

Workshop on “Emission Trading – Challenges for Industry”

DRAFT REPORT

TIME: May 13-14, 2004

PLACE: Tallinn, Estonia

PARTICIPANTS: Industrial enterprises and associations from energy and different industrial sectors – cement, glass fibre, construction, pulp and paper, oil refinery, etc., ministries of environment and/or their subordinated institutions, scientists and consultants from Estonia, Latvia, Lithuania as well as experts from Denmark, Finland, Germany, UK, and the Netherlands. In total 55 participants.

GOALS OF THE WORKSHOP:

- To increase knowledge and understanding about the EU greenhouse gas emission allowance trading policy and related requirements.
- To discuss main challenges and potential solutions with regard to emission trading for industry e.g., monitoring, reporting, compliance control, potential markets and procedures.

PROCEEDINGS:

Opening of the workshop, by Ms. Heidrun Fammler, Baltic Environmental Forum (BEF)

Ms. Fammler opened the workshop and welcomed participants. She pointed out that greenhouse gas (GHG) emissions trading scheme (ETS) is one of the most important recent developments in the EU legislation influencing the industrial sector. It is an economic instrument for environmental protection to reduce emissions of GHG in an economically efficient manner. At the same time it is a new and challenging issue both for competent authorities and industry.

Ms. Fammler informed that in February 2004 BEF organised a meeting for competent authorities to discuss developments and main challenges with regard to National Allocation Plans (NAPs) as well as first experience and future plans for introduction and administration of CO₂ tax in the Baltic States. Currently all Baltic States have submitted their NAPs or its drafts to the European Commission (EC). The emission trading scheme should start operating from January 1 2005, thus the main goal of this event is to discuss its specific requirements and consequences to the business sector.

Later on the agenda of the workshop was presented.

SESSION I. GENERAL OVERVIEW ON THE EU EMISSION TRADING SYSTEM

Requirements for the business sector

by Mr. Jochen Harnisch, Ecofys GmbH, Germany

Mr. Harnisch introduced the main provisions of the Directive 2003/87/EC¹ elaborated in order to achieve the GHG emission reduction targets for Europe set by the Kyoto Protocol (1997). The target sector for the Directive is large emitters from the heat/power (combustion installations) and industrial sectors e.g., refineries, coke ovens, production of iron and steel and sinter, cement and lime, glass and ceramics, pulp and paper. Waste incineration, primary aluminium production and chemical processes are not yet included. However, for example, incineration of waste other than biomass (e.g., waste from cement industry) is covered by ETS.

¹ Directive 2003/87/EC establishing a scheme for greenhouse gas emission allowance trading within the Community and amending Council Directive 96/61/EC

Mr. Harnisch informed that the EC has already issued the Monitoring guidelines and is preparing the Regulation on Registry. Also in summer 2004 the Directive 2003/87/EC will be amended by the so called “Linking Directive” linking Kyoto flexible mechanisms with the EU emissions trading scheme (ETS).

Mr. Harnisch gave a brief overview on the main principles and obligations of the EU ETS. According to the Directive, Member States have to decide about the amount of CO₂ emission allowances to be allocated to each relevant installation. For emissions trading operators have to:

- apply for CO₂ emission permit and emission allowances;
- set up an emission monitoring system (calculation or measurements);
- submit annually verified emission reports.

Operators of installations can transfer and borrow allowances within one trading period (e.g., 2005-2007). By the end of the period operators have to return an amount of allowances equivalent to their annual emissions. Operators could benefit from:

- timely adaptation of investment strategy and operating practices;
- long-term access to relevant inputs: biomass, electricity, new raw materials;
- wise use of allowance price fluctuations;
- international reduction projects.

Potential risks to companies could be related to:

- investments done either too early or too late;
- over-investment at low allowance prices;
- speculative allowance price fluctuations;
- legal disputes about emissions reports and permits;
- indirect effects: electricity prices and sector policies;
- penalties and negative publicity.

He also pointed out that currently there are several price estimations ranging from 1 to 10 Euro per ton of CO₂ in the first period. The price uncertainty is very high. It can be influenced by various factors and can also vary a lot during the trading periods.

