

**UK Emissions Trading Group****Working Groups on Implementation of the EU Directive****Note of the 53rd meeting of WG 5/6 - Allocation – held at 10.30 am at BERR  
Conference Centre, 1 Victoria Street, London on 15 November 2007****Attendees:**

Bill Thompson	In the Chair
John Craven	Secretary
Dave Beardsworth	BCC
Bryan Bateman	CPI
Richard Boarder	Castle Cement
Lisa Constable	DEFRA
Matt Croucher	SMMT
Ryan Donaghey	SBAC
Sofia Fernandez Avendano	Total E&P
Ian Goldsmith	Corus
Martin Haworth	British Lime Association
Jim Herbertson	ExxonMobil
Richard Leese	BCA
Arnold Lewis	Cemex UK Cement
Andy Limbrick	AEP
Ian McPherson	UKPIA
Gerry Miller	MINESCO
Alex Morrell	EDF Energy
Iain Morrow	BERR
Allen Norris	Pilkington
Steve Reeson	FDF
Pete Roscoe	BERR
Jim Rushworth	LCUK
Neil Smith	E.ON UK
Gareth Stace	UK Steel
John Stockdale	British Glass
Nick Sturgeon	CIA
Rebecca Timmins	Centrica
Penny Tomlinson	RWEnpower
Rob Walker	SMMT
Daniel Waller	AEA/ALCAN
Ruth Whittington	Enviros
Roger Wiltshire	BATA
Sue Young	ConocoPhillips

**Introduction**

1. Following a safety briefing Bill Thompson explained that he was chairing the meeting on behalf of Chris Anastasi who had been called away at short notice and sent his apologies. In addition to the usual updates the agenda would particularly focus on competitiveness issues.

**Minutes of the meeting held on 18 October 2007 - and Actions**

2. The minutes of the last meeting were agreed as an accurate reflection of the discussion.

3. Actions from the minutes of the last meeting had been completed or would be dealt with under later agenda items except those below on which updates were given, as follows.

4. Paragraph 7 – There remained no further information on Commission's benchmarking project – including a list of the sectors chosen – but this would be communicated to John Craven for circulation to WG5/6 as soon as possible.

- *Ongoing action DEFRA*

5. Paragraph 9 – John Craven reported that Chris Anastasi had not yet been able to identify a Chair for the subgroup on the cost of the EU ETS and had therefore now suggested that the study might instead be carried forward via a questionnaire. Bill Thompson had further suggested that the questionnaire might be directed to Trade Association representatives. WG5/6 members supported this approach and Bryan Bateman emphasised the importance of input reflecting the costs of the regulators. Since the work was intended to feed into the Government's impact assessment for the Phase III consultation document, the results would be required in the early part of 2008.

- *Action John Craven – to take forward*

6. Paragraph 10 – In response to Andy Limbrick, John Craven advised that there was currently no further information on the timing of the proposed consultation on Phase II auctioning although drafting of the consultation document was currently underway.

## **EU ETS update**

### Government response to Climate Change Bill consultation

7. Iain Morrow reported that the Climate Change Bill was being published that day and was expected to receive Royal Assent in the early part of 2008. The published Bill would reflect most of the changes proposed during the public consultation and parliamentary scrutiny on the draft Bill. The provisions had been made more robust in various ways. In particular, the Committee on Climate Change would be asked to report on whether the Government's target to reduce CO<sub>2</sub> emissions by at least 60% by 2050 should be strengthened further and also asked to look at the implications of including other greenhouse gases and emissions from international aviation and shipping in the UK's targets.

8. The role and responsibilities of the Committee had been strengthened by requiring the Government to seek the Committee's advice before amending the 2020 or 2050 targets in the Bill, and its independence from Government had been further established by confirmation that it would appoint its own chief executive and staff, and by increasing its analytical resources. Increased transparency would be achieved by requiring the Committee to publish its analysis and advice to Government on setting five-yearly carbon budgets.

9. Parliament's ability to hold Government to account had also been strengthened by requiring the Government to explain its reasons to Parliament if it did not accept the Committee's advice on the level of the carbon budget, or if it did not meet a budget or

target. There would also be improved information and streamlined reporting, including a requirement for the Government to report annually to Parliament on emissions from international aviation and shipping - in line with the UN Framework Convention on Climate Change - and a requirement to report to Parliament on its proposals and policies for sustainable adaptation to climate change.

