



The EU-ETS So Far – An Industry Perspective

Lessons for North American Market Design

David Hone
Group Climate Change Adviser
Shell International Ltd.



Key Design Criteria for an ETS

Aim: Redirect available capital towards more CO₂ efficient projects via a market price for CO₂ emissions.

- Based on a long-term environmental objective, with clear compliance points.
- Allocation must establish a scarcity for the trading system to function.
- The point of regulation (allocation) set by the "make or buy" principle.
- The system should be treated as other commodity markets would.
- Must recognise key abatement / reduction technologies from the outset and must be ready to embrace technologies as they mature (e.g. CCS).
- Must have access to project offset mechanisms (e.g. CDM, JI) and should not limit their use. Linkage to other systems is essential.
- Built on a sound infrastructure base (definitions / M&R / IT).



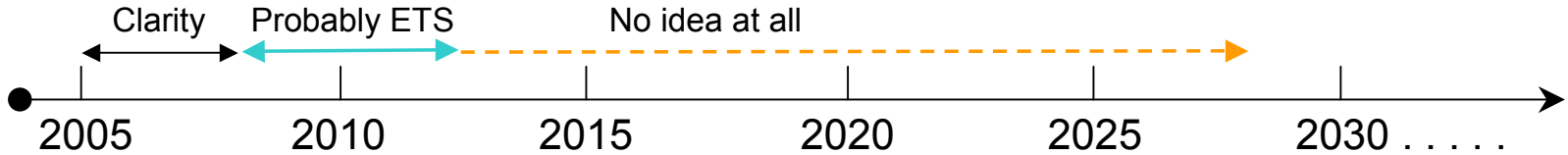
Capital in the market

- Trading redirects available capital towards more CO₂ efficient projects via a market price for CO₂ emissions.
- All commodity markets function like this – they direct capital towards the creation of the commodity.
- The trading system should not withdraw that capital from the market.
 - An emissions market should not be a source of revenue for government.
 - Auctioning should be seen as an allocation tool only, which means in-built recycle of collected funds.
 - Don't use the capital to fund favoured projects.

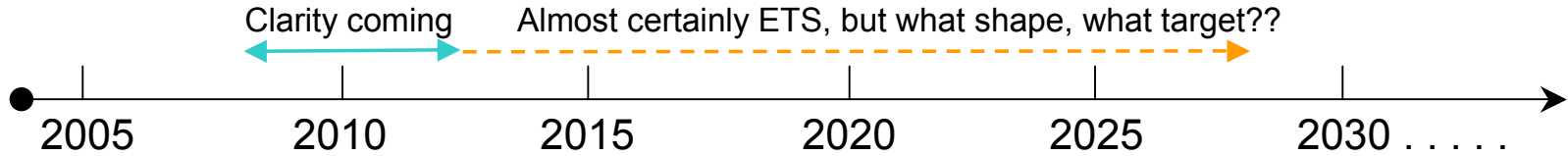


Long Term Objective

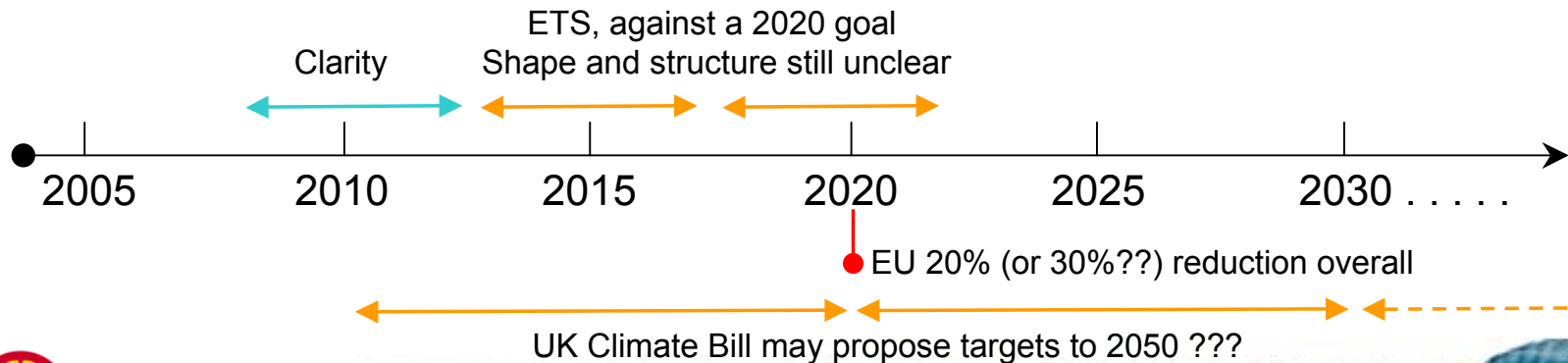
Phase I – EU-ETS (in 2004)



