

TRANSCRIPT

WHAT WILL PHASE III LOOK LIKE?

DEBATE

Introduction

I am going to hand over to Bill Kyte to run our Panel Session this afternoon, which is going to look at the topic of “What will Phase III look like?” and create an opportunity to debate some of the issues around this. I will ask the Panel to come up as well and I will ask Bill to introduce them.

Bill Kyte

We are going to have a change of gear now and I am going to try and make this Panel Session a bit short and sharp and then afterwards you are going to be woken up and do a bit of work yourself and then we will have a final discussion. So, we are going to have a half an hour Panel of discussion. I am going to ask the Panel questions and I have asked them for the answer to each of these questions to be very short, one-minute maximum each. Afterwards, around the tables, we will have a ten-minute sort of delegate discussion for you to decide upon what the two most important issues for Phase III are as a table. Then we will spend ten minutes going and collecting those from each table and then the Panel, based upon that, will have ten minutes to sort of come back on what those issues are. Hopefully we will have a lively session here.

So, I will go straight into it and introduce our Panel.

We have got **Martina Priebe** from the International Emissions Trading Association, Manager of the EU ETS.

Iain Morrow from the Department of Trade and Industry, who is looking forward to strategy for Phase III.

Stephan Singer from Climate Change in WWF.

So you have three very different viewpoints here in the Panel and I hope they will all be short, sharp and provocative. So the first question I am going to ask.

Question (01:55)

What should be harmonised in the EU ETS and I will ask Stephan, Iain and Martina?

Answer

Stephan Singer: Thank you Bill. First of all we want an EU wide cap ignoring the national allocation plans in the future. So we need this EU wide cap based on the overall greenhouse gas emission reduction target being agreed hopefully very soon at the end of Government's Council. Second, we need an EU wide cap on the purchases of CDM/JI and AU to make sure that the EU wide cap is effective with a high carbon price in working domestically to trigger change here.

Iain Morrow: I suppose the main thing that people are talking about harmonising at the moment are new entrants. There are good internal market reasons for doing that. There is the possibility of harmonising for the allocation to existing plant, again still for discussion. Possibility of harmonising some of the rules on combustion and installation, beyond that it is rather unclear.

Martina Priebe: Well adding to this list I think you are all aware that the EU ETS Directive which continues, which doesn't have a sunset clause after 2012, does not specify whether EU allowances will be given out for free or whether they have to be sold to auctions. So at least there should be some

harmonisation between member states in this respect. There should be harmonisation on the quantities and the way these allocations are distributed. New entrants and closure reserves would also fall into the category of harmonisation, as well as already mentioned installation levels. Last, but not least, seeing Anne-Marie Warris here, monitoring and reporting guidelines or whatever regulations this will be.

Question (03:56)

BK: Thank you. Excellent answers.

Now moving on to the sectors and gases. Which sectors and gases do you think should move into the EU ETS past 2012? If we keep the same order.

Answer

SS: All gases from large installations should be included as long as they are as good monitorable and verifiable as CO₂ from fossil fuels. That would include, for instance, the aluminium sector, covered emissions and PFC's. Would include the chemicals and others production. Would include methane from coal-mines (the remaining ones) and would include CO₂ from ammonia and petro chemicals, but would not include surface transport. Would not include housing, because we believe the ETS is not the silver bullet for everything. The non-trading sector needs different instruments to get permission of actions than wider trading.

IM: OK. Slightly different view. Carbon capture and storage - I know it is not a gas or sector, but it should be in. Aviation. We would like surface transport to be seriously considered. That is not to say that we have a definite view on that, but we do think it is worth considering. On the exotic gases we think it needs to be on a case-by-case basis and you need to look at the other regulation that already covers those gases and question the benefit of including those gases in the trading scheme. The Commission's review is including, is looking at a number of other gases. N₂O from nitric acid, CO₂

from production of petrochemicals, CO₂ and N₂O from production of ammonia fertilisers, CO₂ and PFCs from aluminium and CH₄ from coal mines.

