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Dear David

Response from the Confederation of Paper Industries to the EU ETS Joint Consultation on the Possible Phase III Opt-out for Small Emitters & GQCHP Issues for Phase II NER

The Confederation of Paper Industries Ltd (CPI) works on behalf of the UK's paper industries. CPI represents the whole of the paper chain starting with the recovery of used paper, papermaking, conversion into finished products and distribution. The paper-making sector, which includes the manufacture of pulp, paper, board and tissue, is the most energy-intensive of all the activities in our industry and "production of pulp and paper" is a listed Annex 1 activity in the EU ETS Directive.

CPI, through the Paper Sector Climate Change Management Company Ltd, advises the papermaking sector on compliance with the requirements of EU ETS and co-ordinates verification activity on behalf of the mills. There are 42 paper mills in EU ETS at present emitting some 3 million tonnes per annum of CO₂ (1% of the traded sector).

CPI's website may be found at www.paper.org.uk

1. Do you consider opting out small emitters from EU ETS III (post 2013) would be beneficial to the installations affected?

In general we support the principle of simpler, appropriate and cost effective regulation.

At present neither the final details of EU ETS Phase III nor the installation level energy efficiency targets for the new CCA are finalised (assuming any EU ETS opted out paper mills would participate in CCA). This means it is simply not possible at this stage to make a definitive assessment of the advantages and disadvantages of opting out.

It follows that the logical approach would be to allow a voluntary opt out at a later date when more issues have been resolved or clarified.

The key unresolved issues are;

- The pulp & paper sector is accepted as at risk of carbon leakage, meaning that sector installations will continue to receive an amount of free allocation throughout Phase III EU ETS. The level of this free allocation is not yet finalised. As the specific benchmarks will be set by the 10% most efficient installations (and allowance will be made for the overall reducing cap) it is clear that at least 90% of installations will be short of allowances compared to business as usual.
- Accepting that there will continue to be uncertainty over the cost of purchased allowances to cover shortfalls, this uncertainty generally falls as the time period shortens, thus supporting a voluntary opt out approach.
- Initial indications are that the new CCA will seek to implement substantial reductions in relative energy use. The relative difference between the CCA target and the tightened EU ETS Phase III cannot yet be judged.

2. Order of preference between the four options

Option 1 – no opt out – We do not support this option. Smaller installations contribute a small amount to overall EU ETS emissions, while the installations themselves have to comply with the difficulty and expense of compliance. Member States with equivalent national measures should give operators an opportunity to opt out of EU ETS.

Option 2 – Mandatory opt out – We do not support this option. The unresolved issues in both EU ETS III and new CCA mean it is not possible to assess the impact on different installations.

Option 3 – Partial voluntary opt out where no negative impact on competition is identified – We express no opinion, as the unresolved issues in both EU ETS III and new CCA mean it is not possible to assess the impact on different installations.

Option 4 – Voluntary opt out – This option is our strong preference as it allows installations to make their own assessment of the relative merits of opting out.

3. Any competition issues either within a sector or with other sectors?

The potential for competitive distortion is inevitable where thresholds for inclusion in schemes are set. Indeed the current threshold for inclusion mean that a number of smaller mills are already excluded from EU ETS and this does not seem to cause undue competitive problems. The requirement for opted out installations to join a broadly equivalent national scheme will further reduce competitive issues and within the UK a clear differential between CCA and EU ETS will also help. However the paper sector is competitive internationally and across the EU, meaning that likely different implementation between Member States means that if there are competitive distortions, the UK Government cannot avoid them through its own strategy. If this is the case then no doubt the UK Government would seek to ensure UK industry is not disadvantaged. This can be achieved by allowing installations the maximum flexibility.

Specific issue around biomass if the opt out were to be made compulsory.