Phase II – EU-ETS (in 2006)



Future phases – EU-ETS (in 2007)



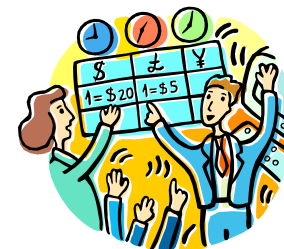
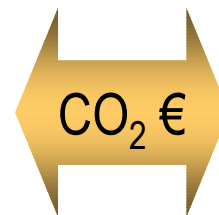
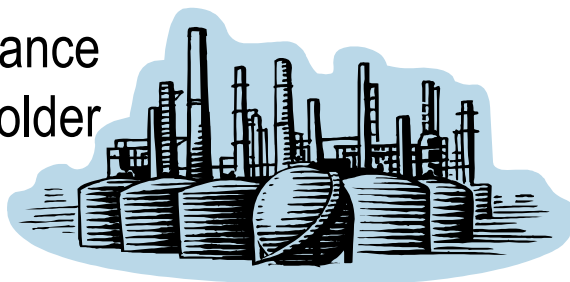
Establishing a scarcity (supply and demand)

- **Absolute caps with up-front allocation.**
 - EU-ETS is built on this principle.
 - No ex-post adjustments.
- **Good basic data required.**
 - EU was lacking extensive data on which to base Phase I allocation.
- **Allocation plans which deliver the objective.**
 - EU Commission showing resolve for Phase II against Kyoto driven objectives.