Discussion:

Participants discussed the following questions:

- Decision on opting out from the ETS shall be taken by national government; however the companies still are obligated to fulfil the necessary monitoring requirements to demonstrate comparable reductions of emissions. For example, in the Netherlands the most important requirement for industry installations to opt out is monitoring. The Netherlands is considering opting out for small installations. In the UK, the government has applied opting out for participants of the UK emissions trading scheme. Still they have to prove that they are taking measures to reduce emissions.
- The Baltic States are rich in biofuels; however a lot of them (e.g., wood chips) are exported abroad. Thus importing countries are benefiting from incineration of biofuels by saving more allowances. Unfortunately there are no provisions for counting such “imaginary allowances”. As the process is driven by the market forces, the Baltic States should just motivate its companies to sell biofuels to local power plants instead of exporting them.
- Submitted NAPs show that countries are having “industry friendly” approach for granting allowances, which threatens to create excess of allowances. If the price gets too low (less than 1 Euro), there will be a big danger that no real market will emerge. Now the EC has to make decision for approval/rejection of NAPs.

Impact of the EU Emission Trading to Electricity Sector

by Mr. Valdur Lahtvee, Stockholm Environment Institute Tallinn Centre (SEI – Tallinn), Estonia

Mr. Lahtvee introduced the European Union of the Electricity Industry “Eurelectric”, which represents the industry in public affairs, particularly in relation to the EU legislative institutions in order to

promote the interests of its members in the political sphere and ensure awareness of the industry's policies. More information about the union is available at www.eurelectric.org.

Mr. Lahtvee pointed out that the electricity industry is fully committed to contributing its share of the required emission reductions, but is, nevertheless, concerned that any measures taken should be as cost-efficient as possible and cause as little distortion to the market as possible. During the adoption of the Directive 2003/87/EC, "Eurelectric" submitted a number of Position Papers on the EC's original proposal, and on the drafts produced by the European Parliament and the EU Council of Ministers.

He emphasized that the energy production sector is the main contributor to CO₂ emissions. Concerning enterprises, emissions of some energy producing companies are higher than some country's total emissions. Estonian CO₂ emissions are relatively high in comparison with other European countries. For example, in year 2002 emissions were 12,2 t CO₂ per capita. However, Estonia has fulfilled its Kyoto commitment – for the year 2001 the CO₂ reduction compared to 1990 was 55%.

Mr. Lahtvee presented the different estimations of the EU ETS impact to electricity prices depending on the prices of CO₂ allowances, electricity demand and supply, capacities available, etc. in Europe. Potential increase for electricity price in the Baltic States depends on national conditions and on final outcome of NAPs.

In conclusion, Mr. Lahtvee pointed out that electricity sector:

- is positive towards launching of the EU ETS as cost-effective market based tool to mitigate climate change, however expresses concerns that too much burden is put on electricity sector via tough NAP and that other sectors' emissions are not properly addressed within the EU ETS as well by environmental regulations;
- is pro-active to seek innovative measures and take voluntary actions in order to reduce GHG emissions by improved technologies and increased energy efficiency in production and supply, but considers that more measures should be taken at end-users side of the electricity and by other sectors like industry, transport etc.

Discussion:

- Electricity sector price increase estimations are usually presented taking into account the so called "worse case scenarios" – very high increase of electricity demand, very low allowance price, high investments needed in new facilities, etc. From another hand currently most of the companies in the Baltic States are using fossil fuels (coal, oil shale, liquid fuels) thus not complying with the EU requirements, for example on large combustion plants. Possible income from emission trading will not cover the necessary costs thus increase in electricity price still can be envisaged.

Overview on the Baltic National Allocation Plans (NAPs)

ESTONIA

by Mr. Tiit Kallaste, SEI - Tallinn

Mr. Kallaste informed that the preparation of the Estonian NAP started in September 2003 with checking of eligible installations, data collection, etc. Preparation of NAP was carried out mainly by experts from the SEI-Tallinn and the Tallinn University of Technology. A Climate Expert Commission involving 20 experts from competent authorities (e.g., Ministry of the Environment), research and development institutions, industry, etc. was established to supervise the process. The first draft NAP was ready in April and was put on Internet for public hearing. On 13 May the Estonian proposal for NAP was discussed by the Estonian Government.² The English translation of the NAP will be also prepared.

