the progress on an international agreement.

A number of respondents (10) agreed with the Government that single Member States should not have a veto over project types included or excluded within the EU ETS. Respondents recommended that harmonising approval procedures across the Member States would be a more constructive process. One respondent suggested that the administration and development of international project credits could be taken on by an EU mechanism or board such as the Government proposed European Carbon Bank.

Some respondents considered that there should be recognition of all sectors within the EU ETS in order to maximise the cost effectiveness of emissions trading on a global basis.

Q48. Do you agree that credits from LULUCF projects could potentially be included in the EU ETS in the future? If so, how can the problems with inclusion of these credits be overcome?

Only a third of respondents answer this question. The majority (24) of respondents who answered this question considered that if the main problems relating to LULUCF projects could be overcome then these credits could be included within the EU ETS. A number of respondents commented on the importance of including this sector within carbon mitigation schemes. However, a small number (1) did not agree that they should be included and others (2) were not sure.

Figure 57 Summary of responses to Question 48

Q48 Do you agree that credits from LULUCF projects could potentially be included in the EU ETS in the future? If so, how can the problems with inclusion of these credits be overcome?

	Number of respondents	% of all respondents	% of respondents to this question	Number of respondents
No answer	64	68%		
Yes	5	5%	17%	
Yes with caveats	19	20%	63%	
No	1	1%	3%	
Didn't answer the question	3	3%	10%	
Not sure	2	2%	7%	
Yes - MRV, additionality, permanence & leakage	13	14%	43%	
Work with UNFCCC/ agree with UN/ allow CDM credits	8	9%	27%	
Total number of respondents to this question	30	32%		

The main concerns related to accurate monitoring, reporting and verification (MRV), and issues surrounding leakage, additionality and permanence of these projects. However, respondents considered that if these issues could be overcome then LULUCF projects should be included within the EU ETS.

Some respondents (8) commented that the EU should take the lead from the UN and include credits that are verified under the UNFCCC. They commented that if these issues had been addressed at the international level, it should also be sufficient at the EU level. However, one respondent stated that even if the issues of LULUCF could be solved at the UN level, these credits should not be included in the EU ETS until the practical or cost-benefit impact had been considered.



A key area raised by some respondents around addressing the issue of permanence. Some respondents highlighted that temporary international credits (tCERs and ICERs) may provide a solution. However one respondent considered that temporary credits were not the sufficiently suitable and credible long term guarantor needed to trade in the EU ETS. The New Zealand Permanent Forest Sink Initiative and the New South Wales Greenhouse Gas Abatement Scheme were identified as examples of LULUCF schemes that have developed measures to overcome the permanence issue.

One respondent highlighted that there were different categories of LULUCF that should be treated separately when considering approval within credit schemes. As an example Afforestation and Reforestation schemes can currently be awarded CDM credit. Respondents outlined that a number of alternative approaches exist to address the temporary nature of LULUCF projects.

Q49. Do you agree with the Commission’s proposal to provide for credits from European Community projects? If not, why not?

Around 43% of respondents answered this question. Of the respondents who expressed an opinion on this, the majority (85%) supported the proposal, some (14) qualifying this with the fact that the credits must be shown to be additional/ be robustly verified. However, a number of respondents (4) commented that they did not agree with the proposal and a further small number (2) were not sure.

Figure 58 Summary of responses to Question 49

Q49 Do you agree with the Commission’s proposal to provide for credits from European Community projects? If not, why not?

	Number of respondents	% of all respondents	% of respondents to this question	Number of respondents
No answer	54	57%		
Yes	34	36%	85%	
No	4	4%	10%	
Not sure	2	2%	5%	
Yes if robust and/or additional	14	15%	35%	
Yes...cost effectiveness	5	5%	13%	
Total number of respondents to this question	40	43%		

The main reason given in support of the Commission’s proposal was the potential to reduce emissions more cost effectively (5).

A small number of respondents were strongly against this proposal, including two environmental NGOs. The main arguments against were:

- ◆ the EU ETS should only drive emissions reductions within the traded sector;
- ◆ there should be other policies in place to reduce emissions outside the traded sector; and
- ◆ the double counting risks are too significant.

Monitoring, Reporting and Verification

Q50. Do you agree with the Commission proposal to introduce a regulation (to be agreed by the Commission-chaired committee of



Member State representatives) to replace guidelines on monitoring and reporting?

Around 59% of respondents answered this question. Opinion was divided, though the need for consistency and robust monitoring and reporting practices was broadly supported. Over half of respondents that provided a view (29) did not agree that there was a need for a regulation; around a third (17) agreed with the proposals and the remainder (9) were not sure.

Figure 59 Summary of responses to Question 50

	Number of respondents	% of all respondents	% of respondents to this question	Number of respondents
No answer	39	41%		
Yes (agree)	17	18%	31%	
No (disagree)	29	31%	53%	
Not sure/ both	9	10%	16%	
Consistent implementation/ enfmt of MRG, not a Regn	11	12%	20%	
Current system works well/ well understood	9	10%	16%	
(Not sure, but) (more) consistency needed	9	10%	16%	
Total number of respondents to this question	55	59%		

There was some support for maintaining the current arrangement (i.e. in agreement with the UK Government) (39). Respondents mentioned that it allows local practices to be reflected and provides flexibility at a national level. A number (9) commented that they consider the existing approach works well and/ or there are benefits in the fact it is now understood. Another common assertion (11) was that the existing guidelines need better enforcement, rather than replacement with regulation⁸⁴. A number of respondents stated that until it has been demonstrated that there is significant variation between Member States, there is not a case for a regulation, or that they would support regulation if a need is demonstrated.