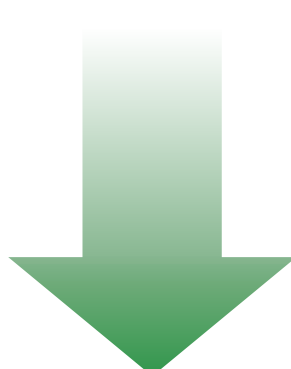


Trading is built on a “make-or-buy” premise

Allowance holder



Fuel switching
e.g. coal to gas
or oil to gas



Invest in energy
efficiency
projects



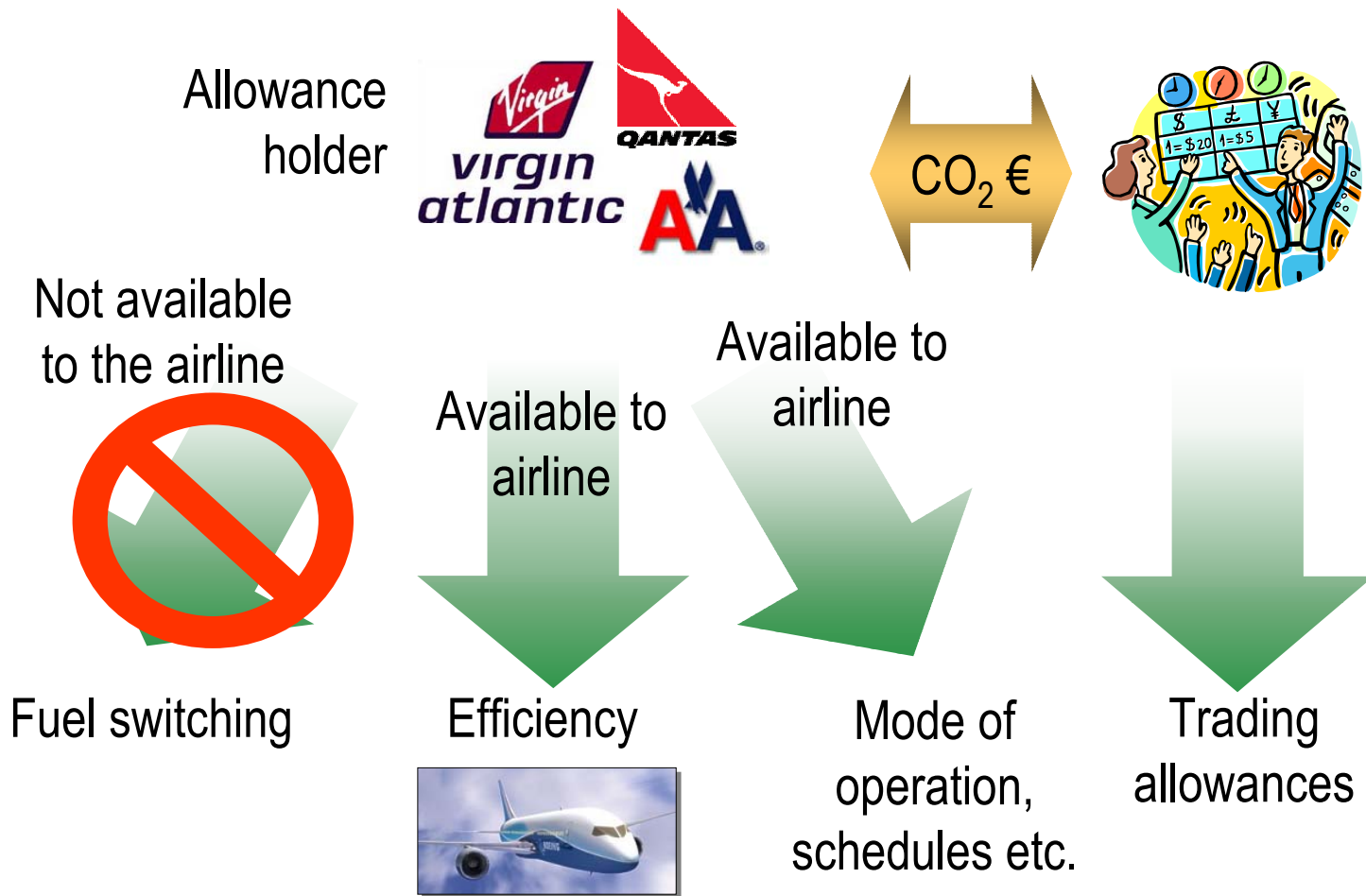