² The Estonian Government adopted the NAP and on 19 May it was send to the European Commission

Mr. Kallaste informed that in total operators of 43 installations (36 - energy sector, 5 - mineral industry, 2 – other activities) have to be involved in the ETS. Two different base line periods were chosen: years 1995 –2003 for boiler houses and 2000 – 2003 for industry, including power generation. Total allocation for 2005 – 2007 is ~65 Mt. Reserve includes allowances for new entrants and *force majeure* – 3% (1.94 Mt).

Mr. Kallaste pointed out the main challenges for the operators of installation:

- to be a seller of saved allowances and gain more income for less carbon-intensive technologies;
- to learn from the pilot phase and be prepared for trading under the Kyoto scheme with aim to realise the project based ERU's³
- to learn about the company's own potentials in energy efficiency.

He also admitted that operators are willing to participate in the EU ETS, however, there are still confusions and many open questions with regard to e.g., EU ETS and Joint Implementation, etc.

Discussion:

- For the Baltic States there is no need to “reach” Kyoto target, while the situation is totally opposite in “old” Member States. However, unfortunately, neither the Directive nor Guidelines handle this opposite situation in the “new” Member States.
- During public hearing period, the main questions/concerns from industrial enterprises were related to the amounts of allocated allowances, overall bases for EU ETS, principles of pooling, additional allowances for early action, etc.

LATVIA

by Ms. Dagnija Blumberga, Riga Technical University

Ms. Blumberga informed that also in Latvia preparation of NAP started in September 2003 and was carried out by the experts of the consulting company “Ekodoma”, the Riga Technical University, Ministry of Environment and industry representatives (6 experts in total). Necessary data were collected by sending out questionnaires to all companies potentially involved in emission trading, as well as visiting them for data clarifications. The draft NAP was put in Internet for public hearing from March-April 2004. On 1 May, after approval of the Government, it was submitted to the European Commission.

Ms. Blumberga explained that in Latvia the base years were set differently:

- For energy activities - average coldest year (1997);
- For energy installations which started to operate after 1997 – base years 2001 or 2002;
- For industries - based on the developments and achievements of the company and future projections.

Additional emission allowances were given to those installations which have already implemented GHG emission reduction measures (e.g., fuel switch, improvement of district heating pipelines, and improvement of boiler efficiency).

In Latvia for 71 installations (60 – energy, 1- production and processing of ferrous metals, 10 – mineral industry, 1 – paper production) participation in ETS is mandatory. 24 other installations from energy sector will participate voluntarily. For the first period 4, 9 million allowances are allocated.

With regard to the next steps to be taken, Ms. Blumberga informed that the Cabinet of Ministers Regulation on GHG permits should be adopted soon. Two other Regulations on “Activities allowed with emission allowances and pooling” and on “Monitoring and reporting of GHG emissions” are currently also under preparation. Until the end of September 2004, all installations mentioned in NAP will have to receive GHG permits by relevant Regional Environmental Boards. The Latvian

³ Emission Reduction Units issued under Joint Implementation

Environmental Agency has been assigned as the responsible institution for implementation of emission trading scheme, including managing of registry etc.

Discussion:

- In Latvia high reserve (36%) was left for new entrants – 5 big combined heat and power plants and 1 condensation plant (400 MW) in accordance with estimations of the Ministry of Economy. New entrants will receive allowances based on benchmarking for new technologies.

LITHUANIA

by Mr. Martynas Nagevicius, “Ekostrategija”

Mr. Nagevicius informed that the preparation of Lithuanian NAP started only in February 2004, involving experts from the consulting company “Ekostrategija”, Lithuanian Energy Institute, Ministries of Environment and Economy, industry, etc. Similarly to Latvia, questionnaires were sent to enterprises for collection of data. Checking of data, including direct communication with operators, was performed. The draft NAP was put for public hearing in April 2004 and on 3 May has been sent to the European Commission.

It is anticipated that there will be a significant growth of the economy and increase of production in following years in Lithuania. Closure of the Ignalina Nuclear power plant in 2009, increase of production in electricity as well as in district heating sector due to increase of consumption demand is envisaged, thus leading to increase of GHG emissions in the country. Increase in biofuel use is also expected.

Mr. Nagevicius explained in detail the methodology and formulas used for allocation of allowances of the industrial sectors in Lithuania. Allocation of allowances to the energy sector installations was done by use of benchmarks. In total 107 installations will be involved in the emission trading process. In total for the first emission trading period 39.5 million allowances are allocated. Reserve of 5% is allocated for new entrants.