Policies are encouraging the move towards greater use of biomass for energy production (especially the UK RHI) with a number of paper mills having already invested or in the process of doing so. EU ETS effectively rewards investment in biomass through the allowance allocation methodology. It would be counter productive if mills were to fall below the 25,000 threshold due to an investment in biomass and then be penalised by an automatic opt out of EU ETS and so lose the reward of having excess allowances. The requirement that opted out installations must have a rated thermal input of less than 35 MW may not help as this excludes emissions from biomass. There may also be a specific issue for sites with a third party CHP operator as in these cases it is not yet resolved who will receive any free allocation – the heat producer or heat user. If the allocation were to be made to the heat user (as seems logical), then the heat user could be a zero emitter for purposes of EU ETS (all emissions arising from the third party), meaning the site could be compulsorily opted out of EU ETS and lose the allowances on offer. It is unlikely this would happen to equally across the EU as the third party energy supply model is not consistently used.

4. Any views on the proposal that CCA & CRC offer equivalent measures to EU ETS?

No comment.

5. If an installation is opted out will it fall into CCA or CRC?

At present all paper mills are in CCA and those meeting the eligibility thresholds are also in EU ETS. In the new CCA, the provision to avoid double counting means any mills remaining in EU ETS will have CCA targets changed to electricity only. Accordingly this means that any EU ETS opted out site would simply be fully covered by the new CCA.

With a mandatory opt out, a number of sites around the 25,000 tpa threshold could be in the strange position of either being opted in or out of EU ETS, yet even a relatively small change in production would see them being forced to opt out or rejoin the scheme. Better to allow such installations to make their own decision on the advisability of opting out.

If a mandatory opt out is implemented, then it would seem sensible to allow a margin around the 25,000 tpa level without triggering an automatic requirement to change schemes. In essence, if a mill is below the limit and opts out it would not come back into the scheme until its emissions were say 5% above the limit whilst it would then be included until its emissions fell to say 5% below the target. If the band was set sensibly then mills would generally either be in or out unless they made some structural change to their business. Without such arrangements the scheme administration would actually become more complex rather than simpler as is the intention of the proposals.

6. Which scheme incurs the most internal costs – EU ETS, CCA or CRC?

All three schemes require proper internal record keeping and so costs cannot be differentiated on that basis.

However EU ETS has especially complex Monitoring, Reporting & Verification rules; in particular the requirement for independent verification necessitating an annual site visit. The mandatory involvement of independent verification inevitably incurs additional direct costs as well as time required for preparation and management of the verification – this effort on top of the routine effort required to maintain proper scheme and emission records. Additionally annual and other fees levied by the scheme regulator are high in EU ETS compared to CCA (or CRC). The cost estimate in the Impact Assessment for the direct cost of independent verification at £2,000 per site per year is reasonable. Additionally, within EU ETS the responsibility for compliance is strictly with the installation, while for CCA, responsibility is effectively shared with the Trade Association. The removal of the annual site visit requirement, plus the additional support from the Trade Associations within CCA also offers a saving in site staff time estimated as a minimum of four days per annum. It should be noted that because the new CCA will still include electricity purchases, sites not opted out of EU ETS will be in both schemes, while opted out schemes will be within (for them) an expanded CCA.

Q 6-12 Predominantly aimed at hospitals

No comment.

Q13. CHP New Entrant Reserve

We support the proposal that the unallocated CHP NER should be added to the pool of allowances available for the NER in general. However any demand for new CHP generation equipment should of course be assessed and allowed for – we are aware that a number of paper mills are planning new CHP likely to be commissioned towards the end of Phase II. We have urged such installations to ensure their proposals are logged with the administration of the GQ CHP scheme.

We also suggest that allowances from closed installations should be added back into the NER pool on the basis that capacity has been lost and is being replaced in the normal course of business. We understand this is the normal procedure followed in other Member States. We have experienced considerable capacity closures in the paper sector during the course of EU ETS Phase II, and yet the new Palm paper mill has no free allocation of allowances and is not likely to get one. We understand that should this mill have been built almost anywhere else in the EU it would have received a free allocation. A similar issue will be faced by any new installation commissioned during the remainder of Phase II.

Please do not hesitate to contact me if there is any additional information you require.

Yours sincerely

Steve Freeman
Energy & Environment Manager