

UK Emissions Trading Group

Working Groups on Implementation of the EU Directive

**Note of the meeting of WG8 – Post 2012/Phase III – held at 2.00 pm at the DTI
Conference Centre, 1 Victoria Street, London on 16 August 2006**

Attendees:

Bill Thompson	Chairman
John Craven	Secretary
Chris Anastasi	British Energy
Bryan Bateman	CPI
Helen Bray	CIA
Ian Calvert	CHPA
Caroline Doble	Enviros
Luke Edwards	Drax
Charles Eyre	Eyre Consulting
Stephen Geldart	UKPIA
Ian Goldsmith	Corus
Juan Ibinarriaga	Merrill Lynch
Andy Kelly	Centrica
Richard Leese	BCA
Arnold Lewis	Cemex UK
Andy Limbrick	AEP
Ian McPherson	UKPIA
Mark Meyrick	EDF Trading
David Morgan	CPI
Allen Norris	Pilkington
Tony Oates	British Lime
David Odling	UKOOA
Walle Oppedijk van Veen	BHP Billiton
Freya Phillips	EDF Energy
Jim Rushworth	Lafarge
Gillian Simmonds	CBI
Chris Slavin	Buxton Lime
Neil Smith	Eon UK
Wendy Stephenson	UK Steel
John Stockdale	British Glass
Jane Thornback	CPA
Penny Tomlinson	RWEpower
Rob Walker	SMMT
Daniel Waller	FES/Alcan
Sue Young	Conocophillips
James Davey	DEFRA
Iain Morrow	DTI
Nicola Kirkup	DTI

Chairman's welcome

1. Bill Thompson welcomed those present – including James Davey from the DEFRA unit responsible for the GHG emissions inventory who would follow up the forward emissions analysis given by Beth Child at the inaugural meeting – and Iain Morrow and Nicola Kirkup from DTI. The meeting would particularly focus on issues arising from the 'Exchange of Views' at the inaugural meeting – which would then form the basis of a WG8 work programme going forward.

Minutes of the inaugural meeting on 22 June 2006

2. There were no comments on the minutes of the inaugural meeting of WG8 held on 22 June 2006 which were agreed as a fair reflection of the discussion.

Forward projections - presentation by James Davey

3. James Davey gave a presentation - as subsequently supplemented by the expanded version at Annex 1 – comparing historical CO₂ emissions and BAU through to 2020 with pathways representing respectively the 2000 Climate Change Programme, the 2006 Climate Change Programme (leading to double the Kyoto target) and the 2006 Energy Review.

4. The Energy Review pathway reflected all measures discussed in the Energy Review Report - including a review of building regulations and measures to engage the efforts of individuals – but carried the Phase II EU ETS cut of 8m tonnes through to 2020 without further reduction, ie it took no account of the (probable) addition of aviation or the (possible) addition of surface transport . There were no further details as to how the 2020 position would move on to the 60% reduction target for 2050. David Odling pointed out that the 60% reduction target by 2050 advocated by the Royal Commission on Pollution was based on 2000, as opposed to 1990.

EU ETS Review stakeholder questionnaire – summary of responses

5. The meeting considered DEFRA's summary of anonymised replies (copy at Annex 2) from the 53 organisations that responded to their EU ETS review stakeholder questionnaire.

6. Ian Morrow explained that the questionnaire had been issued to help the UK Government to identify relevant policy issues in good time to feed back to the Commission as they developed their position in the autumn. The Government would do this on the basis of the complete summary – as opposed to any one specific message. However it had yet to be decided whether to write formally to the Commission, nor had the Commission yet identified a stakeholder process for MSs.

7. On the responses to Q6 – expansion to additional sectors or gases - it was pointed out that inclusion of the aluminium sector would inevitably bring in other gases.

UK process for handling the Commission's Review

8. Ian Morrow referred to the paper at Annex 3 outlining the UK process for handling the Commission's review. This was geared to four Government workstreams respectively addressing the cap, allocation and harmonisation, coverage and global markets (including JI/CDM and Linking). He would be happy to answer specific questions.

9. The following main points arose in discussion.

- a) There was no information as yet on timing of work going forward– current work was in the nature of a scoping exercise and the timetable would be determined by information, currently awaited, about what the Commission was

planning and decisions on how best to feed into that. Current indications were that the Commission would publish their review in September.

b) The UK Government was aware of the need for Parliamentary scrutiny in relation to the output of the UK process.

c) It had been decided not to set up a separate group on competitiveness - all four groups would look at that. Allen Norris suggested it was necessary to have a separate policy group looking at competitiveness – this was a crucial issue for UK industry in the context of potential transfer of production away from the UK.

d) John Stockdale added that account should be taken of the need to incentivise development of energy saving devices and products. James Davey responded that the Energy Review recognised the need to reduce demand.

