

**Final Report of the 2<sup>nd</sup> meeting  
of the ECCP working group on emissions trading  
on the review of the EU ETS**

on

***Robust Compliance and Enforcement***

**26-27 April 2007**

**Berlaymont, Rue de la loi 200, 1049 Brussels  
Centre Borchette, Rue Froissart 36, 1040 Brussels**

**Agenda Item 1: Welcome and Overview of the Review Process**

The Chairman, Mr Jos Delbeke (European Commission) welcomed participants. After introducing Ms Yvon Slingenberg as the new Head of Unit in charge of the EU ETS, he pointed out that a draft agenda for the 3<sup>rd</sup> meeting and the final report of the 1<sup>st</sup> meeting has been sent to participants after having received a number of comments that have been taken into account in the final version. He asked for comments on these two documents as well as on the agenda of today's meeting. Participants did not have comments on any of these documents.

**Agenda Item 2: Monitoring, Reporting and Permitting**

**Presentations**

Mr **Howard Leberman** (UK Environment Agency) highlighted the importance of consistent, robust and full implementation of the monitoring and reporting Guidelines (MRG). In his view, accreditation of independent verifiers is critical. He advocated amending the Directive to ensure a single standard for accreditation, which should be ensured by the European Co-operation for Accreditation (EA) and stressed the role of monitoring, reporting and verification for the reputation of the EU ETS, notably in relation to linking with other emission trading schemes.

In his presentation, Mr **Dop Schoen** was not in favour of transforming the MRG into a Regulation due to the resulting lack of flexibility of the legislative instrument. He asked the EU Commission and Member States to better enforce the MRG, and to ensure consistent and aligned application thereby make sure that there is a level playing field. As for the verification process, among other issues, Mr Schoen stressed that based on the strategic assessment the verifier should decide whether there can be an exemption for the site visit of particularly remote locations such as offshore platforms. He advocated introducing Community level accreditation for verifiers through the national accreditation bodies. The feasibility of monitoring other GHG before including them into the EU ETS should be checked. In general, the MRG should allow flexibility and pragmatic solutions.

According to Mr **Ronald Kalwij** (Royal Cosun), monitoring cost for SME (small and medium enterprises) are still 10 times higher than for large installations despite the new monitoring system. He identified a number of further improvements, such as verification of the energy bill to be conducted by the corporate controller, no monitoring of bio fuels, monitoring of the whole site, even if monitoring is applicable to only one part of the plant, exclusion of spare boilers.

Mr **Tomas Wyns** (CAN-Europe) addressed some shortcomings of the current MRV system such as a different interpretation and implementation of the Monitoring Protocols (MP) in Member States. He recommended that the M&R rules should be implemented in a more harmonised way. With a view to rendering the MRV system with the MP foolproof, he advocated ensuring a good technical verification of MPs and establishing a legal link between verification of CO<sub>2</sub> reports, MP and permits.

Mr **Jochen Harnisch** (Ecofys) set out some key problems emerging from different implementation at MS level of permitting, monitoring and reporting. He recommended an approach based on more harmonisation accruing from EU legislation for which he identified a number of policy options, among which the establishment of a M&R Regulation. Mr Harnisch concluded by highlighting the role of the MRV system of the EU ETS, which can serve as a blueprint for other schemes. In his view, international linking makes further harmonisation of MRV inevitable.

### **Discussions:**

The debate showed that there is a general agreement among all stakeholders on the need for further harmonisation. However, stakeholders are split on the way how to achieve it. In the light of 2020 emissions reduction targets, some Member States, supported by some NGOs, favoured a harmonised approach based on Regulation, as this will have a direct effect and may help to make the system fully fraud-proof. Other Member States as well as representatives from the industry pointed to the need of subsidiarity, and wondered whether currently existing problems could not be solved by better implementation through Member States. Representatives from the industry stressed that current MRG are already binding and could be tighter, if need be. Any solution should be cost-effective and should be based on an analysis of the underlying problems including those of small installations. With respect to the latter, opting out based on an emission threshold or an approach taking into account sector specific features was suggested. Some Member States proposed that competent authorities should validate all monitoring plans before issuing the greenhouse gas permit.