Discussion:

- Particular procedure with allowances in case of closure of plants is not specified in the Lithuanian NAP. In Estonia in such case allowances are deleted, but in Latvia companies will still have possibility to sell them. Also in the Netherlands if the company has been on the list, received allowances then it will still have possibility to sell them. In the UK a company can keep the allowances received, but will not get allowances for the next years of the period.

SESSION II. PRACTICALITIES FOR THE BUSINESS SECTOR

Monitoring and reporting, verification, penalties

by Mr. Chris Dekkers, Ministry of Environment, the Netherlands

Mr. Dekkers outlined the main provisions concerning the ET requirements. He emphasized that it requires:

- proper legislative setting;
- monitoring and reporting structure of emissions;
- inspection and enforcement structure and defining the competent authority ;
- registry of transfers of emission allowances;
- procedure to acquire and account for emission rights.

He pointed out the following main tasks for operators of industrial installations with regard to monitoring, reporting, verification according to the Directive 2003/87/EC:

- submission of permit request and monitoring methodology;
- implementation of monitoring methodology;

- preparation of emission report in line with approved monitoring methodology and having it verified by independent verifier at the end of a year;
- submission of verified emission report before 31 March of each year;
- submission of sufficient emission allowances before 30 April of each year.

Mr. Dekkers informed that the EC has issued the “Monitoring guidelines” for implementation of the requirements⁴. He introduced to the content and main provisions of the guidelines. Mr. Dekkers pointed out that fulfilling the monitoring provisions are crucial in the EU emission trading scheme and the key task for operators.

After monitoring protocol is approved by competent authority, operators have to implement it and prepare the emission report. Independent verifier verifies emission report according to verification protocol, having reference on the monitoring protocol. In case incompliance is found during inspection, not only the company, but also then verifier gets fined.

In the Netherlands a particular competent authority (independent from IPPC authority) is established responsible, for example, for validation and approval of monitoring protocol, operation of registry, supervision of verification, enforcement, etc. In order to support industrial operators, the “Monitoring guidelines” as well as monitoring protocol have been translated and put into the national regulations.

Concerning verification, there are various national options possible – either to define a national verifier or hand the task over to private verifying institutions. Currently there are initiatives (from e.g., International Emission Trading Association, the Netherlands, etc.) to establish standards for verification – accreditation. On 27 May, an international conference on this issue took place.

Mr. Dekkers indicated that there are various bases for inspection and enforcement of requirements at enterprises, including fine and penalties. Concerning fines, for example, if sufficient emission allowances are not handed in, there shall be an immediate fine of €40 per tonne of CO₂ according to the Directive.

Discussion:

- The Directive refers to combustion installations with a rated thermal input (capacity of heat production) exceeding 20 MW. If the company has a boiler with a capacity of 100 MW, which in practise operates only for 10 MW, the installation still falls under the scope of the Directive. In the Netherlands, such company shall ask for permit adjustment for the actual conditions, which would enable it to fall out from the scope of the directive.
- According to the “Monitoring guidelines”, calculations are favoured above measurements: fuel has to be measured, but CO₂ emissions should be calculated. CO₂ monitoring in stack may be used only if proved that it is at least the same accurate as calculations. In any case company needs to present a monitoring protocol and competent authority has to make the decision on its acceptance.
- Verifier has to be independent from the company, but also from the competent authority. Thus it is not possible that the same competent authority which issues and inspects the permit, also verifies report. For example, in Germany verification is given to EMAS verifiers. The Netherlands preference is given to ISO 14 000 verifiers, but in the UK – verifiers of the national ETS. No common training for verifiers is envisaged on the EU scale.

Overview of potential emissions trading markets

by Mr. Jussi Nykänen, GreenStream Network Ltd., Finland

Mr. Nykänen briefly introduced the *GreenStream Network*. It was founded in 2001 and currently is the leading North-European company in the environmental markets. It is a member of International

⁴ Guidelines provide verifiable procedures for all operators and installations participating in the EU ETS to implement their CO₂ emission monitoring systems, including the choice of emission factors and requirements for quality control and documentation. Guidelines are available on Internet:
http://europa.eu.int/comm/environment/climat/pdf/c2004_130_en.pdf

Emission Trading Association, Emission Trading working group of European Federation of Electricity Traders, and Renewable Energy Certificate System. Among other issues the company is dealing with brokerage of CO₂ emission allowances and Green Certificates.