Change the
mode of
operation



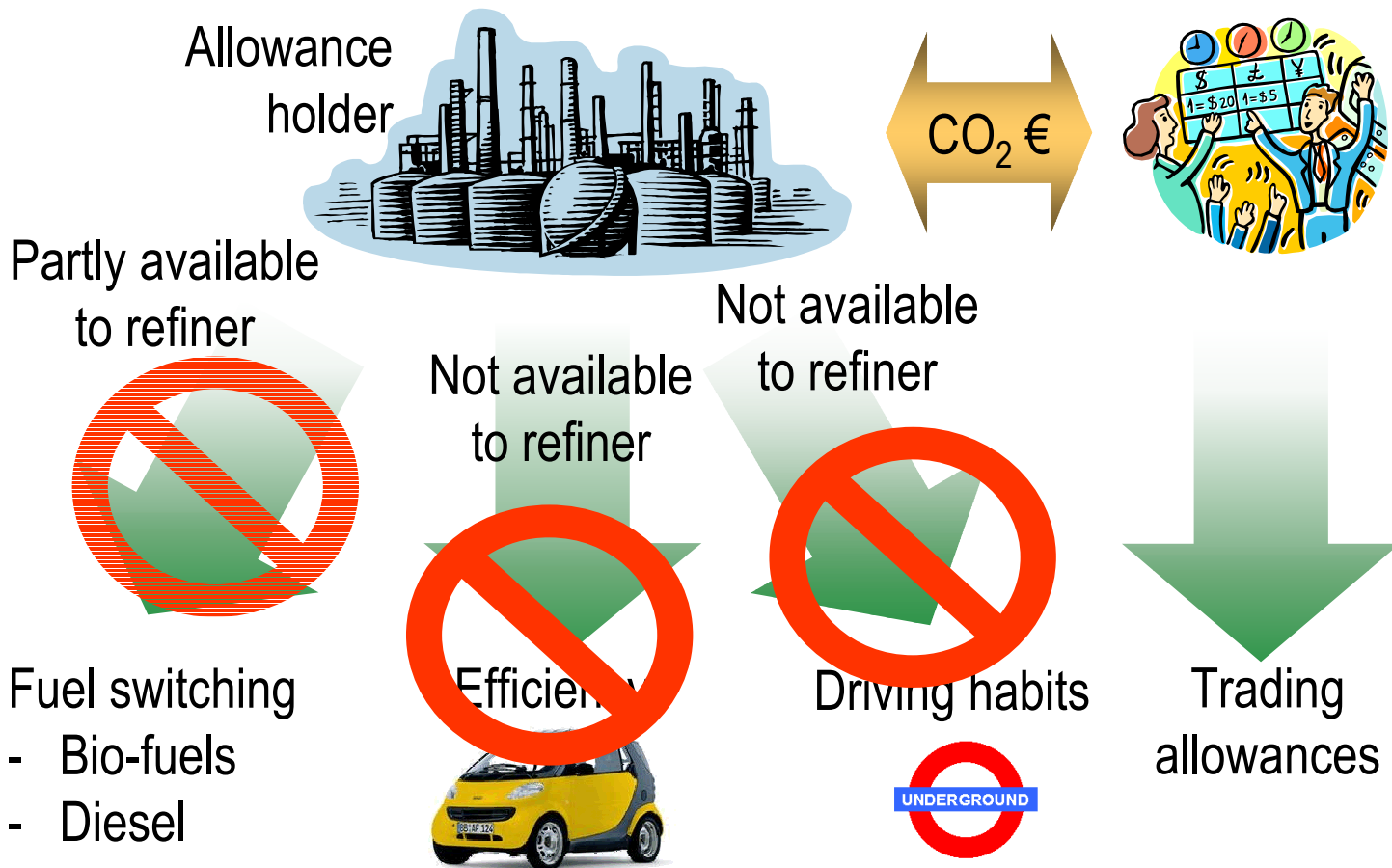
Trading
allowances



A reasonable fit for aviation

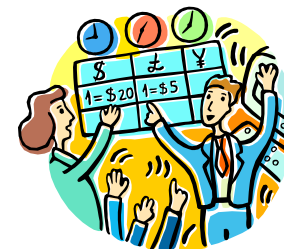
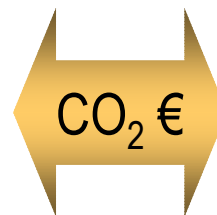