A number of stakeholders addressed institutional matters. Some of them advocated a depoliticised and independent European Agency, which, according to some NGOs, should also be responsible for accreditation and for the assessment of the implementation of the Directive in Member States. Some Member States considered the idea of an agency rather difficult.

While representatives of the Carbon trading sector were in favour of quarterly reporting in the interest of transparency, some representatives from Member States and the industry pointed to the additional burden, in particular for small installations emerging from these stipulations. They highlighted that an appropriate balance must be kept.

According to the Carbon trading sector, site visits should continue to be a significant feature of the MRV scheme, while other industry representatives again highlighted the principle of proportionality.

Representatives from the energy intensive industry suggested reconsidering the fall back approach enshrined in the new MRG, while the Commission justified it as an innovative idea that would prevent any unjustified deviation, while reinforcing the principle of cost-effectiveness.

### **Conclusions:**

The chairman indicated he did not intend to present a coherent summary, but highlighted three points:

1. Monitoring, reporting, verification and permitting are closely linked together. Many achievements can be recognised, but lots of things still remain to be done. It is very important to acknowledge this in the light of market developments and the international dimension. There is a high degree of agreement among stakeholders on both the elements to be addressed and the need for further harmonisation. This does not mean that everything has to be regulated into the last detail, since Member States and operators pointed out that there are different national circumstances and different circumstances of operators. Thus, a complementary comitology approach might be appropriate to deal with technical details and guidance.
2. There have been many comments on institutional issues, such as a plea for a European Agency, which should be depoliticised, independent, centralised, managing information in order to prevent leaks, catering for more regular reporting, but has also to be seen in the international context. A common system of accreditation of verifiers has also been suggested. Responsibilities of the different parties involved in monitoring, reporting, verification and permitting must be very clear, as otherwise even a revised and improved system may not work.
3. It has been recognised that more can be done for small installations. However, the way to follow is not clear, since any kind of emission related threshold would require monitoring and thus not solve the problem of monitoring costs. There are also calls for a diversified threshold for small installations in different sectors, which, taking environmental integrity into account, may be difficult to handle. Furthermore, simplicity is an important matter for small installations.

### **Agenda item 3: Compliance and Enforcement Issues in Relation to Expansion of the EU ETS**

#### **Presentations:**

Mr **Roman Michalak** (Republic of Poland) presented the Polish system of forest management, where he concluded that responsible forest management would contribute to the achievement of EU reduction goals. As a main challenge, he identified conserving and increasing carbon pools through afforestation and

reforestation & sustainable management versus substitution of non-renewable energy by use of biomass.

Mr **Günther Seuffert** (European Commission) presented status and challenges of monitoring biological sinks. He identified a number of uncertainties in terms of monitoring sinks, such as the fact that the atmosphere does not see stock changes but fluxes, but also risks related with terrestrial sinks, which may easily turn into a source of carbon (permanency risk). Hence, current monitoring/reporting of sinks may not be adequate to guarantee accurate estimates. Instead, the methodology for conservative estimates could further be developed, to allow easier estimation, and to guarantee at the same time that sinks are not overestimated.

Mr **Mark Major** (European Commission) presented the state of play on ETS and shipping. According to him, there are currently a number of policy options under consideration. Mr Major set out the advantages and disadvantages of including shipping in the EU ETS and concluded that the Commission will continue to pursue international action, study the EU policy options and consult stakeholders.

In his second presentation, Mr **Jochen Harnisch** (Ecofys) presented issues and policy options for MRV emerging from possible new activities to be included in the EU ETS. With respect to N<sub>2</sub>O from the chemical industry, CCS, aviation, shipping, domestic projects and sinks a number of specific issues would need to be considered, with some of them (in particular concerning N<sub>2</sub>O, CCS, aviation, and to a lesser extent shipping) feasible and others, such as sinks and domestic projects, challenging, as they may require to introduce new elements, usually not available in a cap-and-trade scheme. In his view, the right hierarchy of instruments would be determined by the political will defining the corner stones and the degree of flexibility required by the technical issues involved. The risk involved, however, may be that the hierarchical legislation becomes fragmented and internally inconsistent.