Those that were in favour of a regulation often cited the need for more consistent and rigorous enforcement of the scheme rules. However, not all respondents (e.g. some of those categorised as 'not sure') were convinced that a new regulation would provide this. A trade organisation suggested that a combination of regulation with more flexible guidelines could be the optimum compromise.

Other points included that:

- ◆ a regulation is logical to put these rules on the same footing as the auction rules and the verification and accreditation rules;
- ◆ any changes to be made under a Regulation (comitology via EU ETS Article 23(3)) must be fully consulted on; and
- ◆ any additional administrative burden should be avoided.

⁸⁴ For instance, The reporting of process emissions was cited by a number of cement industry respondents as an area needing more consistent treatment.



Q51. Do you agree with the Commission proposal to introduce a regulation (to be agreed by the Commission-chaired committee of Member State representatives) for harmonised verification and accreditation? If not, why not?

Around 59% of respondents answered this question. There was considerably more support for this regulation than that discussed under question 50. Around 71% of respondents who answered (39) agreed that there should be a regulation for verification & accreditation, however 20% did not (11) and a further 9% (5) were not sure.

Figure 60 Summary of responses to Question 51

	Number of respondents	% of all respondents	% of respondents to this question	Number of respondents
No answer	39	41%		
Yes	39	41%	71%	
No	11	12%	20%	
Not sure	5	5%	9%	
Consistency need (but not nec Regn)	18	19%	33%	
Yes...as long as no more complexity or cost	3	3%	5%	
No...inflexible (e.g hard to update)/ local flexibility	6	6%	11%	
No...existing system works ok (in UK)	6	6%	11%	
No...bureaucratic/ no benefit	1	1%	2%	
Total number of respondents to this question	55	59%		

A strong majority was supportive of this proposal; although a rationale was not always provided, the most common reason stated was that a regulation would enforce consistent and reliable verification and accreditation across all MS.

Those that disagreed were industrial companies, the majority of which were from the cement, ceramics, lime and mineral wool sectors. The main reasons given were similar to those provided under Q50, i.e. that: the current system in the UK works satisfactorily; centralised regulation would reduce the scope for local flexibility; and there is not evidence that a regulation would improve matters. A number of respondents from the cement sector were concerned that the introduction of new regulation would result in the reissue of EU ETS permits and so additional costs.

Other points raised included that:

- ◆ such a regulation may create a monopoly/ oligopoly of verifiers across Europe, disadvantaging national companies;
- ◆ the proposal would be supported as long as it does not result in expensive or complex new administrative requirements.
- ◆ the rule that organisations missing the March deadline would be blocked from trading was not supported.

Q52. Do you agree with the Commission proposal that the excess emissions penalty index should increase automatically in line with the European Index of Consumer Prices? If not, why not?

Around half of respondents expressed an opinion on this point. There was no suggestion that there should not be a penalty, indeed some respondents expressed



their support for one. A strong majority of those that answered (81%) was supportive of the penalty increasing in line with this index. The main reason, where given, was that it is important for the penalty to remain an effective deterrent.

Figure 61 Summary of responses to Question 52

	Number of respondents	% of all respondents	% of respondents to this question	Number of respondents
Q52 Do you agree with the Commission proposal that the excess emissions penalty index should increase automatically in line with the European Index of Consumer Prices? If not, why not?				
No answer	47	50%		
Yes	38	40%	81%	
No	9	10%	19%	
Not sure	0	0%	0%	
Total number of respondents to this question	47	50%		

Some union respondents called for reviews of the price, in order to prevent companies routinely paying the penalty⁸⁵. Several respondents disagreed, giving the following reasons:

- ◆ rate changes should be based on actual events in the system as a whole;
- ◆ the deterrent is already sufficient and annual updates are an unnecessary administrative cost;
- ◆ linking to the EU index could create distortions, as inflation affects MS differently; or
- ◆ it should be based on the price of carbon, e.g. five times the current price.

Q53. Do you agree with the Commission's proposal for a central registry run by the Commission? If not, why not?

Just over half (about 51%) of respondents had no comment or answer with regards to the Commission's proposal for a central registry run by the Commission. About 58% of those that did (28) agreed with the Commission's proposal and a lower percentage (about 31% i.e. 15) did not agree with the proposal and an even lower percentage (about 5% i.e. 5) were not sure or did not give a definitive answer.

Figure 62 Summary of responses to Question 53

	Number of respondents	% of all respondents	% of respondents to this question	Number of respondents
Q53 Do you agree with the Commission's proposal for a central registry run by the Commission? If not, why not?				
No answer	46	49%		
Yes	28	30%	58%	
No	15	16%	31%	
Not sure	5	5%	10%	
Total number of respondents to this question	48	51%		

Of those who did not agree, seven organisations from the chemical, cement and lime sectors stated that they were content with the UK registry, find the registry operator very helpful and are concerned that the current efficient system will be

⁸⁵ It is unclear whether they understood that organisations paying the penalty will still have to buy the allowances they missed.



replaced unnecessarily. Other concerns centred on losing control to a central system and losing lessons already learned/ work already completed. One of the most common comments from a wide range of respondents (even some of those that answered 'yes') was that the delays currently being experienced in this area do not set a good precedent, particularly not where they affect the issuance of allowances. Even those that acknowledged an advantage in holding some registry details centrally were not convinced that this should be at the expense of Member State registries.