10. In response to Bill Thompson, Iain Morrow confirmed that there was a wide degree of cross-party support for the Bill. As to further work on targets, plans were already in place from the Energy White Paper and these would be revised as necessary in the light of the anticipated Commission package (now postponed to January 2008) covering the EU ETS, renewables and burden-sharing.

### Phase II NER

11. Pete Roscoe referred to a previously circulated letter to the ETG reporting high demand for free EU ETS allowances from the Phase II NER. The size of the NER had been fixed, after extensive analysis and consultation with industry, to meet expected demand and there had been very few advocates of a larger NER (though quite a few wanted a smaller one). It had been agreed that the NER would operate on a first come basis and, in the event that it should run out, that operators would be required to buy allowances from the market.

12. Since the queue for Phase II new entrants had opened on 1 August, 68 applications (including later Phase I applicants) had been received, of which 4 were not duly made and 1 was rejected. An indicative total of 71 million allowances had been applied for. The distribution between the CHP and non-CHP was still to be fully determined but the components of the NER (in millions of allowances, rounded - from the Phase II NAP) were:

New entrants (non CHP)	44.9
CHP	27.5
Later Phase I new entrants (non CHP)	6.8
Contingency fund	2.4
Total	81.6

13. The Environment Agency (EA) and other regulators were still assessing recent applications to determine allocations. They expected to finish this work during November and would publish data, to indicate the number of allowances applied for, on their website. At that stage a clearer view of the NER queue would emerge facilitating more information about the extent to which claims for free allowances would be fulfilled.

14. There was no intention to make changes to the NER in the light of the pressure. Judging by the pattern for Phase I, it would take an average of 60 days between receipt of applications and their determination so it was not currently possible to know how many allowances would actually be issued in practice – several millions could be returned to the main reserve/others in the queue. Pressure was higher on the CHP side which was ring-fenced – although the NAP included provision for it to be merged back into the main NER in 2010.

15. Bryan Bateman mentioned that he had been in touch with BERR about the interaction between the Department and the regulator following an instance where an application had been duly determined by SEPA and then ‘undetermined’ by the EA. Peter Roscoe confirmed that decisions were the responsibility of the regulator and that BERR could not advise on particular determinations since any appeal would be for the Secretary of State, BERR to resolve.

16. In thanking Pete Roscoe for his report, Bill Thompson asked whether, given the potential impact on business decisions, a fixed timetable could be considered for reporting the state of the NER - it was noted that updates in Phase I had been infrequent, the most recent having occurred in February. Pete Roscoe responded that BERR would be happy to consider this and also agreed to report back to the next meeting.

– *Action Pete Roscoe*

### Phase III

17. Bill Thompson noted that the Commission’s package including proposals for Phase III EU ETS had been delayed twice and was now scheduled for late January 2008. It was understood that the proposals would not go to the Commission’s normal inter-service consultation until very late in the process, the intention being that each DG would need to negotiate its positions at a high level to ensure consistency. Recent delays may reflect some differences of view between DG Environment and DG Enterprise on the interaction of the 20% renewables target with an EU ETS cap.

18. WG5/6 members added that their contacts had indicated that some changes might possibly be introduced by Regulation as opposed to being included in a revised Directive, thereby placing less power by Member States to vary implementation and supporting a more harmonised approach capable of enforcement through the Courts. As to whether control by MSs over NAPs in Phase III would therefore be more limited, Iain Morrow anticipated that there might be less, as opposed to no, flexibility than in earlier Phases. However, a total lack of flexibility would be difficult to live with for a single market comprising 27 MSs each with different national issues. Key elements such as cap fixing might be decided centrally but it was unlikely that this would be the case for every detail of allocation. Gerry Miller asked whether an issue arising from the Regulation versus Directive debate might be whether the Commission would gain access to the proceeds of auctioning. Iain Morrow commented that any such proposal would seem likely to raise major objection from many MSs.

19. In response to questions from Bill Thompson and Bryan Bateman about Government interaction with the Commission in the run-up to publication of their package and the scope for parliamentary scrutiny thereafter, Iain Morrow said that officials regularly met with their opposite numbers there and would also shortly be meeting several MEPs. UK Ministers also met Commissioners frequently and would be engaged in a parliamentary scrutiny process once firm proposals were to hand. Input to the Commission from UK trade associations – especially those with strong European links – would also be welcome.