MP: Well, from an IETA point of view the debates it seems to us is whether we want to have fairly broad EU ETS in the future, or whether we want to concentrate with a few emitters on CO₂ emissions and then deepen the approach. Also whilst from our mandate we believe that there should be many sectors and emissions included. I think the previous speakers have already said that. We should set some criteria, but given the time I am not getting on to those. Just to give an example: you cannot just take any gas. For instance CH₄ from gas tubes [pipelines], it's a simple leakage, so it doesn't really make sense to include those gases in an EU ETS trading scheme. We should rather look into the regulation or other measures you have at your disposal.

Question (06:35)

BK: Thank you. Now we have already heard carbon capture and storage mentioned. How best can this actually be incorporated in the EU ETS, or should it not be incorporated? Should it be incentivised by some other mechanism?

Answer

SS: WWF strongly believes that CCS may play a role in the future, but we need a separate legislation for addressing those issues which are not linked to emissions or emission reduction per se. That includes safety of storage, liability, proper site assessment, which need a separate legislation and should be independent of the ETS in order not to overburden the ETS because it is complicated enough. Then we would like to see, independent of the ETS, carbon capture readiness for all new coal fired power stations as soon as possible and mandatory CCS for all new coal and gas fired power stations, preferably some date in the next ten years. Of course a transition to carbon capture for all existing power stations and of course the strength and cap,

which should be automatically part of an EU legislation to cut emissions drastically. Automatically incentivise carbon capture and storage be part of the CCS, but again liability and safety of storage require a different legislation.

IM: CCS should be included in ETS. Like the previous speaker I believe that many of the issues that you need to deal with don't fall directly within the ETS legislation and long-term liability and monitoring. You need to look at other legislation like the OSPAR which we have been.

MP: The potential of CCS is huge, but uneconomic for the moment. So, an inclusion in the EU ETS I think is advocated in this respect, but just like Stephan we also think that there should be adjacent legislation if only to regulate the choice of sites and the oversight of how CO₂ is stored. As to the mechanics we believe it should be in terms of crediting, rather than giving out EU allowances, if only again, how do you want to monitor CO₂ in storage? So, it looks like to me that credits would probably be the most viable mechanism.

Question (08:47)

Thank you. We have often heard business right the way across Europe talking about that the period of allocation and the period of certainty is far too small. How can we actually deliver within Phase III that predictability that business needs to make those investments that will produce emission reductions?

Answer

SS: We definitely would wish, as part of a long-term agreement not only in the EU but also in the overall post 2012 process, hopefully a legally binding target for the EU, also for 2050 and then working back what that would mean for the various commitment paths. A long term legally binding greenhouse gas and emission reduction target should ideally be something like 80% of greenhouse gas emissions in naturalized countries and is consistent with staying below

2° global warming. Then you would have predictability, you would have the framework. It is a tough one I agree, but it is what is needed and then you would work back what this would mean for whatever ten years or five years commitment depending on what has been decided in the legal framework debate.

IM: I am not actually going to answer that question. I am going to turn it round and say: given the number of business people in the audience what are the most important issues for you in terms of predictability? The sort of messages we have been getting in Government are the number of allowances, the cap, the use of JI/CDM credits, which sectors and gases are included, and links to binding international targets. The question I would ask is: are those the right elements and if so which is the order of priority?

MP: Well this will be a short answer. If only that in IETA the thinking process is on going, but we are tending towards a ten-year rolling cap. A little bit like the Australian states and territory emissions trading proposal. So that means changes could be introduced within that ten-year period, but will only become effective after the period expires.

Question (10:50)

Thank you. Now one of the big issues that is being talked about allocation and the Commission has particularly raised is whether we should continue with the system whereby a member state sets caps or should there be EU wide caps, or should there be sector caps? So what are your views on some of these issues?