Many of those that answered 'yes' did not provide more detail and some of those that answered positively shared the concerns above. Concerns included the risk of teething problems and unnecessary additional costs. One respondent suggested that a central registry should be supported by separate but linked national subordinate registries to guard against 'catastrophic central failure'. Another (which did not agree with the idea) agreed with a similar approach. One respondent stated that consideration should be given to whether this central registry should be run and managed by a European Carbon Bank.

Q54. Do you have any further views on any aspect of the Commission's proposals to amend the EU ETS from 2013?

Respondents provided additional information and commented on a range of different points in response to this question. Refer to Section 0 of this report which presents an overview of the points raised.



Themes by sector

The separate Appendix document to this report provides a detailed breakdown of responses to each question by sector. The purpose of this section is to identify the key issues for different groups of respondent and to highlight where the views of particular groups deviate from the norm or were particularly mixed. This is provided in addition to the organisation- or sector-specific comments and general trends under particular questions in Section 0.

Large electricity producers

Fifteen organisations were classified in the large electricity producers (LEP) sector for the purposes of this project⁸⁶. This was the largest number of respondents from a single sector. A key concern was the fact that allocation to these installations was not a subject for consultation. In the light of the allocation methodology chosen for LEPs, there was considerable comment around auctioning, particularly that the Commission timetable be brought forward, that auctions start in sufficient time to fit with forward contracts, that its level be harmonised across MS⁸⁷ and that auctions be open, transparent and non-discriminatory. There was a relatively strong view that the same allocation approach should apply to the on-site production of electricity but that biomass plant should not be included in the scheme. Views were mixed around whether the allocation methodology to CHP is sufficient.

The sector was generally in favour of the proposals regarding the scope of the EU ETS, with no strong objection for the move to a broad definition. There was also broad support for the Commission's proposals for expanding the EU ETS. Although the sector shared the respondent-wide concerns on the feasibility of MRV for the sources listed, there was support for including CMM and for the methodology proposed for including CCS.

The need for long-term certainty was emphasised again in response to questions on the cap (and potential changes to it in the face of international agreement) and there was strong support for a longer length phase. There was a relatively strong view (when compared to the balance of views over all respondents) that there should not be an EU-wide NER and support for the UK proposal of 1.2% rather than the level suggested by the Commission. Views were mixed on the definition of new entrant.

Other Electricity Producers

Five respondents were categorised as 'other electricity producers' which included a water company and other organisations also included under LEPs⁸⁸. As a result, the views and concerns of this group were consistent with those of the large energy producers (see above). However, views around whether the current guidelines on monitoring and reporting should be replaced with a regulation were somewhat more mixed.

Offshore

There were six respondents from offshore organisations, which included five large oil and gas companies and the sector association. It expressed concern that its sector is not always understood in the context of the EU ETS. Respondents

⁸⁶ This included the Association of Electricity Producers (AEP) and the Carbon Capture and Storage Association (CCSA) since the views of the latter largely aligned with the others in this category.

⁸⁷ The majority of the sector argued against the Government's position on harmonised minimum levels of auctioning across the EU.

⁸⁸ Some organisations were counted under more than one sector in order to ensure that the full range of views was taken into account in this chapter



highlighted that the inclusion of flaring would affect the emissions covered in Phase II and this affected their view on how/ whether it would be appropriate to use historic emissions data in future e.g. to distribute allowances. There was also some concern around the treatment of on-site generation. Respondents argued that there is often no alternative energy source available offshore and did not support 100% auctioning for these installations. The sector association questioned the difference between electricity generation and production and there were also concerns that the allocations proposed for CHP were insufficient.

All the respondents supported the broad definition of combustion installations and the majority agreed all installations should be able to apply for exclusion under the de minimis rule. The sector typically supported the higher de minimis threshold suggested. However, the sector did not agree with the definition of new entrant proposed (6 'no'). The sector association raised concerns around the competitiveness of the UK offshore sector in an international market and commented that this should be considered in any consideration of carbon leakage.

Downstream Gas

There was only one respondent categorised in this sector. It supported the moves to 100% auctioning for all electricity production (not just LEPs) and viewed this as the most appropriate allocation methodology for all sectors not subject to carbon leakage. However, it raised concerns over the potential of restrictions on the use of CERs/ ERUs in the absence of an international agreement. It also did not agree with the proposed definition of new entrant.

Refineries

There were six respondents from the refineries sector, four of which also operate installations in the offshore sector plus another refinery operator and the sector association. As a result, the general views of these respondents corresponded to those expressed by the offshore group.

Key issues raised by the sector association included the risks that full auctioning would present for carbon leakage in the sector. It commented that 100% free allocation was required if the aim of free allocation is to prevent this. The majority objected to the criteria for determining which sectors are at high risk of carbon leakage. Views were split evenly regarding whether the revised list of activities in Annex 1 has achieved a broad definition, but there was a relatively strong view that the definition of a new entrant should include major investments at existing sites. The sector association and others also highlighted that heat use at refineries should be taken into account when calculating allocations four commented that the allocation methodology for CHP was not sufficient.