e) Jim Rushworth asked which group would address intensity-based benchmarking/post-period adjustment. Iain Morrow envisaged that these issues would be considered in the allocation and harmonisation group.

f) Bill Thompson asked whether, in relation to the level of cap, the relevant Government workstream would look EU-wide or just at UK sector emissions. Iain Morrow responded that the workstream would look at how the ETS process fitted with whatever international agreement was reached for post 2012 – this debate was not yet at the level of the cap.

g) In response to Penny Tomlinson, Iain Morrow confirmed that he would be happy to bring to WG8 the output of the various workstreams. Information would also be published on the DEFRA website.

h) In response to Freya Phillips, Iain Morrow said that it was not yet possible to be more explicit about the nature of consultation/interaction over the next six months – there was nothing yet available to form the basis of consultation.

i) Ian Calvert asked whether it was intended to use consultants. Iain Morrow confirmed this and Bill Thompson added that it would be useful for WG8 to be advised of the scope of their contracts/ToRs. John Craven said that in the past WGs had found it helpful to engage with consultants at a formative stage of their work – this was consistent with the ETG's approach of contributing at the formative stages of Government thinking. Bryan Bateman commented that it would be appreciated if early warning could be given of any consultancy work – this had often seemed somewhat rushed in the past.

j) Andy Limbrick asked for information about DTI representatives on each of the workstreams. Iain Morrow responded as follows:

Cap – Iain Morrow

Allocation and harmonisation – Nicola Kirkup

Coverage – Iain Morrow: Chair

Global markets – Osman Sabhir

k) In response to a question from Mark Meyrick as to whether the 8m tonnes made any assumption of JI/CDM credits post 2012, Iain Morrow confirmed that

these would be additional. The UK Government was generally enthusiastic both about the use of such credits post 2012 and also links to other global markets.

l) Ian Goldsmith said that, on the basis of past evidence, it could not be assumed that other MSs would follow the lead of the UK Government. Iain Morrow responded that the UK was undertaking informal discussions with a group including representatives of 6 MSs - and meetings were also being held on a regular basis with representatives of larger MSs.

m) Bryan Bateman asked about the scope to develop a common interpretation of the Directive, eg on scope/definition of combustion. It was a problem that some definitions were unique to the UK whilst the definition of combustion was 'international'. Nicola Kirkup replied that such work was underway but was at an early stage - it was too soon to say whether the UK approach would be more widely adopted.

n) Iain Morrow said that the clear message from stakeholders was that harmonisation should not be pursued 'at all costs' but only where the lack of it was unhelpful.

o) Chris Anastasi asked how far UK scenario work would be linked to UEP modelling. James Davey said that Phase I and II UEP modelling would need to be improved so that it was more closely affiliated to the creation of sector caps – this was the time/opportunity for this to happen.

Conclusions from the 'Exchange of views' at the inaugural meeting

10. Bill Thompson referred to the 44 bulleted points included in the minutes of the inaugural meeting as a result of the 'Exchange of Views'. He noted that there appeared to be more interest in harmonisation on allocation than Government might have thought to be the case.

11. He had endeavoured to reflect on some of the main issues arising from these points in the presentation at Annex 4 which included slides on certainty, pathways to a lower GHG future, period length, promotion of new technologies, competitiveness, EU-wide benchmarking allocation and 'other'.

12. Bill Thompson drew attention to the following main points in relation to the slides indicated.

Pathways to a lower GHG future

- there was a need for longer-term signalling by the EU
- EU long term targets were not yet definite and unlikely to be discussed until later
- it was important that the EU ETS was not the only instrument in use for tackling climate change

Period length

- a period length of 25 years was too long

Promotion of new technologies

- additional transitional incentives were required to promote new technologies
- harmonisation of new entrant and closure rules across the EU was necessary to reduce investment uncertainty

Competitiveness

- transparency of information was important – in order to see whether competitors were being treated equally
- again, need for harmonisation of new entrant and closure rules (unless there was 100% auctioning)
- important to achieve a JI/CDM credit flow

EU-wide benchmarking allocation

- the burden sharing agreement currently made this too difficult to resolve
- a radical system could be in place from 2012 with allocation from an EU centrally defined pool
- more information could usefully be sought about the Dutch covenant system – a series of voluntary agreements but geared to the top tranche of global benchmarks
- the cement industry was well-placed to operate with a global benchmark
- ex post allocation was not possible under the current Directive

'Other'

- historic grandfathering was generally not sustainable in the longer term
- however some sectors were likely to be too heterogeneous to fit in with an EU-wide sector benchmark
- there was a little interest in a system of longer term carbon contracts which the Government would need to underwrite
- long-term contracts with break clauses had been mentioned – but the concept needed further explanation

13. The following main points arose in a wide-ranging discussion. Note: These points are recorded on a non-attributable basis, consistent with the approach for the inaugural meeting to which they relate.