*Auctioning/competitiveness*

20. Bill Thompson confirmed that DG Environment in particular continued to have a final goal of 100% auctioning (though not necessarily for Phase III) and that the question was therefore the pace at which this could be achieved for particular sectors. There might be some minimum level of auctioning for all sectors but it had not been clarified whether the European power sector would be exposed to 100% auctioning immediately in 2013. Andy Limbrick agreed that there was no information but added that the UK power sector expected to be moving rapidly to a high level of auctioning.

21. Work was proceeding in DG Enterprise on criteria to be applied to each sector in the event of 100% auctioning to take account of the degree of energy intensity, degree of global exposure and pass through potential. It was not clear whether there would be different types of criteria for different sectors – but sectors would be expected to justify why they could not be made subject to 100% auctioning. Richard Boarder said that criteria should allow for CO2 intensity to take into account process emissions.

22. Attention was also drawn to a proposal for exposed sectors to be subject to an escalator starting at 10% and rising by 5% per annum through the phase to reach 50% by 2050. In acknowledging this proposal, Nick Sturgeon expressed concern about the pace of decision-making, the European Chemicals Federation having been given only two weeks to produce data to demonstrate exposure.

23. Iain Morrow said that he hoped to receive more information about the escalator proposal at a meeting the following week. However, UK Government thinking was now focussing rather on the need for a reduction from 100% free allocation, recognising that auctioning was not the only burden on sectors – they had also to cope with the burden of how many allowances they needed to buy, given all targets. In response to Richard Boarder, Iain Morrow added that the UK Government was not yet at the stage of identifying any one consultancy report as the basis for a conclusion, nor could he say whether the GHK report to the Commission would prove to be heavily influential in their decisions. Other MSs were producing their own reports and the UK remained open to consideration of reports commissioned by sectors (e.g. from Hatch Beddows in the case of steel).

24. Ian Goldsmith commented on what he saw as the continuing failure to recognise the high level of exposure of the aluminium sector. Lisa Constable responded that the UK position was that aluminium should not be included because of carbon leakage and – as an alternative - they were encouraging the Commission to develop a global agreement. Nick Sturgeon said that the chemical sector was in a similar position to aluminium in so far as fertilisers - not yet in the scheme – contained key energy intensive elements in ammonia and N2O.

25. Bryan Bateman emphasised the need to agree how auction proceeds were used and suggested that it would be informative to look at work on the recycling of funds in Canada. Bill Thompson reminded the meeting that Freya Phillips was chairing a WG8 subgroup that would be preparing a report to Government on the use of auctioning proceeds. (See also paragraph 39.)

26. Gerry Miller cautioned against adopting a narrow definition of competition and production of an impact assessment that merely referred to the recommendations of

particular consultants. Government representatives confirmed that work had not yet begun on writing the impact assessment and added that suggestions from ETG members as to what to include would be welcome.

*Review of Climate Strategies Report/Feedback on Carbon Trust overview of Climate Strategies Report*

27. John Stockdale gave the presentation at Annex 1 (already circulated to WG5/6 members) by way of update on his subgroup's work on competitiveness in general and the Climate Strategies (CS) Report in particular. Another meeting of his competitiveness subgroup was scheduled for that afternoon and was due to consider further work including that commissioned at the previous WG5/6 meeting. The final version of the CS Report was currently expected to be published at the end of November together with an overview under preparation by the Carbon Trust. As noted in his presentation, he was acting as the ETG's nominated reviewer for the final report. Along with some other sector representatives, he had also attended a seminar at the Carbon Trust on 9 November that was intended to inform their overview and which had received a presentation from Michael Grubb.

28. Bryan Bateman – who had also attended the Carbon Trust seminar – commented that he had not gained much additional information from Michael Grubb's presentation and expressed disappointment that the seminar had not addressed the criterion of profitability, as opposed to GVA. In his view, the impression gained – as also from a recent presentation in Sweden by Niall Mackenzie – remained that auctioning would make little difference – it was important for industry to remove any such impression. It would be helpful if Michael Grubb's proposed more detailed analysis ('deep dive') of three sectors could be extended more widely, albeit that additional funding would then be needed. Nick Sturgeon added that the consultants would like to do more work on the chemical sector but lacked the funding and were looking to the sector for input. Iain Morrow agreed to consider whether any further funding might be available from BERR.