### **Discussions:**

In the debate, most stakeholders taking the floor expressed deep concerns about sinks to be included in the EU ETS. Doubts concerning the permanence of sinks, leakage risks, the matter of additionality as well as the complexity involved were mentioned in this respect. NGOs highlighted the role of forests for the climate, but stressed that the EU ETS is not the appropriate tool to deal with forests. Very few Member States were in favour of giving sinks a role in the EU ETS, and some of these only on condition that MRV issues were properly addressed. Representatives of the carbon trading sector also recognised the complexity of including sinks into the ETS, but were however convinced that the market would find ways to mitigate the risks.

Some Member States explicitly asked the Commission whether shipping, road transport and sinks would be considered for inclusion, at least in terms of the impact assessment.

### **Conclusions:**

In concluding the session, the Chairman responded to the questions concerning the potential inclusion of sinks, road transport and shipping in the EU ETS. He confirmed

that the impact assessment on the review of the EU ETS Directive would deal with some transport issues. However, there are still many topics, which are not clear yet, such as the scope of “road transport” which could encompass passenger cars, lorries and long-haul distance transport or any of them separately. The Chairman made clear that the EU ETS will not be extended to road transport at the expense of current taxation regimes, as this would be environmentally detrimental. As for shipping, he confirmed that the Commission is currently studying three options: including shipping in EU ETS, a variation in harbour dues or a mandatory CO<sub>2</sub> index limit, which would involve the IMO. In his view, it is too early to have a clear view on road transport and shipping, but no option will be excluded at this stage.

#### **Agenda item 4: Verification**

##### **Presentations**

The analysis by Mr **Jeroen Kruijd** (PWC) showed a large variation in terms of verification and accreditation in MS. In particular he underlined the unclear quality of the process. He identified a number of policy options with respect to both verification and accreditation, among which the adoption of verification and accreditation Guidelines or a verification and accreditation Regulation. He concluded that a harmonised EU verification and accreditation would by far be the most desirable approach to ensure trust in the EU ETS. International linking and market operation requirements would make further harmonisation of verification and accreditation inevitable. Finally, he pointed out that transparency in requirements and performance of verification and accreditation should be enhanced and the role of the competent authority herein clarified.

Mr **Johan Pype** (Tractebel Engineering) pointed to the large difference among verifiers concerning their role, but also how verifications are notified and executed. He reported a similar observation on the range of knowledge of verifiers. Against this background, he considered increased harmonisation and the development of verification guidelines very important.

Ms **Anne-Marie Warris** (IETA) presented her views on accreditation and verification and what has to be done in terms of harmonisation. She also identified a number of elements that should be an integral part of accreditation in the future, such as impartiality, consistency (‘a tonne is a tonne’), harmonisation, comparability and transparency. Among other things, she advocated a single ‘standard’ for accreditation process and functions, and a peer evaluation, which should take place at regular intervals.

Mr **Wolfgang Seidel** (German Emission Trading Authority, DEHSt) presented requirements for good verification and outlined the potential for harmonisation of accreditation and verification. He confirmed specific needs for an EU-wide regulation of verification, which could be accompanied by an accreditation forum at Community level, which could provide further guidance. He argued against a centralised accreditation at Community level and concluded that uniform application of the provisions on monitoring, reporting and verification is essential for a level playing

field within the EU ETS and that there is a need and a potential for harmonising verification of emission reports.

### **Discussions:**

The debate showed a clear tendency in favour of a more harmonised approach on verification including verification standards applying across the EU. However, Member States appear divided on whether this should be achieved by means of legislative measures (Regulation) or through better guidance by the Commission. While some Member States considered the harmonisation of Monitoring Plans at EU level the most important issue, others called for better implementation and application of existing legislation.

Some stakeholders advocated Community-level accreditation of verifiers (through national accreditation bodies), in which the specifics of individual sectors should be taken into account, while some Member States and representatives of the energy intensive industry would not support this approach. National accreditation bodies should be recognised, which may, however, apply common criteria on accreditation.

On the matter of site visits, some representatives from the industry prefer the verifier to decide on the need for site visits. In their view, he should also have the competence to decide on exemptions, for instance in the case of small emitters and remote areas. Others would also like to see the CA (competent authorities) involved, while some MS want the CA to decide.