Chemicals

There were eleven respondents from the Chemicals sector (the second largest sector after LEPs). It included respondents from two sector associations and installation operators. A key issue for this sector was the risk of carbon leakage, including for those that use large amounts of electricity as well as direct emitters (and there was concern around the validity of the criteria proposed by the Commission). There was widespread support for free allocation to address this and for the timely identification of the sectors that are at risk. There was also support for a de minimis rule at a higher emissions level (e.g. 50ktCO₂) to exclude small emitters.

A number of respondents from the sector did not agree with the broad definition of combustion installation proposed. There was some support for expansion of the System to the activities proposed (and to chlor alkali but not necessarily to soda ash



and ammonia). The treatment of CHP and on-site generation was also considered key (that the allocation to CHP should take account of both electricity and heat generation and that on-site generation should not be subject to 100% auctioning). There was wide agreement that free allocation should be based on EU-wide benchmarks (and support for expansion to include only activities that would facilitate their development). There was a mix of views regarding the different issues of new entrants, with an agreement with an EU-wide NER based on a percentage of the overall cap, but concern that the level proposed is too high.

Engineering and vehicles

There were two respondents from this sector. One key issue for this sector is the move to a broad definition of combustion and consequently the inclusion of small combustion units <3MW. The sector considers they should be allowed optional exclusion and highlights that baseline data must be recalculated to reflect the change in scope. It supports a de minimis rule at a higher level (and suggests a 50ktCO₂ limit). The treatment of CHP (the output from which is used on-site) was also a concern; there was a view that allocation based on heat alone is not a sufficient incentive. The sector association supported sector caps and the use of grandfathering rather than benchmarking. It also agreed with the UK Government that the NER proposed by the Commission is too large. The sector flagged itself as one that cannot pass costs through and that is part of a global market, factors it asks are considered in the assessment of risk from carbon leakage.

Aviation

There were four respondents from this sector. The respondents were generally supportive of the inclusion of aviation under the EU ETS. However, they expressed strong concerns around the impact of the extra costs associated with their inclusion, which they argue will reduce the competitiveness of EU-based companies compared to their international counterparts and that they are costs that cannot be passed on. The sector was particularly concerned that the costs may increase the risk of carbon leakage. One respondent highlighted the difference between the economics and drivers of commercial airlines and those that operate aircraft as 'workhorses' (for training or cargo transport).

Land transport

There was one respondent from this sector. A key issue was that the rail industry, by using electricity to power some of its trains, is already affected indirectly by the EU ETS. It argued for the equitable coverage/ treatment of all modes of surface transport in order to avoid competitive distortions. In particular, the respondent suggested that the cost of carbon should be added uniformly across all fuel types. Further, the respondent emphasised that investment decisions in the rail industry are made over long time frames (between 20-40 years) and therefore argued that the Commission should adopt carbon reduction parameters that are not too sensitive to short term fluctuations in fuel prices.

Public sector

The public sector included six organisations including three central government departments/ their representatives, two hospitals and a university. There was considerable concern that these activities should not be included in the EU ETS at all given their critical nature, and a view that other policy mechanisms may be a more appropriate way to incentivise emissions abatement. Although views around some issues varied, a common theme was that the abatement targets set by the EU are not stringent enough and that there is a risk of over allocation of free allowances which will reduce the overall efficiency of the System. There was general support for the proposal to enable all capacities of installation to opt-out. Views were mixed



around whether providing free allowances on the basis of heat output for CHP is sufficient for incentivising the uptake of this technology. There was general support for linking of the EU ETS with other systems.

Food and Drink

Four sector associations responded from the food and drink industry. Views on many issues varied amongst these respondents. The risk of carbon leakage and exposure to international competition was raised by some parts of the sector. The move to a broad definition of combustion installation will affect the scope of food and drink activities covered. These respondents supported the proposal that all installations will be eligible to apply for opt out and preferred the 25ktCO₂ emissions threshold. The treatment of CHP was another issue that was raised as being of concern (that the allocation proposed is insufficient) and there was some support for the exemption of biomass plant.

Pulp and Paper

There was only one response from the paper sector, from the sector association. It listed its primary concern as being the cost of purchasing allowances if auctioning is adopted (and provided estimates of those costs). It does not support the auctioning of allowances and supports free allocation, including for industrial CHP plant (based on electricity and heat output). As an alternative, it supported the exclusion of electricity generators without a supply licence from the general provisions made for electricity generators. The respondent supported the 25ktCO₂ threshold for opt-out and that all installations should be eligible to apply for opt-out. The respondent disagreed with the proposal that on-site production of electricity should face 100% auctioning from 2013 and agreed that free allocation helps to reduce the risk of carbon leakage.

Aluminium

Two companies and the sector association responded from this sector. Overall, they supported the carbon reduction targets set by the Commission but expressed concerns relating to direct costs (purchase of allowances) and indirect costs (via electricity price increases). Suggestions to alleviate this included allocating free allowances for indirect emissions and for energy generated by the industry itself, in both cases based on efficiency benchmarks. It supported the exclusion of emissions from secondary production (recycling) and voiced concerns around the move to a broad combustion definition.