Mr. Nykänen pointed out that the first commitment period for emissions allowance trading set by the Directive 2003/87/EC is 2005-2007. Nevertheless, although the volumes are small, trading has started already. For example, in February 2003 the first trade with EU ETS emission allowances between “Shell” and “Nuon” was performed. Nearly all trades are done via brokers. Mr. Nykänen emphasized that the current prices are reflecting “experimental deals”, but the real trading will start only after the NAPs will be finally approved. The test trades are done in order to learn and to create a network. The contracts of companies create a basis for further deals. Currently learning-by-doing is a key for successful risk management in future.

He also pointed out that the companies should keep in mind that EU ETS market is more complicated than the other markets and price prediction is quite difficult. Besides, the trading procedures are not yet clearly defined. Current average price is ca. 7 – 7,5 Euro per tonne of CO₂.

Mr. Nykänen advised, that in order to be prepared for EU emission trading, companies should take the following steps:

- collect the basic emission data;
- apply for the emission permit and deliver the emission monitoring plan to the authorities;
- estimate its own position in the market;
- increase know-how on emission trading (a test deal);
- create a trading strategy linked to risk management strategy;
- include the price of CO₂ in the project feasibility studies;
- add allowances into the financial accounting;
- develop reporting procedures.

Discussion:

- Enterprises in the Baltic States, especially largest ones, are seriously considering the emissions trading, although even test deals have not started yet. The main uncertainties are related to unclearness of the market infrastructure as well as on the final amount of allowances allocated. Broker companies are already approaching enterprises for future contracts.

SESSION III. ALLOWANCE MARKETS AND TRADING

National registry – the UK experience and future perspectives

by Ms. Lizzy Pearson, Department for Environment, Food and Rural Affairs (DEFRA), UK

Ms. Pearson explained that the national registry was established in the UK in order to support the UK emissions trading scheme. It started to function in March 2002. The registry was developed and maintained by the IT department of DEFRA. It has required £ 800 000 (ca. 120 000 Euro) to build up the registry and requires £ 75 000 (ca. 113 600 Euro) per annum to maintain it. All system data is stored within the SQL database located on the internal network. Access to this database is strictly controlled to ensure integrity of the data. The system has been built using Microsoft product set: Windows 2000; SQL Server 2000; COM+.

Ms. Pearson demonstrated the emission trading registry outlook and introduced to the procedures for putting new entrants into the registry. She pointed out that the registry is accessible via the internet at (<http://www.defra/etr>). Anybody can access the system and register themselves to open an account. User access to the registry is controlled by username and password. All interaction between users and the registry is encrypted using SSL (same as online banks). Ms. Pearson emphasized that the money transfer from a buyer of allowances to a seller is separated from the allowance flow through the national registry.

Ms. Pearson outlined that the main challenges for maintaining the register are related to:

- dealing with the cyclical nature of the market – resourcing the peak in activity, especially helpdesk activity, towards the end of the compliance period;
- training/educating of users – especially small businesses that do not have much resources to deal with new initiatives;
- making sure that people remember their passwords.

Discussion:

- Transfer of allowances is done between the sellers and buyers of allowances automatically. Registry administration in the UK does not see the trades, but can see the accounts. Parties need to follow carefully their transfers themselves. In case of wrong transfers, especially in case of very fast (“liquid”) market it is not so easy to receive the transfer back.
- The UK Government cannot sell the registry. It cost £ 1.4 million to set it up. UK has been open to other Member States to collaborate in the development of the registry. The bilateral agreements have been done also to share the costs for registry. The most cost effective way for other countries is to have the hardware hosted by another country. For “old” Member States the fee for the licence of software is £ 70 000 (ca. 100 000 EUR), for “new” Member States – £ 35 000 (ca. 50 000 EUR) including also training, support for maintenance.
- There is also a German company TRUSES, contracted by the EC, which is elaborating European roof for the national registries. There are also other national registries developed, e.g., Norway, France – French Bank CDC IXIS Financial Engineering Group being also ready to sell the software to other countries, etc. Nevertheless, for example, Sweden and Finland have chosen the UK’s registry. The demonstration version of this registry is available.
- Baltic States are currently evaluating all the possible options for the registries. Cooperation of the Baltic States in sharing efforts and resources would be useful. Further responsibility of registry maintenance in Latvia will be on the Latvian Environment Agency, Estonia – Estonian Environment Info Centre, Lithuania – Lithuanian Environmental Investment Fund.
- Only from the balances it is not possible to see if the company is in compliance or not. At the end of compliance year, verifier has to input the emissions data, registry automatically surrenders the account. If there is a lack of allowances, the administrator receives a report on that and sends it to the competent authority.