Representatives from the industry put forward the idea of a Verification Forum comprising verifiers, Member States and the Commission. The suggestion was much welcomed by almost all stakeholders including the Commission.

The debate also confirmed that all non-conformity issues but the emissions fall under the responsibility of the Member States and their CAs respectively.

### **Conclusions**

Following the debate, the chairman drew the following conclusions:

1. While a lot has been done and achieved in terms of verification, there is still room for better implementing the current legislation.
2. The role of the competent authorities in Member States is essential, but subject to important differences in practical implementation.
3. The Commission would look favourable to a Forum of and with verifiers and MS, but would involve also small verifiers, in order to take account of the fact that verification is a diversified business. Subject to agreement of stakeholders, the Chairman proposed to organise the Forum before the summer break, in order to allow contributing to the legislative work of the Commission.
4. There is a general call for using some standards. Whether this could be achieved by means of harmonisation by legislation, guidance, guidelines or voluntary processes, is left open for the time being. However, there is a clear

impression that the legislative issue must be addressed, in order to provide the necessary structure to other processes based on guidance or voluntary action.

5. With respect to accreditation bodies, it is considered premature to conclude whether a centralised body or the European Cooperation for Accreditation should be the preferred route. However, regular checks and follow up of what accreditation bodies are doing need to be provided for.

#### **Agenda item 5: Perspectives for Compliance and Enforcement in the EU ETS**

##### **Presentations**

Ms **Lesley Ormerod** (Environment Agency, UK) presented the results of work of the IMPEL EU ETS group, which confirmed that robust, harmonised MRV & compliance underpin the EU ETS. However, common approaches and definitions are required as well as focussing of effort on the biggest emitters. Accreditation and verification must be performed to the highest standards and consistently across Europe. It has also to be borne in mind that strong environmental integrity and a comparable set of rules would provide the basis for linkage of the EU ETS with developing schemes in other countries.

Based on the experience of the 1<sup>st</sup> Trading Period, Ms **Iris van Tol** (Emissions Authority, The Netherlands) presented various ideas on inspections and sanctions with a view to achieving a high level of compliance in the entire EU. She highlighted the need for a clear structure of responsibilities between the public and private domain as well as clear monitoring and reporting structures and requirements supplemented by an adequate inspection and enforcement strategy as well as the importance of a high level of acceptance by the industry. Finally she advocated the establishment of an institutionalised forum of competent authorities and the need for developing EU guidance on inspections and sanctions.

Mr **Jarno Ilme** (Energy Market Authority, Finland) set out the potential offered by IT to further improve the EU ETS. He showed that effective utilization of IT represents an essential tool for enforcement, inspection and overall compliance. He concluded that the development of IT systems of operators, verifiers and CAs should be encouraged.

Mr **Sanjeev Kumar** (WWF) presented ideas on improving enforcement in the EU ETS. Based on his analysis of the problems and solutions how to cope with them, he concluded that penalties must be included in the revised Directive to ensure a platform on which Member States could further build upon. Furthermore, all enforcement issues must be accessible to the public, while good practice and continuous improvement should be encouraged and supported.

Mr **Reid Harvey** (US Environmental Protection Agency) described monitoring, verification and enforcement currently applied in the US cap-and-trade programmes (SO<sub>2</sub> and NO<sub>x</sub>). Main lessons learnt included applying reduced requirements for smaller emitters; imposing progressively stringent substitute data requirements for data loss to ensure continuous reporting; requiring comprehensive electronic reporting

to enable targeted audits and introducing automatic statutory penalties greater than cost of allowances.

In his second presentation, Mr ***Jeroen Kruijd*** (PWC) set out various policy options on enforcement. He also presented elements for the architecture of a EU ETS Compliance System. In his view, the EU ETS needs proper legal instruments for enforcement as well as further harmonisation, in particular in the light of linking the EU ETS with other emissions trading schemes. Important elements for such a system would be standards, structures and adopting information technologies.

### **Discussion:**

The debate showed that a number of Member States impose sanctions in the case of non-compliance, while others do not foresee any sanction. Representatives of NGOs supported an enlarged scope of the Directive to include provisions on penalties in the event of non-compliance. Some Member States and competent authorities considered existing rules sufficient and highlighted the need to ensure compliance with existing rules before introducing new ones.