**- Action Iain Morrow**

*Oxford Economics report*

29. Commenting on the Oxford Economics report introduced at the previous WG5/6 meeting, Bryan Bateman said that, notwithstanding that it was a macro study, he had found the structure and approach to be better than that used by CS. However, it would be useful to see the underlying detail and he had requested this from Niall Mackenzie. Jim Rushworth added that a 3-4 digit view would be helpful. Iain Morrow undertook to discuss further with Niall Mackenzie and BERR economists to obtain as much underlying data as possible.

**- Action Iain Morrow**

*Inclusion of Importers into the EU ETS ('Border tax adjustment')*

30. Bill Thompson said that a request to DG/Enterprise at the Spring Council (to consider how European industry could be protected against unfair competition) had resulted in a proposal which the Commission had presented to Business Europe in October. This had been briefly discussed at the previous WG meeting and subsequently circulated to WG8 members. The essence of this was that if an importer brought in a product with a carbon footprint lower than in the EU they would be eligible for an EU

ETS credit. Similarly if the product carbon footprint was higher, the importer would be required to pay for EU Allowances.

31. Richard Boarder expressed the view that it would be impossible to negotiate such a proposal in time for Phase III but Sue Young pointed to the fact that the French Government was very keen and that Total had produced a paper – which it would be useful to see if possible.

*- Action John Craven to pursue*

32. Nick Sturgeon said that he did not support any kind of ‘border tax adjustment’ for three reasons – the problem of ‘workability’, the inconsistency with efforts to achieve liberalised trade and the undermining of the UN process of multi-lateral follow-up to Kyoto.

#### *Phase length*

33. In response to a question about information on proposed phase length, Bill Thompson said that Point Carbon had reported a Commission spokesman mentioning 8 years; others round the table had also heard this figure quoted.

#### *Definitions*

34. On harmonisation of sector definitions – which varied across the 27 MSs - Lisa Constable said that DEFRA was considering this both internally and externally. She confirmed that they would be discussing with sectors - including with the AEP - and added that a separate piece of work was in hand on how CHP should be treated. Lisa Constable also mentioned that it appeared that the Commission might move to a broad definition of industrial installation.

#### **Aviation**

35. Lisa Constable reported that negotiations were continuing in Brussels on the inclusion of aviation in the EU ETS, with most areas still under discussion. The Portuguese EU Presidency was pressing for political agreement by the end of the year.

On 13 November, the European Parliament had voted on this issue in its 1<sup>st</sup> plenary session. The main conclusions were:

- That all flights into and out of the EU should be included from 2011
- That the level of the cap should be set at 90% of the total emissions from aviation for the average of 2004-2006
- 25% of allowances should be auctioned
- There should be a 2x multiplier applied to emissions from aviation to account for the non-CO2 impacts.

36. The UK supported the start date with all flights and also supported higher levels of auctioning than the Commission’s proposal (currently about 4%) and was pleased that the European Parliament shared the UK’s aspirations. That said, the UK was content with the Commission text that 100% of the 2004-2006 average would be an appropriate level of ambition for the industry. The UK did not agree that a multiplier was a suitable method to tackle the non-CO2 impacts of aviation and supported the Commission’s proposal to bring forward separate, tailored measures by the end of 2008 on this.

37. For BATA, Roger Wiltshire added that the European Parliament vote was a milestone in a longer process set to continue for the next 6-12 months.

**Updates on other ETG WG5/6 subgroup work not substantively covered by earlier items**

Benchmarking

38. Jim Rushworth gave the presentation at Annex 2 (already circulated to WG5/6 members) by way of update on the benchmarking work that was ongoing within sectors. His benchmarking subgroup was due to meet that afternoon to review progress and it was intended to provide a further report to the WG5/6 meeting in January 2008.

Proceeds of auctioning

39. John Craven noted that no formal report was available in the absence of Freya Phillips but it was understood that her proceeds of auctioning subgroup – including a representative from HM Treasury - had completed some preliminary exchanges and that it was hoped to present a more detailed report to the WG5/6 meeting in January 2008.

**Further WG5/6 meetings – currently scheduled for 10.30 am – 12.30 pm at the BERR Conference Centre:**

40. Further WG5/6 meetings were currently scheduled from 10.30 am – 12.30 pm on Monday 10 December 2007 and Tuesday 15 January 2008, both at the BERR Conference Centre. Later note: The 10 December meeting has now been cancelled and the potential agenda rolled forward to the meeting on 15 January.

**John Craven  
ETG Secretariat  
7 December 2007**