These respondents expressed concerns around the risk of carbon leakage but largely agreed with the Commission's criteria and that free allocation helps to reduce the risk. The respondents back the Commission's proposal to undertake an evidence-based review of the sectors most at risk from carbon leakage.

Iron and Steel

There were two responses from this sector. While there was general acknowledgment that the EU ETS can generate carbon reduction there was a concern that without international agreements for carbon reduction the EU ETS in its current form will increase the risk of carbon leakage and consequently may fail to achieve its targets. Although the respondents generally agreed with the proposals regarding carbon leakage, there was some uncertainty about the role that sectoral agreements could play to reduce the risk. Views were mixed on whether free allocation should be based on EU-wide benchmarks.

Views were also mixed around whether access to project credits should increase once international agreement is reached, although there was agreement that if



agreed the EC should seek bilateral agreements with third countries. One respondent voiced concern that the timing of the consultation was too late to influence decisions.

Cement

There were three companies and two associations from the cement sector. There was a view that the definition of combustion installation creates a disparity in treatment between cement and hazardous and municipal waste installations. The majority of respondents supported the 25ktCO₂ emissions threshold as there are a number of sites below this threshold. Also, there was agreement that all installations should be eligible to opt out. The majority of respondents agreed with the proposed method for including CCS and emphasised that its potential for all activities, not just electricity generation, should be considered. There was also strong agreement that biomass installations should be excluded.

The majority of respondents from this sector considered the cap too low and do not agree with auctioning but did agree with the proposal for allowing borrowing between phases. The majority of respondents disagreed with the proposal that there should be an EU-wide new entrant reserve based on a percentage of the overall cap. Similarly, the respondents disagreed with the definition of new entrant.

Lime

There were two respondents from the lime sector. The views of the lime sector were similar to those of the cement sector. There was uncertainty regarding the proposed method for including CCS. The respondents disagreed with the proposal to introduce a regulation to replace the guidelines on monitoring and reporting.

Glass

Only the trade association responded on behalf of the glass sector. The respondent supports the 25ktCO₂ emissions threshold and that all installations will be eligible to opt out. The respondent also supports the proposal for including CCS. It disagrees with the proposal that on-site production of electricity should face 100% auctioning from 2013 (it argues that this will undermine the investment in CHP). The respondent also disagrees with the Government's proposal on harmonising minimum levels of auctioning across the EU. It argues in favour of harmonising in order to avoid distortion of competition and political induced decisions by pressure groups in Member States. It commented on the methodology to be used to calculate emissions data for CCA opt out installations.

Ceramics

There were three respondents from the ceramics sector, including the sector association. An important issue for the respondents was the definition of installations; the respondents agreed with the Annex 1 broad definition but expressed the desire that all installations should be subject to the same threshold. Respondents supported the proposal that all installations will be eligible to opt out, but there were mixed views around the appropriate emissions threshold. Another key issue for these respondents was the risk of carbon leakage. The respondents disagreed with the criteria for determining what sector is under high risk and argued that the criteria should include competition from alternative materials that do not bear the cost of carbon and are not subject to carbon scrutiny on whole life costs. The respondents disagreed with the proposal that all sectors apart from those deemed at risk from carbon leakage should move to full auctioning from 2013 with some degree of free allocation. All the respondents urged the Commission to undertake a review of which sectors may be at risk of carbon leakage.



Construction/ Mineral Wool/ Wood

There were three respondents from this sector. Views varied somewhat. One respondent highlighted the issue of competitiveness distortions and the risk of carbon leakage. It was also concerned about an automatic revision of the target if international agreement is reached (i.e. that the abrupt revision of targets should be avoided). Another respondent shared this view. It also argued for the consistent EU-wide treatment of rock and glass wool sites that are included under the broad definition. One respondent was concerned by the high costs of auctioning should the sector be included and at the risk of carbon leakage. It urged Government to conduct an IA on the wood panel industry and particularly to examine the risk of carbon leakage. The same respondent stressed that while MRV of emissions from forestry is difficult, it would support the potential inclusion in the future of forestry under the EU ETS.

Coal

There were three respondents on behalf of the coal industry. The coal industry raised serious reservations about the proposals in this consultation. Its views were most consistent with those of the LEP sector. A major concern related to auctioning and the costs for the sector, which it does not agree can be passed on to consumers. Further, it was concerned about the timing required for the full adoption of CCS, which has not yet been tested on a large scale. However, all respondents agreed with the proposed method for the inclusion of CCS.

There were mixed views on the government's position on harmonised minimum levels of auctioning across the EU. There was support for the proposal that on-site production of electricity should face 100% auctioning from 2013. There was agreement with the criteria for assessing which sectors are at risk from carbon leakage and that free allocation can reduce the risk of carbon leakage.

Others

This category includes all the respondents from the remaining sectors. There were 22 respondents in this category representing a large number of activities and interest groups. As a result, different concerns and issues were raised by different respondents and consequently we have not summarised them here. However, since many of these organisations can be differentiated by type (e.g. NGOs, banks), their views are split out in the next section of this report.



Themes by organisation type

The purpose of this section of the report is to summarise themes by type of organisation. The separate Appendix document to this report provides a detailed breakdown of responses to each question by organisation type. We have focussed on those groups where there was a minimum of five respondents.