SESSION IV. EMISSION TRADING IN PRACTICE

The UK Emissions trading scheme

by Ms. Jill Duggan, DEFRA, the United Kingdom

Ms. Duggan introduced the UK’s emission trading scheme started in 2002 aiming at achieving real and cost effective reductions in 6 green house gas emissions as well as to obtain experience of emissions trading for government, business and traders, in advance of international schemes. 31 participants within a range from large multinationals enterprises such as “BP” and “Shell” to local authorities and museums having large boiler houses are taking part in this scheme. Power supply industry, transport and domestic sector were excluded from the trade because of concerns related to potential increase in electricity price. The scheme will run until 2006 in parallel to EU ETS. However, EU allowances may not be used in the UK scheme. The so called Climate Change Agreement participants have received a discount on climate change levy.

During approximately one year period transactions have involved 5-7 million allowances. A reduction of 4.64 million tonnes CO₂e was achieved by participants against baseline already in the first year being much more than anticipated.

Participation in the scheme gave several benefits to participants e.g., experience of monitoring, reporting and verification, using registry. Besides that, it was important that principles for emissions reductions were put on the agenda for management of the companies. Also the Government gained experience in setting baselines, operating the auction, monitoring performance, producing protocols

for compliance and verification of emissions, opportunity to examine rules and statistical information required for smooth running and fairness as well as administering a trading scheme – dealing with closures, downsizing, etc.

Discussion:

Answering the questions, Ms. Duggan explained that

- In the UK emission trading scheme companies could set voluntary emission reduction targets, however it was supervised that the set targets compared to the baseline are “real” targets to be achieved. Before establishing the scheme, there has been a dialogue between competent authorities and industry on emission trading conditions. Reporting, monitoring and verification requirements are the same strict as required by the EU ETS. Also fines and penalties in case of non-compliance can be imposed.
- UK will apply for temporary exclusions from the EU ETS for 11 enterprises involved in the UK scheme.

3 parallel working groups. Discussion topics:

- 1a & 1b groups: How do I prepare my company for: monitoring, reporting, verification?
- 2 group: How do I prepare my company for: marketing and trading allowances?

Comprehensive information about the discussions in the working groups is presented in the Annex .

SESSION V. EU EMISSION TRADING SCHEME AND THE KYOTO PROTOCOL

Emissions Trading and the Linking Directive

by Mr. Morten Prehn Sorensen, ECON Analysis, Denmark

Mr. Sorensen gave an overview on the draft Linking Directive that aims at allowing operators in the EU ETS to use CDM (Clean Development Mechanism under the Kyoto Protocol) and JI (Joint Implementation mechanism under the Kyoto Protocol) credits to fulfil obligations. He informed that on 20 April the EU Parliament approved a text agreed with the Council. Therefore all provisions of the Directive are effectively settled and the Council only needs formally to adopt the agreed text. The Linking Directive will amend the Directive 2003/87/EC and Member States will have 12 months to implement it after entry into force.

When the system will start working, competent authorities will have to convert ERUs⁵ and CERs⁶ of operators to EU emission allowances. For the first trading period there will be no limitations for such transfers.

Mr. Sorensen explained in details the possibility of double counting between JI and EU ETS that occurs when 1 tonne of emission reduction results in both one excess EU emission allowance and issuance of one ERU. Concerning direct emission reduction, for example, in case of JI project at an power plant covered by the EU ETS, ERUs can only be issued to the installation if the same number of EU allowances (EUAs) is cancelled from the operator’s account.

Concerning indirect emission reduction, for example, in case of JI project that reduces emissions at an installation covered by the EU ETS and the project activity is not conducted at the site of the installation (e.g., wind power plant or electricity savings), ERUs can only be issued to an installation if the same number of EU allowances (EUAs) is cancelled from the national registry.