Answer

SS: We would definitely like to have an EU wide cap in order to have a more harmonised, more effective and less burdensome agreement on what that would mean for individual installations. I have said before in the beginning we want to promote a cap being based on the level of the overall greenhouse gas

emission reduction target agreed by the European Union for 2020 and long-term and definitely the ETS sector should take based on its economic potential, a slightly higher burden or benefit, however you want to call it, compared to the non-trading sector.

IM: We would like to see a more harmonised process for setting caps, whether that means at EU or member state level we have no view yet.

MP: Bill, it seems to me that the answer to this really has two sides. The first side is who is actually determining the level? The second side is who is actually centrally distributing the allowances? Now it seems to me that we have already been taken over by events in Phase II. Whilst we still believe we have national caps, the fact that the Commission has applied a formula, which has so accurately been explained in one of the previous presentations, so we are already finding ourselves with some kind of central level setting. The future may look like we could continue with some kind of burden sharing, which then will end up in some kind of zero net gain. So that might actually then be that this particular cap will be determined more centrally by the European Commission or the EU member states working together. If it comes to centralised allocation then we are looking more at the theoretical possibility of 100 per cent auctioning or harmonised benchmarking system, but that obviously has its own difficulties.

Question (13:21)

Thank you. We now come to an issue that I once likened to Banquo's ghost at the feast that was given in Macbeth and where perhaps only one sector of society saw it. I refer of course to auctioning. Now there are many issues relating to auctioning, but one I would like to explore is: should we move from a maximum amount that can be auctioned where it is voluntary, to a minimum amount that needs to be auctioned and it is mandatory?

Answer

SS: Well we are aiming at the ceiling and not at the bottom and we still believe that judgement is open and we would opt for 100 per cent auctioning as soon as possible for a couple of reasons. Not only to overcome the windfall benefits and the power sector bill, but also to create something that I would call equity dividend. We need lots of money globally to increase investment and actions. Not only in renewable energy and efficiency in Europe, but also worldwide. We have talked about carbon capture and storage. We need to bridge the marginal cost of CCS deployment in India, China, and South Africa etc. We need to help those countries to decarbonise. Last, but not least, we need lots of money for legitimate adaptation in these developing countries to adapt to climate change. To give you a simple calculation of what money could be raised from auctioning. If you assume a price of 20 Euro per tonne of CO₂ and you currently assume that the eligible sector of the EU 27 ETS emits 2.3 giga tonnes of carbon dioxide. Then you would have, based on the 20 Euro per tonne of CO₂, something like 46 billion Euro available per year. I am not saying everything should be given to the sectors I mentioned before. If you would compensate some of those few industries from the energy and carbon intensive sector, which are exposed particularly to competitiveness issue, you would compensate them, you would still have lots of money available for the other purposes. Something like 15 to 20 billion dollars per year available. What I call the fairness of equity dividend for developing countries, and other actions in Europe I think would be more than enough to help decarbonise our economies, not just in Europe, faster than we may think.

IM: In the long-term we want to see 100 per cent auctioning. The question is how fast do we move there. The main consideration I would think is the ability of different sectors to pass on the cost of allowances and that is linked to the issue of exposure to international competition. To me that suggests that is worth exploring a sectoral approach much as we did in Phase II, but perhaps dare I say more sophisticated. But no view yet on figures if we were going to go down a minimum mandatory route.

MP: If the question is if we should harmonise or not then definitely we should harmonise as I have already mentioned. The current Directive leaves it totally open to member states whether they should be auctioning or not. We just believe that this could open the door wide to distortions in competition. But as to the point of whether one should advocate auctioning or not. Oh, yes and the way this can be dealt with is either with a cap or as you suggested Bill with the minimum level of auctioning. But to the question whether auctioning should be supported or not, we have nevertheless some serious doubts about this approach, which we know is advocated mostly by Government's, NGOs, European Parliament and so on, because there are some considerations which need to take care of the pure transfer of capital from industry to state coffers. The distributional aspects which also can create huge distortions. Last, but not least, equity concerns, in particular we have for industries highly exposed to competition. We know that all allocation methodologies can take account of this and in terms of auctioning we are definitely looking at some form of recycling because otherwise auctioning will purely and simply be considered as a tax.