The matter of more frequent reporting, i.e. quarterly reports instead of annual ones, were raised in the debate. A number of industry representatives including cross sector associations pointed to increasing costs and rising administrative burden in this respect without bringing about any added value for the market and that there was a risk of unwarranted market reaction due to not properly verified information being brought into the public domain. Some companies including large emitters suggested they would just pursue a compliance strategy. Furthermore, the uncertainty of the first years of the EU ETS triggered by a lack of verified emissions data would not exist anymore.

The Commission acknowledged the fact that many companies pursue a compliance strategy. However, it is also convinced that this is about to change, since companies, on top of their compliance efforts, would increasingly develop a market strategy, in order to benefit from market opportunities. Experience has shown that piecemeal information creates volatility in the market and constitutes discrimination, since information is not available to everybody at the same time and at the same quality. It also has to be borne in mind that more frequent information may diminish the focus on particular data release dates, as can be seen from the US market, and thus provides for more stability on the market. For these reasons, the matter of additional costs has to be weighed up against more and better market information enabling market participants to benefit from market opportunities.

Some industry representatives wondered whether more inspections would not lead to rising burden for the operators and bring about more inconsistency due to the different MS practices involved in inspections.

### **Conclusions**

The Chairman acknowledged that many useful elements have been raised in the debate, also proving the different ways of implementation in terms of compliance and enforcement at Member States level. The Commission would need to make use of the



many existing networks such as IMPEL, in order to identify the most essential elements addressed in the debate for its further work. He pointed out that sanctions and penalties would only represent one element of the whole enforcement cycle and, for this reason, have to be seen in a wider context. The examples of the US and Finland representing more automatic ways of collecting information may provide promising solutions and options. He also noted that as for reporting, the matter of costs has to be borne in mind and weighed up against the benefit of more information.

## **Agenda item 6: Registries**

### **Presentations**

Mr Istvan Bart (European Commission) briefly presented the registry systems in Member States and their relation to the Community Independent Transaction Log (CITL). According to Article 30(f) of the Directive, the review should consider whether a single Community registry would be appropriate. Relevant issues to be taken into account are costs, optimisation of IT functions, functioning under the UNFCCC infrastructure and the role of Member States.

Mr Andrei Marcu and Mr Peter Zaman (both IETA) presented their views on registry developments beyond 2012. They set out the current situation in the light of relevant UN documents and considered advantages and disadvantages of a single European registry. In the short term, it was recommended to get the system going by December 1, 2007. However, IETA would support any outcome that will allow to implement the “best solution” within the given parameters.

### **Discussions:**

The discussion focussed whether exchanges of allowances should first be registered under the ITL or whether the CITL should be the first addressee for MS registries. This has to be very carefully considered. Many stakeholders agreed that the operational independence of the EU ETS is absolutely essential. The ability of entities to communicate across different systems was also emphasised.

Representatives from the industry warned against greatly increasing transactions costs in the EU ETS as a consequence of the current system, if developing countries demand an extension of the share of proceeds as part of a post 2012 agreement.

NGOs took the view that including new sectors in the EU ETS might not happen, if it is subject to approval from parties outside the EU ETS.

Some Member States underlined the importance for the EU to be compliant with the Kyoto Protocol and identified the need for further discussions.

Some stakeholders urged the EU Commission to reprioritise the need for Member States to meet their Kyoto Protocol Article 17 commitments and for the national registries to connect to the ITL as planned.

### **Conclusions**

In concluding the session, the Chairman pointed out that currently the EU ETS represents the only framework, where carbon trading among companies is underpinned by robust monitoring, reporting and verification rules and compliance is enforced by sanctions. Article 17 of the Kyoto Protocol has to be seen as an enabling provision allowing trading. There are no spontaneous compliance provisions at UN level. The only existing ones are those at EU level, which are good.

**Agenda item 7: Concluding Remarks by the Chair**

The Chairman concluded that during the last two days a very good harvest of ideas has been reaped concerning the improvement of monitoring, reporting, verification and permitting. It is now up to the Commission to decide which of the various options will be further explored and possibly incorporated in the legislative proposal. He also stressed that better implementation of what is already on the table would also be a clear option.