... but this doesn't apply for road transport



... but this doesn't apply for road transport

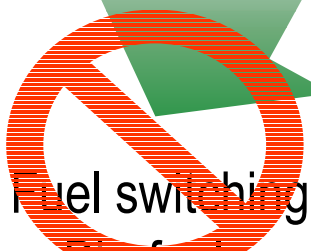
Allowance holder



Partly available to manufacturer

Partly available to manufacturer

Not available to manufacturer



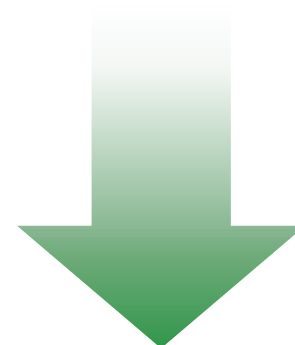
Fuel switching
- Bio-fuels
- Diesel



Efficiency



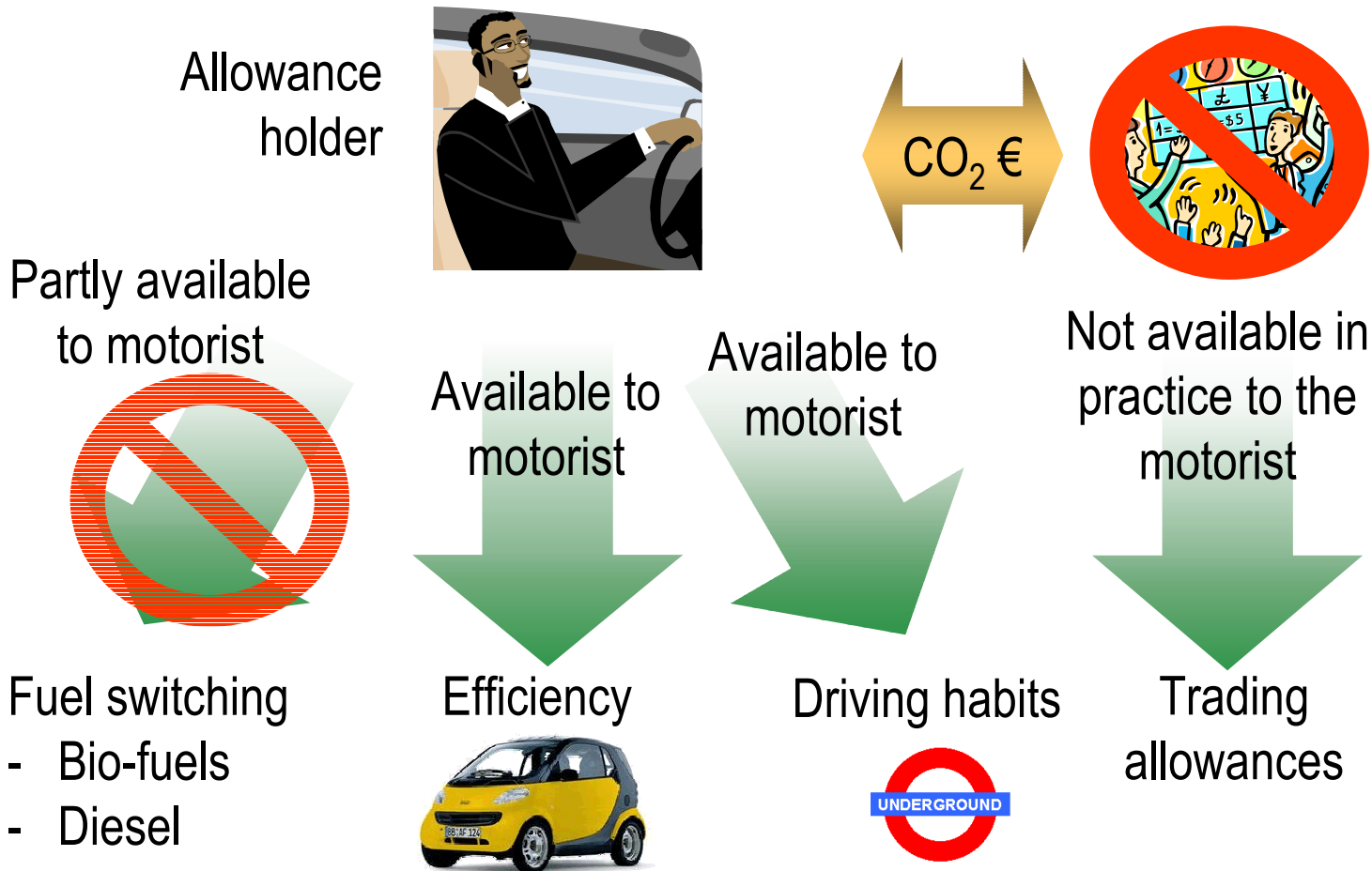
Driving habits



Trading allowances



... but this doesn't apply for road transport



It's still a commodity market

That means “let the market decide” !!

- Avoid price caps
- Avoid price floors
- Generally avoid trading limits (e.g. flow of offsets into the system)

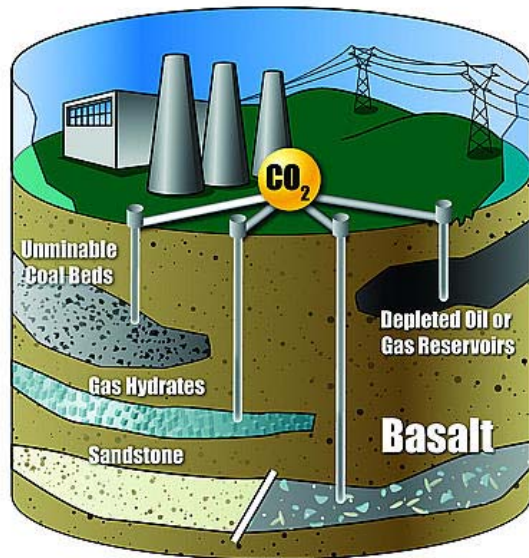
But do encourage liquidity

- Respect property rights once given
- No borrowing from future periods
- Allow banking (environmental limit??)