Question (18:00)

Well the Panel has been so efficient that I am now moving into my reserve set of questions and I want to actually widen it out and look at Phase III in relation to the international discussions that are going on. So I would ask the question do people, do the Panel think that there will be a global agreement post 2012 and what sort of shape it would take and who will actually be involved in it?

Answer

SS: Half a minute? [Couple of minutes for this one.] Well definitely we believe that there will be a post 2012 agreement. It is definitely hard to predict who will be involved, which sectors will be involved, what the overall framework will be, and what the numbers will be. I think that is the salt in the soup. We believe strongly that the US will come back in two years time when Bush has gone. Whoever will be the new President definitely I think that is

our assumption, only ours, will be part of the new regime past 2012. Probably not immediately in 2013, it will take a couple of years, but we are quite optimistic that is what will happen. Getting the US back on board will also give very strong signals to other large industrialising, but still developing countries like China and India to look into ways in which they could come back. Not come back, which way they could join a global common market. I think psychologically and mentally it is very important to make sure that only for currently industrialised countries a cap and trade regime will work. Absolute caps only for them. I think we would be completely stupid to ask China, India, South Africa and Mexico all the time and say what is your contribution, what is your contribution. We make a mistake, we make the mistake to corner China. I think some of us were very insensitive in a way. We should take note that lots of actions are happening in China already. Many actions in the renewable and energy efficiency field which are very promising and I would wish that many other developing countries, and even developed countries, will take similar actions. Our belief is to get those countries on board in a speedily decarbonising way and help them to overcome, to decouple the economy, economic growth and carbon emissions. It is not to ask them what you can do for Kyoto. I think we have to ask ourselves what can the carbon market do? What can our businesses do? What can stakeholders like NGO's do to help you to be part of an emerging global regime, rather than cornering them and asking them and showing them the hand. Say we want to work together jointly and I have great faith to be honest with you in the European Union, particularly in the China/EU negotiations on helping China to deploy a couple of technologies. Not only CCS, although CCS is a major part of it, but I think that is the way to work with these countries.

IM: Yes, but I have enough trouble keeping up with ETS quite frankly so I am not sure what the future global picture will be like. I think the challenge will be making sure that ETS is compatible with it.

MP: Again I think IETA, as an international organisation, was not set up just to look at the EU ETS. In fact it is perhaps one third of our preoccupation. So

we are looking into a truly global market and we are seeing positive signs. As already mentioned, even in the United States, which has not ratified the Kyoto Protocol, we have RGGI, we have California and the Mayor's initiatives. So there is a lot going on and we see actually that there is scope even though negotiations do not have to start when those systems are in place. They have to start now on how we can get together. I also don't think that anybody is pointing at China and India in a negative way, but I think realistically if those countries, those states will have the same level, the same quality of life, we would need two times more resources than we have than the earth is giving us. So there is a real problem here. I think as Stephan says it cannot be under pressure, but it cannot just be letting it go. So, the strategy definitely has to be in co-operation. CDM/JI is pointing in a good direction, but I can see that at least China, India maybe later, can participate in some kind of a emissions trading scheme. I don't see why they shouldn't.

Question (22:48)

Given that there are a few schemes beginning to be up and running. The RGGI system, California, and perhaps a nascent market in Australia. Do you think, a very quick response, that the EU ETS would be able to link to these?

Answer

SS: Yes, and I think they should, but based on credible and transparent rules. I think California maybe the most likely and most promising example to link.

IM: I think we should seriously consider it. Things I would consider when looking at linking to particular schemes are: There is monitoring and reporting. There is compatibility to different types of schemes. There is the issue of predictability for participants in the ETS if you are suddenly expanding the market substantially that could impact negatively on predictability.