Mr. Sorensen pointed out several aspects for the companies to consider when choosing between JI and EU ETS. In general the benefits of JI vs. the EU ETS in supporting investment projects in emission

⁵ ERU – Emission Reduction Unit issued under Joint Implementation

⁶ CER – Certified Emission Reduction Unit issued under Clean Development Mechanism

reductions will depend on the transaction costs and risk profile for the specific investment project. Some specific issues to consider in assessing costs and risks are:

- EU ETS is usually easier, quicker and less costly compared to JI;
- For JI there might be a so called “Kyoto risk” on validity of emission reduction units;
- JI offers secure baseline while there is an allocation risk in second period of the EU ETS;
- Only government buyers to early JI credits; and
- There is a possibility for awarding indirect emission reductions under JI, but not in EU ETS.

As a rule-of-thumb it is thus likely that the EU ETS will be preferred for small, high return and equity financed projects, which generate only direct emission reductions. If these conditions are not met, pursuing the investment under JI could be more beneficial.

Discussion:

- There will be monitoring requirements also for JI, but not the same as for EU ETS. Here the verifiers will be accredited at the Supervisory committee at the UN framework level for Joint Implementation. National authorities will have the responsibility of project approvals.
- The EU ETS can in the future be linked up to emissions trading schemes of non-EU countries under the Kyoto protocol.

CONCLUSIONS

The emissions trading system (ETS) and the Baltic States

- The ETS was set up for “old” Member States, who are in need to fulfil Kyoto targets while the Baltic States (and most of the other new Member States) have no problems with fulfilling Kyoto targets. Therefore there exist open questions, e.g., what is the target for the new member states? Who is then buyer or seller of allowances?
- Another problem is the forecast of development, as there are big changes still ahead in the electricity sector after the break down in the beginning of 90s, for example, new technologies will be installed, new power plants are being set up; oil shale industry in Estonia undergoes deep changes; in Lithuania closing of Ignalina nuclear power plant requires new power generation on other fuels etc.

National Allocation Plans (NAPs)

- The NAPs in the three Baltic States have been submitted to the European Commission;
- There are differences in allocated reserves: in Estonia/Lithuania: 3-5%, but in Latvia 36% (due to many expected new power plants);
- Large electricity suppliers seem to be well prepared, having also participated in trainings. They are mostly waiting for NAP to be set up and then plan starting the trade while district heating plants and other industries need additional training and information;
- EU guidelines give CO₂ calculation higher preference than measurements;
- Currently, there is not much experience for calculating CO₂ in the Baltic States. Mainly environmental monitoring is performed, thus industries are insecure how to calculate;
- The monitoring protocol system needs to be set up on national level and agreed upon with all stakeholders. Besides, the system should be developed in dialogue with industry;
- The necessary documentation will be among the main challenges for enterprises.

Verification

- Verification system needs to be set up. “Old” Member States are mostly choosing international verifiers from large auditing companies (e.g., KPMG, PWC, EMAS verifiers in Germany), which might be too costly for the new Member States. The Baltic States should consider joint Baltic verification accreditation system. Besides, it might be useful to organise training for national verifiers. There is an urgent need for competent authorities to nominate the verifiers and start dialogue between industry, verifiers and authorities.

Emission trading

- Currently deals are made between a few market players to test out the system among “old” Member States. These deals are small, mostly buying and selling at same time to reduce the risk.
- Currently in NAP drafts most countries gave large amounts of allowances to their industries which may result in having many sellers and only a few buyers on the market. Thus it is unclear how the market will develop and what effect this will have on the price. Currently the market is still rather virtual, NAPs are not yet approved by the EC, and thus it is difficult to predict how the whole process will develop next year.

Registry

- Large costs are necessary, which might be too high for the Baltic States, for establishing a new registry.
- There exists an UK-based registry system, where several other Member States have joined its setting up process. They will pay a fee for the license of 100,000 EUR, while for new Member States the potential price could be 50,000 EUR.
- Cooperation between three Baltic States would be necessary for setting up the hardware for three countries and, perhaps, to have one hardware system and three sets of software.

JI vs. emissions trading

- Operators in the Baltic States will have to consider on a case-by-case basis whether to pursue emission reduction projects under JI or the EU ETS.
- Investment projects that reduce emissions at an ETS installation can in some instances choose between JI and the EU ETS to gain a carbon value. Specifics of the investment activity (e.g. size of emission reductions, financing needs and risk profile) will determine whether one should be preferred to the other.