Recognising new technologies

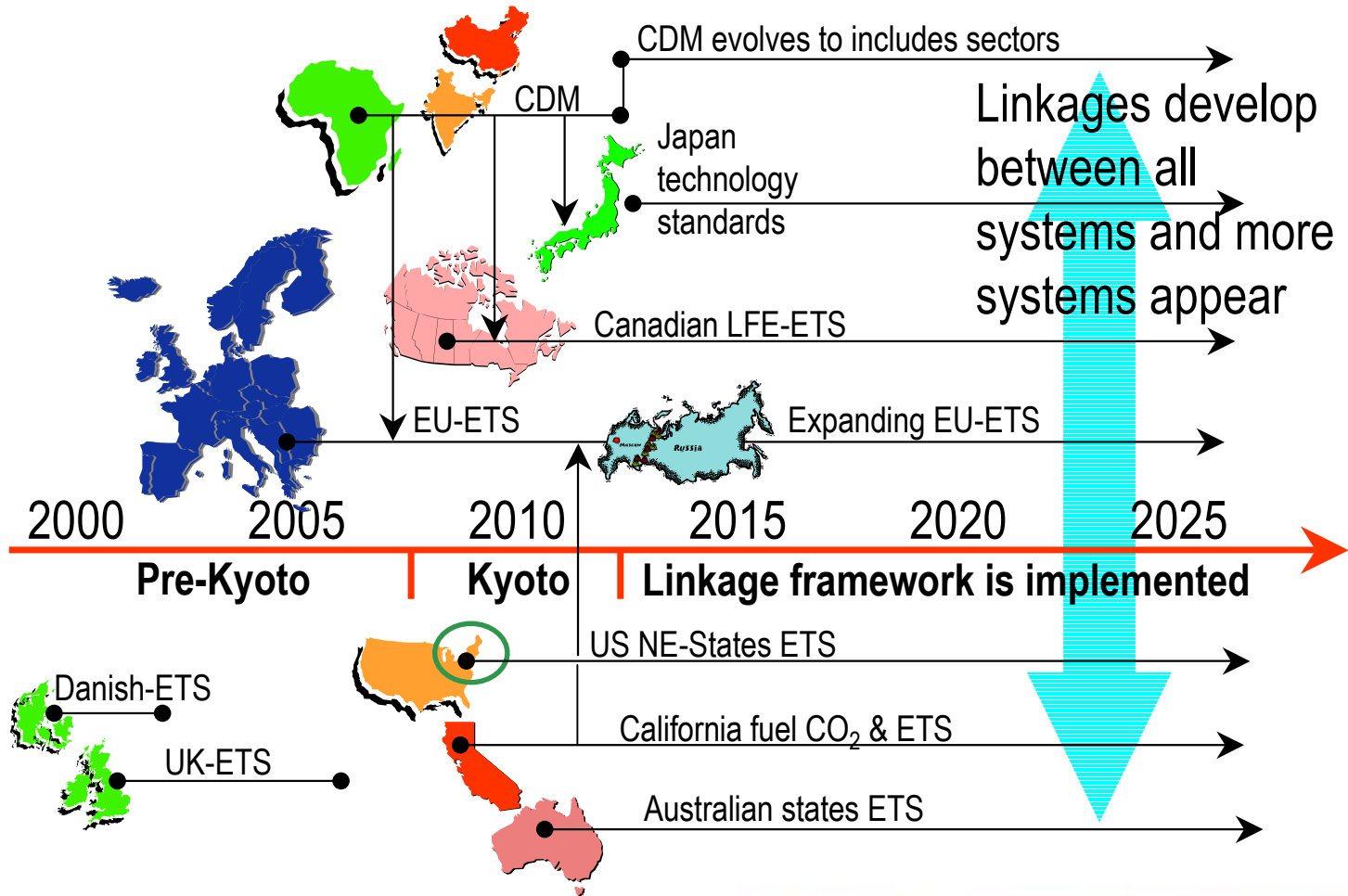
Must recognise key abatement / reduction technologies from the outset and must be ready to embrace technologies as they mature (e.g. CCS).



CCS not currently recognised by the EU-ETS but government and industry are working closely together to establish a protocol.



Linkages and offsets are essential



Foundation and infrastructure are essential

Same rules across the system

- EU-ETS suffers from different member state rules.
 - Definition of an installation
 - New entrant and closure rules
 - Reserve policies

Infrastructure must be in place early

- EU-ETS registries not all up and running initially
- International Transaction Log still to be delivered (but on its way)

Sound Measurement & Reporting foundation

- Pre-work pays off (e.g. API Protocol)



The Challenge and Benefits For Industry

Challenge:

- Working with government to convert a growing melange of state systems, agreements and voluntary actions into a single coherent approach.

Benefits:

- Delivers the required environmental result.
- Stable future investment environment.
- Equitable treatment within the economy.
- Lowest cost solution.