MP: Well at the time before the Harper Government took over we were very seriously looking into the linking between Canada and the EU ETS. I think that gave us some good insight that indeed you can link and even the very thorny issue about relative targets. When you listen to the European Commission and Justin Baker, he thinks it is the devil, so you can never link with somebody having relative targets. But even there we have found solutions of how this is still possible to link. So I am quite positive taking that particular case where we have been quite far in looking at the possibilities of linking. I am quite optimistic about the other systems, but it is work ahead.

Question (24:52)

Just to end on a personal note. I ask each of the Panel for their personal, if they had a personal wish, what they would wish to see for one change in the EU ETS? One change only.

Answer

SS: OK, actually good question. We would like to see a strong cap on the year 2050. What makes the carbon sector carbon free by 2050. The power sector, not the carbon sector, sorry.

IM: We need to think seriously about setting the limits of the scheme further ahead.

MP: I would side with the second speaker.

End of Question and Answers (25:28)

OK. Well thank you all very much. I think there is an awful lot that the Panel has given us.

Now I am going to turn it over to you and you are going to do some work. You have got ten minutes in each of your tables to discuss and come up with two of what you consider the top issues for Phase III of the EU ETS.

[tables bring up issues for panel to discuss]

Well, thank you very much. You have all been very efficient and now that gives us a little bit of time for the Panel to respond on these. I am also going to ask our Chairman, who has been noting all of these down, whether he notices any things that are really standing out to him from the list of things that he has got there. So basically you have got three minutes each.

Panel (34:58)

SS: Thank you Bill.

To start on the very back over there I am very happy that someone mentioned CHP. I think we tend to under-estimate the potential of CHP, not only in Europe but globally. Just to remind you currently we have about less than 10 per cent of CHP as a percentage of the power produced in Europe. It could be much, much higher. I think I fully agree if you find a piece in the future, hopefully harmonised legislative piece for the ETS to give the benefits for CHP, definitely we would support that one.

Second what I realised was that there is a common notion among those of you who are industry, and I assume most of you are, some are associated with industry, on a harmonised European wide cap setting, plus predictability which goes beyond the next five years likely commitment period. I think that meets WWF's NGO's perception on having predictability linked, but also with quite tight and strengthened caps for the future. So we are quite pleased with that one.

We may probably disagree on the issue of who would set this cap. Certainly I don't want to open that one up. But I think if there is a kind of promotion from

certain stakeholders, including industry, NGO's, others and think tanks on a more harmonised system based on an EU wide cap, I think we need to get our brains together and to have a kind of common understanding on who should set the cap. Is it a Commission? Is it a group of wise bold men? Is it think tanks? I think we need to give this proposal out to be productive, to be constructive and to shape the debate. WWF is offering to work with you on that one.

The last issue for me is a little bit of concern - the issue of the request for increasing the global system. Yes, of course we need more globalised commitments to climate change abatement, but I want a little bit to make a more globalised system of the ETS or for the ETS a precondition for accepting strengths on Phase III. I think we have to be aware of the simple fact and it is a simple fact. We cannot have China and India and other large developing countries or sectors with a similar level of target, with a similar level of compliance as we have asked industrialised countries such as the European Union large industrialised sector to take up a target. It wouldn't work from a couple of equity reasons, from a couple of reasons as regarding industrial development. I think we have to be quite realistic on that one. It means industrialised countries still have to take the first step and take the lead on driving emissions reductions forward because we are still the largest emitters globally. I think that has to be capped and might nevertheless agree an increasing decarbonisation of the sectors, including credible CDM projects in those sectors and large industrialised developing countries. A definite yes to that one.

IM: OK, there are three issues that I picked out as coming up again and again.

First was giving a long-term view principally I think of the cap, but possibly for other decisions as well. Secondly having a global system and thirdly having a more harmonised approach.

There were a couple of other issues that were quite interesting to me. A simpler energy policy and clarity on CCA's. We're publishing a little advertisement here, we're publishing an energy white paper this spring. You may want to look out for that.