*Report by Daina Indriksone
Baltic Environmental Forum*

Working group discussions/findings/conclusions***Working Groups 1a and 1b*****How do I prepare my company for: monitoring, reporting, verification?**

The main discussion points in the working group:

- Experience from national data collection to NAP
 - Calculation of CO₂ emissions based on the EU monitoring and reporting guidelines
 - Data management, documentation, quality control
 - Organisational set-up at my company (organisational and resource request)
- For large enterprises that have actively been participating in preparation of NAPs, the goal to present past and future CO₂ emissions calculations to be achieved was clear. Among the most time consuming tasks was the identification process from what streams CO₂ comes from. But there are still many open questions with regard to calculation of CO₂ emissions, particularly for enterprises using different fuels. Here more information and training for enterprises would be necessary.
 - In relation to monitoring, there are big differences between Baltic countries, especially in respect to CO₂ emissions calculation methodologies on the company level and in relevant legislation on national level. Concerning data management, the approach differs in companies also within one country. In some companies, there is only one responsible person whose task is to deal with the reports, submit the data to Statistical Office, file the data, etc. The additional requirements created by EU emission allowance trading directive will simply increase the working load of that person. In other companies, however, there are more people responsible. Those companies also plan to hire new staff to handle all the new requirements.
 - Currently the national legislation in the Baltic States is developing, thus there is a high uncertainty concerning specific national requirements, timelines, etc. Besides, as NAPs are not finally approved, companies cannot be sure about the number of allowances allocated in comparison to the real energy production growth, equal treatment of different companies, at the same time taking into account specific circumstances at each installation.
 - Several key challenges were mentioned by the participants.
 - On company level, the working group participants were most concerned with all the additional costs, which will occur due to the participation in the emission allowance trading scheme (annual reporting, verification costs, liability for verification, etc).
 - On national level, one of the main problems is institutional set-up. For example, there is still no clarity about registries, validation protocols et cetera. The companies are afraid that the authorities will be too strict while implementing the directive and related guidelines – for example establishing a requirement for the reporters to obtain special licences.
 - Another problem on national level is lack of clarity for the companies. The main suggestion provided by the participants was to have a regular dialogue between national authorities and companies. Also, the companies need clearer instructions, which would be detailed enough and regular information exchange. The authorities should also make the companies to look ahead and push top managers to see the problems. The representatives of the national authorities stressed that most of the problems and communication gaps have occurred due to extremely tight time schedule, which they have been obliged to follow.
 - Finally, the role of information was discussed in details – what kind of information should be directed to companies and how should that process take place. Content-wise, the information flow should consist of regular updates about laws, new regulations and relevant documents. Some of the ways to manage information flow are by web pages, articles, announcements, booklets and leaflets. As a special issue, the role of industry associations was raised as a potential solution.

Working Group 2

How do I prepare my company for marketing and trading allowances?

The main discussion points in the working group:

- Organisational setup at my company
 - Do I have shortage or excess of allowances (am I buyer or seller)? What is the amount?
 - How do I find the market place?
 - How is the market organised?
 - What kind of risks might occur for me?
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- Some of the companies have already thought about delegation of responsibilities with regards to emission allowance trading. The common view is that environmental department will be responsible for monitoring, measuring, calculating and analysing emissions as well as technologies. Financial department (in energy companies – trading unit) will be responsible for trading the allowances. Management board will be involved in elaborating trading strategy.
 - Even though approximate allocation of trading allowances is known based on NAPs, it is still difficult to say whether companies will be buyers or sellers of allowances, since it is uncertain what will be the response from the EC on NAPs. Some companies have performed preliminary calculations of possible excess or shortage of allowances; however they will take precautionary position with regards to trading allowances.
 - Currently, the market is organised in such a way that bilateral agreements are signed between two counterparts and allowances are traded in small amounts through broker firms. Counterparts are rather inactive in making deals and common position of the Baltic companies is that “the market will find them”, not vice versa.
 - As the main risks, miscalculation of necessary allowances and unknown development of market prices for the allowances were named. As an additional challenge, uncertainties with developments of national legislation were mentioned (i.e., how the permits will be assigned, how the monitoring protocol should look like, what will be the verification process, etc.)