- an important point about the Dutch covenant system was that the ex-post adjustment drove the incentive; it dealt with the margin and not with large numbers and would not be sufficient to drive major emissions reduction in every sector
- transparency was also needed on power and gas tariffs across Europe
- an ex-post approach would undermine the EU ETS, which was the EU's preferred tool
- once some certainty (eg 25 years) was in place there would be an incentive to make significant reductions on the back of longer term new technologies

- as the Commission recognised, there was a danger of making too many comments on the basis of only one year's experience of the EU ETS, albeit that any major changes needed to be discussed at the beginning of 2007
- pathways for longer term EU and national emissions reductions were welcomed by most industries - it was noted that some sectors could make greater reductions than others – some may be dependent on new technologies and thought therefore needed to be given to as to where reduction could or could not be made – to help clarify the picture
- it was suggested that it would be helpful to have a sectoral emissions breakdown going through to 2025, but not necessarily to 2050
- the need for forward clarity depended on whether industry had to make reductions or pay for a reduction
- if changes were forced on industry in Europe too quickly, industry would leave Europe leading to heavier overall emissions, not least because of higher transport costs
- it would be useful to ask Government to consider which areas were likely to make the largest reductions - and to do this on a Europe-wide basis given the competition issues
- although the present discussions were aimed at preparing for the issues likely to come forward in the Commission's review in September, in reality the Commission's ambitions for the review were very limited, eg greater harmonisation between MSs/more 'soft' co-ordination/rounding of definitions – ie 'more of the same'. That ought not to preclude the opportunity to make suggestions for robust change, but any such proposals were more likely to emerge next year
- DEFRA/DTI recognised the need for long-term targets/certainty – but this was tied up with future actions both in the EU and globally
- it was not currently possible to secure electricity contracts beyond 2010
- it was important to know both about the scheme and its aims, ie that it would not be taken lightly and that carbon would have a value as opposed to what that value should be; the market would determine the latter
- a new Directive/framework was needed which was clearly understandable by all MSs including definitions – but careful planning of a GHG reduction would not work
- difference of application across MSs was a problem – British industry believed that application in the UK was more stringent than elsewhere. An even-handed approach would do much to counter the current sense of unfairness; also, were sectors outside the EU ETS pulling their weight? It was noted that the Energy Review envisaged that other sectors such as transport and domestic consumers would be included in future plans.
- an approach of looking for harmonisation with soft-co-ordination was the antithesis of the discussion at the inaugural WG meeting about central allocations – although there was an existing possibility to pool, this suggested a need to re-write the Directive
- EU-wide benchmarks and harmonisation were attractive to some large industries/emitters who were internationally competitive; however it would be difficult for MSs to ring fence smaller industries
- it was necessary to understand the context of 2012 and explore what was practical - it would be hard to harmonise when MSs were at different stages of EU ETS development

- level playing fields were necessary across Europe post 2012 – especially in relation to new MSs – the (unpopular) burden sharing agreement would be unlikely to be repeated
- auctioning against a BM on a EU-basis might produce more co-operation
- it did not seem appropriate for DEFRA/DTI to be taking a view about what UK industry ‘would be making’ in 15-20 years’ time; however it would be useful to model globally for big emitting sectors – but would that be practical?

14. James Davey undertook to send to John Craven for circulation a DTI/DEFRA paper on carbon abatement potential which had been published in 2004-2005 – ***Action James Davey***

Chairman’s update on Article 30 Review

15. Bill Thompson drew attention to a Commission slide in the presentation at Annex 4 by way of update on the Article 30 Review. This reflected the comparatively limited nature of the process. As mentioned earlier, current indications were that the Commission would publish their review in September.

Three scenarios to spark debate

16. Following on from the ‘Exchange of Views’ at the inaugural meeting, Bill Thompson had also set out in the presentation at Annex 4 three scenarios to spark debate, ie a ‘bare bones’ approach, a harmonised approach and a ‘tightening current scheme approach’.

17. The following main points arose in discussion of these three scenarios:

- a) Iain Morrow expressed surprise at the suggestion in the bare bones approach slide that JI/CDM was ‘too difficult’.
- b) Rob Walker asked why the de minimis threshold did not appear in scenario 3. Bill Thompson explained that this was intended as a continuation of the current scheme within which there was widespread agreement that small emitters should be excluded. Bryan Bateman noted that the proposed 25,000 tonnes threshold would remove half of his sector from the EU ETS but added that such a move seemed inconsistent with any suggestion that mandatory emissions reduction should be taken down to household level.
- c) Bill Thompson suggested that the Commission and the UK Government should be actively encouraged to introduce a flexible project mechanism scheme post 2012 – might this be agreed as a principle?
- d) Chris Anastasi noted that scenarios might perhaps need to take account of moves - notably in Germany - to call a halt to the EU ETS. James Davey replied that the German Government was strongly in favour of Phase III and that other states may bring positive views – including individual states in the US or Australia (NSW). Iain Morrow added that it was difficult to envisage the scheme being overturned by the European Parliament.
- e) Jim Rushworth commented that both scenario 1 and scenario 2 referred to an EU cap and to a new way of distributing allowances. In his view MSs would

still wish to keep control of their own caps by the time of Phase III. Iain Morrow said that MSs did not currently have total flexibility now on caps and would perhaps have less still in future.