Single company/ organisation

This was the largest group of respondents with thirty-nine single companies and organisations responding to the consultation.

Single companies/organisations generally agreed with the majority of the proposed extensions to the scope of the ETS however the majority did not agree that a broad definition has been achieved based on the list of activities given in Annex 1 of the revised Directive. There was also mixed opinion over the inclusion of agriculture and forestry with the majority strongly opposed but a number open to possible future inclusion. There was general opposition to the inclusion of the EU land management sector amongst these respondents.

Cap

There was general agreement with the level of the central cap proposed by the Commission for meeting a 20 per cent EU GHG reduction target however a number of companies/organisations considered it was too high/slack. The majority agreed with the linear emission reduction trajectory however a few disagreed with the proposed approach.

The majority did not agree with Commission's proposal for an automatic adjustment to a target when international agreement is reached and could not see a role for a European Central Bank. Views over the appropriate phase length were mixed with the majority favouring a shift to 8 years however a fairly large number favoured longer phases whilst an equal number favoured 5 years.

Allocation methodology

Views around the proposed allocation methodology were strong, with a number of companies expressing concern over the impact on competitiveness. The majority disagreed with the Commission's proposal to base the distribution of auctioning allowances on a Member State's share of 2005 emissions. There was also a widely held view that the Commission's proposed timetable for the auction design regulation was too long.

The respondents generally disagreed with Government and commented that hypothecation was acceptable. Most of the companies/organisations who responded did not think that free allocation for heat produced under CHP provided an adequate incentive for the technology. Views over whether on-site generation of electricity should face 100% auctioning were fairly split. The majority did not think on-site generation should be subject to full auctioning however a number of respondents agreed with the Commission and thought that it should (or should except for CHP).

Carbon leakage

Views around whether all sectors not exposed to carbon leakage should move to full auctioning, with free allocation starting at 80% of their share of 2005-07 emissions, were very mixed. The majority of companies did not agree with the Government's position on harmonised minimum levels of auctioning across the EU. A number of respondents thought that the use of GVA to assess increase in production costs was



inappropriate and that profitability should be considered instead. Several respondents also criticised the proposed approach as it is based on historical data and does not consider the ability to attract international investment.

The majority of respondents thought that free allocation would help to significantly reduce carbon leakage, however a number emphasised the need to fully factor in the impact of indirect electricity costs when accessing the allocation levels. A number of companies thought that some sort of border adjustment might be a potential alternative to free allocation to prevent carbon leakage. Support for sectoral agreements was not strong however.

Benchmarks

The majority of companies supported the use of EU-wide benchmarks to determine the levels of free allocation however a number of respondents were unsure. A number of alternative approaches, such as the use of grandfathering, were also suggested. The majority of companies/single organisations did not agree with the Commission's proposal to not have sector caps, with harmonised bottom-up benchmarks used to divide up the sub-cap for free allocation. Whilst the majority agreed that there should be an EU-wide new entrant reserve, a number disagreed.

New Entrant's Reserve

There was support for the Government's view that the NER should be 1.2% of the overall EU cap not 5%. The majority did not agree with the definition of a new entrant in the Commission's proposal.

Linking to other trading systems and project credits

There was support for linkage to other trading systems, however a number of respondents set out a number of caveats. The answers to a number of questions on the details of linking were confused and there was no clear stance on the Commission's proposal to recognise credits post 2012:

- in anticipation of international agreement from projects approved before 2013
- from projects in less developed countries approved after 2012

The majority did not agree with the Commission's proposal to recognise credits post 2012, subject to the potential exclusion of CERs from particular projects established before 2013 by individual Member States. There was also opposition to proposed limits on the use of project credits and many thought that the project credit limits should be harmonised.

A number of companies agreed with the Government that there should be no restrictions on scope of market in advance of an international agreement and a number thought that provisions should be decided at UN level not EU.

Monitoring, reporting and verification

The majority of organisations/companies did not agree with the Commission's proposal to introduce a regulation to replace monitoring and reporting guidelines however there was support for regulation for harmonised verification and accreditation. Although the majority of companies agreed with the Commission's proposal for a central registry run by the Commission, a number disagreed.



Trade or sector associations

This was the second largest group with thirty-eight trade or sector associations responding to the consultation.

The trade/sector associations generally agreed with the proposed changes to the scope of the ETS. They were strongly opposed to inclusion of agriculture however and opinion over the inclusion of forestry was mixed. Some respondents agreed that installations exclusively burning biomass should be excluded from 2013 however a number thought they should still be included.

A number of trade associations did not think that the ETS was the right mechanism to reduce emissions from surface transport. They also cited a large number of issues that they thought should be considered in a cost benefit analysis to determine whether and how international shipping could be included, including: the cost/feasibility of monitoring, reporting and verification, impact on international competitiveness and overlap with existing measures/taxes.

Cap

There was no general consensus over the level of the central cap proposed by the Commission for meeting a 20 per cent EU GHG reduction target. A number thought it was at an appropriate level however an equal number thought it was too high/slack and several were unsure. The majority did not agree with the Commission's proposal for an automatic adjustment to a target when an international agreement is reached. The majority could not see a role for a European Central bank. Respondents from the trade associations favoured a shift to 8 year phases.