Other issues. Better monitoring, reporting. Yes, absolutely.

Somebody asking for transport to be included. Interesting. We had quite a few people saying that they don't think it would be effective so I'm interested to know the basis for that.

Going on to the big issues – long-term view. I think the crucial question for us is how long-term do you need? We hear anything between five and possibly 30 years. To me, setting the rules of the scheme absolutely with no room for manoeuvre for 30 years ahead seems too far. The question is where in that spectrum do you sit? I think we are looking more than five is the right answer, but I am not sure 30 is it.

A global system. Yes we are looking hard at how we might sensibly link to other schemes.

Harmonisation. For me that one comes down to harmonisation on what a lot of people said - allocation and methodology. There are other issues that harmonisation covers. How you define a combustion installation. What sectors are included? It goes on. So harmonisation yes, but harmonisation upon what?

MP: Bill I was waiting a bit for the question where I had to say "I pass", but there wasn't such a question.

What I detect in the room is that you can split the audience obviously between those in the trading sector and looking more to what predictability, harmonisation to avoid distortions in competition. Yes, the CHP issue is a particular issue, but I think it is one which we should take forward. Long-term

views. Then the other side of the audience, which I would think surprisingly is a bit in the minority, which would say caps, stringency, stronger caps, more auctioning. Those are the people which I would place more on the trading side, maybe on the more neutral side saying: well the system has to reduce, it has to give incentives, it has to lead as a good example in order to have further buy-in from other regions. I mean there are so many questions. How much in China and India should we use? By the way you are always coming back to this Stephan, but I think there is now a good approach which is not necessarily reflected in the discussions of the UNFCCC, but if I look at the Commission's energy paper I think there is a quite reasonable strategy on how to deal with these countries and reduction targets which they believe are possible.

I would like to come back though to one particular point which is: who should set the cap? The question I would like to add is: when do we set the cap? We now know at least the European Commission's ambition is that it should be 20 per cent until 2020, but little do we know how this will reflect in the EU ETS. So it almost seems to me for those eager to have predictability, scarcity and so on there should be some kind of mechanism where we can get more certainty ahead until we know what the 2020 target or the 30 per cent actually could be. So I think there should be some mechanism that we can get some certainty earlier than perhaps member states are ready to say on the EU ETS in Phase III.

Bill Kyte (43:10)

Can I ask James for anything that he detected?

James

I was just making a note of what came up and it was quite clear as we went around the room that the Panel have picked it up. Close to half the room mentioned harmonisation. Whatever that means, as Ian said. Whether it is allocation, cap setting, coverage, monitoring and auctioning, but clearly a big

push for harmonisation. Close to half the room again said long-term views, long-term cap so creating that long-term certainty for investment decisions that may last 20 years plus. The other big issue that came up lots of times was the global system and linking. There were at least five or six issues that came up more than once and others were simplifying domestic policy in removing overlaps. Interested to hear that we should look at the energy white paper. Auctioning came up more than once and also recognition of CCS. So I think the Panel picked up on the key themes that came out across the room.

Bill Kyte

Well thank you very much. I think some very interesting messages have come out of this session and I hope you will take some of these messages through to the UK Government. I think the other message that is coming to me, and that Stephan has pointed out, we really need to define what we actually mean by global climate change. I think we are in great difficulty of actually confusing ourselves and confusing developing nations and others, because we obviously can't put the same criteria on the US as we can on China and India. I think we need to be very much clearer in what we actually say about this issue. I think that is something useful for people to think. What do they actually mean by global system? What do they mean and how can it be implemented, because this is the thorny question that has actually got to be addressed in the international negotiations.

Finally, I would like you to join me in thanking the Panel for they have really done an excellent job. They have kept to time, they have answered a number of questions and I think have really got their thoughts over. What I have noted is when you pare it down to the real essentials how much there is in common between NGO, a Government and business.

Thank you very much.

End of debate