

EU Emissions Trading Briefing

EU Emissions Trading for EAG

EAG/38/03

✓ Outline

- Introduction
- EU emissions trading overview
- Business issues

21st November 2003

‘Companies across 25 countries must now start incorporating climate change into day-to-day commercial decisions and begin assessing what innovative steps they can take to reduce emissions’.

Margot Wallstrom: EU Commissioner for Environment 2nd July 2003

What is EU Emissions Trading?

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- ✓ **Applies to all 25 EU Member States**
 - Also applies to Norway (not upstream)
- ✓ **Effective from 1/1/2005**
- ✓ **Cap and trade system**
 - Designated installations allocated allowances for free
 - ◆ Surrender allowances = to emissions by end April following year
 - ◆ Penalties for non-compliance €40-€100/tonne
 - Permitted to sell surplus and compelled to buy shortfall
 - Allocated allowances will reduced over time.
 - ◆ Reductions likely to be in line with national Kyoto targets (12% to 20%).
- ✓ **Industry preferred solution**
 - Provides maximum reduction for minimum cost.
 - Preferable to a tax
 - ◆ Cheaper but more bureaucratic
- ✓ **Provide liquid market in CO₂**
 - Engenders price discovery

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Share of 1998-2001 average emissions

Power Generation	61%
Oil & gas (including downstream)	14%
Iron & steel	8%
Chemicals	6%
Building materials	5%
Pulp & paper	3%
Non-Ferrous	1%
Food & drink	1%
Other	1%

National Allocation Plan (NAP)

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- ✓ **NAP the vehicle for determining :**
 - Sectors and installations covered by scheme (circa 2000 in UK)
 - Methodology for determining allocation of allowances
 - Treatment of new entrants/plant closures
 - Auctioning /Banking
 - Timing of distribution of allowances
- ✓ **Each Member State preparing its own NAP**
 - Potentially 25 different NAP's
 - UK & Germany well advanced. Latin countries well off the pace.
- ✓ **DEFRA runs NAP in UK with support from DTI**
 - Consultation on allocation concluded early October (160+ submissions)
 - Historic emissions data submitted to DEFRA in October
 - Many different views across and within sectors
- ✓ **Commission has final say on NAP's**
 - Requirement to minimise distortions of single market across EU

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NAP : Timetable

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- ✓ NAP determines the allocation of allowances to each UKCS installation in the period 2005-2007 (first period)
- ✓ 23rd September 2003: Submission of historic emissions data to Defra
 - 1998-2002 period
- ✓ 2nd October 2003 : Responses to consultation on NAP methodology
- ✓ **December 2003: Publication of draft NAP**
 - Public document
- ✓ 31st January 2003 : Closure of consultation on draft NAP
- ✓ 31st March 2004: UK NAP sent to Commission
- ✓ 1st October 2004: Commission publishes final EU allocation plan
- ✓ 1st Jan 2005 –Start of EU scheme
- ✓ 30th April 2006- Surrender of allowances for 2005 emissions

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Data collection

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- ✓ Defra requested actual emissions data by installation in period ~~1998/03~~ 2002
- ✓ UKCS Operators submitted upstream data for Operated installations
 - Includes terminals
 - Includes data on flaring but flaring is likely to be outside the scheme.

NAP methodology: Key Issues

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- ✓ **Allocation : Sector or by installation?**
 - **Sector approach permits favours to preferred Industries**
 - **By installation is fairer, treat everybody the same ~ but everybody thinks they are a special case !**

- ✓ **Allocation basis**
 - **Historic emissions basis the most likely, some alternatives:**
 - ◆ **An average of 1998-2002**
 - ◆ **Single year**
 - ◆ **Maximum year for each installation**
 - ◆ *Credits early action and late start/growing emissions*
 - ◆ **Benchmarking**
 - ◆ **Forecasts**
 - **Problems for installations under construction**
 - ◆ *No emissions history= no allocation ?*

Consultation on NAP methodology: Issues

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- ✓ **New entrants: A big issue ~ no easy solution**
 - Allowance 'Set-aside' for new entrants = reduced allocation for incumbents
 - What happens if allowance 'set-aside' too great or too small?
 - Ditto if installations do not deliver (late/early/smaller/bigger/no show)
 - Definition of new entrant poorly drafted in directive
 - ◆ A new well on an old field is potentially a 'new-entrant'
 - Risk of each Member State devising different rules distorting the single market.
 - ◆ DG Comp regard issuance of allowances as 'State Aid'
 - Simplest option is new entrants (uncommitted investments) get zero allocation
 - ◆ Commission preferred option
 - ◆ Allowances purchased in market ~ treats all new entrants the same
 - ◆ Will receive a full allocation for subsequent commitment period
 - ◆ From 2008
 - ◆ Does not apply to committed investments (Annex B by 31st March 2004) these are incumbents

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Issues continued

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- ✓ **Banking: Carry over to second phase (2008-2012)**
 - **Good idea in principle but some complexities for second period**
- ✓ **Auctioning : Sounds like a Tax**
- ✓ **Plant Closure : Surrender of allowances**
 - **Immediately or at end of commitment period**
- ✓ **Future of UK ETS?**
 - **To be determined.**

Business Issues

Business Issues

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✓ December 2003 : Key milestone

- Each installation receives provisional allocation for 2005-2007
- Will enable financial impact to be assessed on each installation
- Data will be available to public
- Will provide indication of HMG CO2 aspirations 12.5% or 20% ?

✓ Commercial/legal issues

- Operator is responsible but partners need to be brought on board
 - ◆ Compliance options
 - ◆ Operator manages on behalf of owners
 - ◆ Each partner manages its own position
- Future agreements need to cover re-imburement of emission cost

✓ Emissions forecasts

- Installation owners need to assess cost of the EU scheme
 - ◆ Develop options to invest in abatement and/or
 - ◆ Trade in market

Summary

- ✓ **Emissions trading is here to stay**
- ✓ **From 2005 all emissions have a cost (up to €40/tonne)**
 - ***Rises to € 100/tonne from 2008***
 - **Cost will increase with time as ‘free award’ of allowances are reduced in line with tighter targets.**
 - **Business plans will need to include cost of compliance**
 - ◆ **Investment appraisal will need to factor in cost of future emissions**
 - **Commercial agreements will need to address impact of scheme.**
 - ◆ **e. g Tariff agreements**
- ✓ **UKCS emissions tend to increase in medium term**
 - **Agging fields tend to consume more energy**
 - **Step change reduction on closure**
- ✓ **Opportunity or threat ??**