Allocation methodology

The trade associations, like the single organisations/companies, were concerned over the proposed allocation methodology and the impact on the competitiveness of their members. The majority of respondents from trade associations did not agree with the Government's position on harmonised minimum levels of auctioning across the EU and did not think on-site production of electricity should face 100% auctioning from 2013. The majority did not agree with the definition of a new entrant in the Commission's proposal. Unlike the Government, the trade associations thought that hypothecation was acceptable

Carbon leakage

Views over whether all sectors not exposed to carbon leakage should move to full auctioning with free allocation starting at 80% of their share of 2005-07 emissions were very mixed. The same number disagreed with the proposed approach as agreed, but with caveats. The majority agreed with the criteria against which it is proposed sectors will be assessed to determine exposure to carbon leakage. Border adjustment mechanisms were seen as a potential alternative to free allocation; however the implications on free trade and the complexities involved were also noted. The majority of respondents were unsure about the use of sectoral agreements however.

Benchmarks

There was general support for the use of EU-wide benchmarks to determine the levels of free allocation however a number of respondents disagreed or were unsure. A number of alternative approaches, such as the use of grandfathering, were also suggested. The majority of trade associations did not agree with the Commissions' proposal to not have sector caps with harmonised bottom-up



benchmarks used to divide up the sub-cap for free allocation. However, a number were unsure or agreed with the Commission's proposal. The majority agreed with the Government that the NER should be less than 5% of the overall EU cap.

Linking to other trading systems and project credits

There was general support for linkage to other trading systems. However, views were mixed over the Commission's proposal to recognise credits post 2012, from projects approved before 2013, in anticipation of an international agreement. The answers to a number of questions on the details of linking were confused and there was no clear stance on a number of issues including:

- ◆ The various elements of the Commission's proposal to recognise credits post 2012:
- ◆ Whether access to project credits should increase by 50% of the increase in absolute emissions reductions once an international agreement has been reached
- ◆ Two trade bodies identified one or more sectors that they thought should be excluded/ included from the project credit market in advance of an international agreement.

Monitoring, verification and reporting

Views were mixed over the Commission's proposal to introduce a regulation to replace monitoring and reporting guidelines. However there was support for regulation for harmonised verification and accreditation. Although the majority of trade associations agreed with the Commission's proposal for a central registry run by the Commission, a number disagreed.

NGO/research institutes

A small number (six) of respondents from NGOs or research institutes responded to the consultation. There were a limited number of responses on the questions covering the proposed extension of the scope of EU ETS. However, two respondents were strongly opposed to the inclusion of agriculture and the EU land management sector. Respondents pointed to a number of issues that they thought should be considered in a cost benefit analysis to determine whether and how surface transport and international shipping could be included, such as where ownership of emissions should fall.

Cap

There were a limited number of responses to the questions about the cap of the ETS. Two respondents commented that the phase length should remain five years.

Allocation methodology

A number of respondents disagreed with the proposed approach to auctioning as they consider that all sectors (other than those exposed to a high risk of carbon leakage) should move straight to full auctioning in 2013. Several considered that the impact of carbon leakage has been overplayed and pointed to research that suggests that free allocation could protect profitability but won't really prevent carbon leakage. A third of the NGOs agreed with the use of EU-wide benchmarks to determine the levels of free allocation however a third were unsure. The majority disagreed with the Government and considered that hypothecation was acceptable



Public sector

A small number (six) of respondents from the public sector responded to the consultation. There were a limited number of responses from the public sector on the questions covering the proposed extension of the scope of EU ETS. There were however a number of comments made about the issues that should be considered when determining when and how to include international shipping in the ETS, such as the impact on competitiveness and risk of carbon leakage.

Cap

Some of the respondents from the public sector disagreed with the proposed emission reduction trajectory of 1.74% per year and did not agree with the Commission's proposal for an automatic adjustment to a target when an international agreement is reached. Views over the appropriate phase length were mixed with one person favouring a shift to 8 years, another favouring a move to a longer period and a third person favouring 5 years.

Allocation methodology

Two of the respondents did not agree that the free allocation for heat produced under CHP provided an adequate incentive for the technology. A couple of respondents were concerned that the proposed approach did not consider the impact on the public sector where there is no ability to pass costs on. Two respondents did not agree with the definition of a new entrant in the Commission's proposal.

Monitoring, reporting and verification

The majority of respondents from the public sector did not agree with the Commission's proposal to introduce a regulation to replace monitoring and reporting guidelines however there was support for regulation for harmonised verification and accreditation.

Regulators

Two regulators responded to the consultation however only one answered the majority of the questions. The regulators broadly agreed with the proposed extension to the scope. Both respondents considered that a 25,000 tCO₂ threshold for the exclusion of small emitters was appropriate.

There were a large number of issues that regulators considered should be considered in a cost benefit analysis to determine whether and how surface transport and international shipping could be included such as the cost of monitoring, reporting and verification, and the impact on international competition and the carbon price.

Cap

Only one respondent answered the questions concerning the cap level and generally agreed with the Commission's proposals. The respondent agreed with the Government that there is a role for a European Central Bank and considered that phase periods should remain at 5 years.