f) Bill Thompson added that some small MSs may prefer an EU-wide benchmarking approach as a means of aiding competition, albeit at the expense of maintaining sovereignty arguments.

g) John Stockdale noted that, for the UK unlike other MSs, BAU included CCA growth and asked how this area could be harmonised. Bill Thompson suggested that it would be possible to move away from an MS-type approach towards an approach based on the technology within individual industries – this would avoid the problem with BAU – where there were currently 27 different answers.

WG-8 work area identification

18. Bill Thompson introduced the two slides included in Annex 4 that set out proposed WG8 work areas. The items underlined were those which appeared to require the most effort. Subject to the group's comments he proposed to develop a series of agendas to address these issues – with the assistance of a small number of work groups – once the Commission's review report had been published in September. In the meantime arrangements were in hand for a meeting on either 18 or 19 September entailing a series of presentations on inclusion of road transport. Later note: This meeting will take place from 2.30 pm – 4.30 pm on 19 September at the DTI Conference Centre.

19. The following main points arose in discussion.

Inclusion of gases

a) On methane, it was noted that Transco had a programme of pipeline replacement underway (due to conclude in 2031), that emissions from agricultural sources were diffuse and difficult to monitor and that coal mine methane was more of an issue for other MSs than for the UK.

b) On F gases, it was noted that the intention to bring F gas regulations into force by 2012 suggested that they did not need to be added to the EU ETS.

c) James Davey added that if WG8 members had any further questions about particular GHGs they should feel free to contact him at james.davey@defra.gsi.gov.uk

Structure of the WG8 process

d) Penny Tomlinson suggested that it would make sense to relate WG8 work areas to the equivalent four Government workstreams identified earlier. However, Freya Phillips noted that these workstreams were based on the Commission's Article 30 review whereas WG8 needed to focus on the issues which it wanted the Commission to consider – some of these were Article 30 issues and some were not. Bryan Bateman added that WG8 should first obtain greater clarity about what Government wanted to do and then map across to produce a work programme matching both this and WG8 areas of interest.

e) Jim Rushworth said that it would be useful to schedule specific meetings on particular Government workstream areas; Ian Morrow supported this and added that he would be pleased to present Government thinking/ideas in this context.

f) Bill Thompson noted that the expectation that the Commission would want a response to their review by Christmas implied a need for an intense series of WG8 meetings, say one per month. It would be necessary to judge the appetite for such a meeting programme given the concentration on the Phase II NAP in September. Ian Goldsmith said that the future of industries was at stake and that the necessary time must therefore be found. Rob Walker commented that he would be willing to give up time for some items but not for others. It was agreed that, once the work programme had been structured in the context of the Government workstreams it would be helpful to ask WG8 members to indicate which of them they were interested in and thus to develop a list of priority issues.

WG8 work programme – next steps

g) Bill Thompson undertook to restructure the proposed work programme on this basis and to consult WG8 members about priorities before developing a series of agendas. – **Action Bill Thompson**

Future meetings

20. Dates for future meetings would be further considered, bearing in mind the likely preoccupation with Phase II NAP issues in September. Note: As previously mentioned, a meeting entailing a series of presentations on inclusion of road transport will take place from 2.30 pm – 4.30 pm on 19 September at the DTI Conference Centre.

Any other business

Delivering a UK Manifesto on the EU ETS

21. Rob Walker asked whether the Secretary of State's initiative on 'Delivering a UK Manifesto on the EU ETS' would be considered within WG8.

22. In discussion it was agreed that, whilst it remained open to individual WG8 members to respond to this in their own right, there might be attraction in channelling a response through the group. John Craven noted that it was proposed to discuss the initiative further at the next ETG Board meeting in early September, particularly as to the need for greater clarity and timescale.

23. John Craven undertook to feed back to WG8 on this issue following the Board meeting. – **Action John Craven.** Later note: Following discussion at the Board meeting, Dr Bill Kyte, ETG Chairman, has now advised Government of the ETG's willingness to support this initiative in the expectation that he would participate in a proposed workshop with CEO level participation to develop ideas for the manifesto. He has also emphasised the desirability of the engagement of Trade Association representatives.

John Craven
ETG Secretariat
25 August 2006