Allocation methodology



Only one regulator answered most of the questions regarding allocation methodology and in general agreed with the proposed approach. However there were a few areas where they did not agree:

- ◆ The regulator did not think that the free allocation for heat produced under CHP provided an adequate incentive for the technology.
- ◆ They also thought that hypothecation was acceptable. The regulator did not agree with the Commission's proposal to not have sector caps with harmonised bottom-up benchmarks used to divide up the sub-cap for free allocation.
- ◆ They did not agree with the definition of new entrant in the Commission's proposal.
- ◆ They commented that the time-table for auction design regulation was too long.

Linking to other trading systems and project credits

Only one regulator answered the questions regarding linkage to other systems. In general the regulator agreed with the Commission's proposal however they disagreed on the following points:

- ◆ Access to limited project credits from third countries that have ratified the agreement
- ◆ Introduction of a regulation to replace guidelines on monitoring and reporting

Bank/trader/consultant

Three bankers/traders/consultants responded to the consultation. There was no response to the majority of the questions from this group. The responses under each section are summarised below. One respondent supported the inclusion of coal mine methane and one thought EU agriculture, forestry and land management should be included.

Cap

One respondent supported the creation of a European Central Bank, however the other two were unsure.

Allocation methodology

One representative from this group thought that the phase length should be increased to 8 years. One disagreed with the Government's position on harmonised minimum levels of auctioning across the EU and thought that hypothecation was acceptable

Linking to other trading systems and project credits

One respondent agreed with the proposed approach however they did not think that the project credit limits that would result from the Commission's proposal are at the right level. Two respondents thought that LULUCF credits could potentially be incorporated in the system in the future.



Other issues

The purpose of this section of the report is to record other issues raised by respondents that were not the topic of a consultation question (other than Q54 which asked for other comments) and are not covered elsewhere in this report. Some respondents provided this in the form of a covering letter or email or a supporting document.

Consultation process

The electricity sector was disappointed that the idea of 100% auctioning was not the subject of consultation. A number of respondents commented that the consultation document was very long and asked a large number of questions. Others commented that the questions were not always straightforward to understand and that they were not sure they had navigated successfully to other documents it referred to (e.g. Commission documents). There was a concern that this consultation is being held too late to influence the Commission decisions. In keeping with the need for stakeholder input, one respondent suggested the creation of a joint ETS policy making forum with industry, trade unions and Government to aid the consultation process.

Decision making in the EU

In addition to questioning the extent to which the findings from this consultation will be able to influence the EU's decisions, some respondents raised questions about the decision making process in the EU. In particular, there was a concern that 'the delegation by the Parliament and Council of implementation powers to a comitology committee made up of policy experts (officials) from Member States can potentially lead to a number of unexpected or unintended consequences. There was also a strong view that it is important that preparation for Phase III, including for auctioning, proceeds to time (some respondents argued that the timetable currently proposed is too long). One respondent suggested the development of an 'EU ETS Observatory' to monitor and report on the industrial/ employment impacts of the EU ETS.

Detailed comments on wording of/ proposed amendments to the Directive

A number of respondents took Q54 as an opportunity to comment on, question, or propose revised wording for, the Directive. Comments included:

- ◆ the definition of electricity production;
- ◆ explanation of what international agreement means required;
- ◆ use the same GHG list as for the Decision on effort sharing;
- ◆ various, including definition of GHG, tCO₂e, Articles 3b, 10a (5), 6 (1), absence of requirement to publish proposal under comitology for comment, force majeure;
- ◆ comments on Avril Doyle's amendments 17 and 18;
- ◆ article 24a (to include carbon removals e.g. to accommodate forestry);
- ◆ article 28a (to accommodate LULUCF);
- ◆ article 14(1), 14(2), 14(3), 24(2)



- ◆ why is the category capture, transport and geological storage required to report all GHG gases listed in Annex II; validity of Article 29 Force Majeure clause.

Choice of emissions trading

A small number of respondents expressed doubts around whether emissions trading is the appropriate tool to incentivise abatement (in these sectors/ to the timescales required). One respondent supported the increased stringency of Phase III but considered many of the complexities could be avoided by using a carbon tax instead.

Allocation methodology

Points raised around the allocation of allowances included specific reference to the treatment of energy intensive industries. For example, two respondents (EEF and UK Steel) commented that energy intensive industries should be given allowances from the auctioning sub cap, relating to their electricity usage. These allowances could then be sold back to their electricity suppliers, offsetting the pass through of carbon costs (see also Question 23).

Interaction with other policies

Some respondents urged that overlap and consistency with other policies and regulations e.g. on passenger transport, aviation, energy generation and carbon (like CRC), should be considered in the policy design. For instance, a sector association commented that other taxes on the sector should be reduced if there is a move to full auctioning. There were also suggestions of ways to treat these overlaps (e.g. one respondent drew attention to an Emissions Trading Group (ETG) working paper on CCA opt-out installations). Others took the opportunity to comment that it is important that other emitters, including households and transport are incentivised to reduce their emissions.

Registry operation

One respondent requested that restrictions on the number of passwords for the registry are lifted.

Whole life carbon impact

One point raised was that the whole carbon impact of an activity or process should be considered in evaluating whether it should be encouraged. An example given was the durability of different building products.

Impact assessment (IA)

Various respondents made comments on the contents of the Impact Assessment, often in relation to the information included about their activities. In some instances organisations provided additional information in support of their view. One respondent highlighted the fact that the IA is only partially complete and some respondents raised questions. A number of respondents asked to be allowed further input into the estimates of the costs and benefits.

