

CATF Comments on the Inception Impact Assessment for Amendment of the EU Emissions Trading System



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The Clean Air Task Force (CATF), a climate and energy organization dedicated to decarbonizing our energy system with staff in the US and Europe, welcomes the European Commission's climate ambition, leadership on the issue, and pursuit of policies to decouple greenhouse gas emissions from economic growth.

CATF applauds the European Commission for its plans to increase the ambition of the EU's 2030 climate goals to ensure carbon neutrality by mid-century. CATF also commends the European Commission for pursuing policy innovation on the road to net-zero emissions by mid-century. CATF is grateful for the opportunity to provide feedback on the European Commission's Inception Impact Assessment for Amendment of the EU ETS.

CATF acknowledges the learnings the European Emissions Trading System (ETS) has provided for carbon markets but also emphasizes that its impact on decarbonizing industry, in part due to the free allocation of certificates, has been negligible. The goal of amending and revising the ETS should thus be to maximize its impact in industrial and system transformation to deliver permanent and sustainable emissions reductions.

Market Stability Reserve

As part of the ETS reform, CATF believes that the Market Stability Reserve should be optimized to be able to address sudden drops in demand for allocations, which will mitigate price fluctuation risk for investors seeking to support low-carbon projects.

Extension of Emissions Trading

To unfold its full effect ETS should cover all fossil fuel combustion and waste incineration, maritime, and transport emissions.

The European Commission should include maritime emissions in the emissions trading system. CATF has analyzed the maritime sector's contributions to the global climate change as well as the possible options for decarbonizing the sector, and we agree with DG CLIMA that, "In view of the increasing emissions from maritime transport and the limited decarbonisation options available, action in this sector is urgently needed." Including maritime sector emissions within the EU ETS is one such action.

Maritime sector emissions cannot be overlooked. If the sector were a country, it would rank sixth among countries with the highest greenhouse gas emissions, ahead of Germany and the United Kingdom. According to the International Maritime Organization (IMO), the sector's greenhouse gas emissions "could grow between 50%

and 250% by 2050;” University Maritime Advisory Services (UMAS), projects that the sector’s emissions will grow 200% by midcentury under a business-as-usual scenario.

As DG CLIMA notes, decarbonization options are limited—but they do exist. In particular, carbon-free hydrogen- and ammonia-fueled shipping systems offer significant promise. Leading engine manufacturers are developing a variety of zero-GHG propulsion systems, including two-stroke ammonia-fueled internal combustion engines, four-stroke ammonia-fueled internal combustion engines, hydrogen fuel cells, and ammonia fuel cells. The progress on zero-carbon propulsion systems is complemented by numerous efforts in Europe and around the world to develop and deploy hydrogen and ammonia production processes that emit low or zero greenhouse gas.

The costs of producing and using hydrogen and ammonia as marine fuel will exceed the costs associated with conventional bunker fuels for some time, however, so policy interventions are necessary to stimulate demand for carbon-free fuels. The IMO has traditionally served as the forum for developing measures to improve the marine sector’s environmental impact, but the institution has so far proven itself incapable of implementing a meaningful GHG reduction strategy. At recent convenings of the Intersessional Working Group on Reducing Greenhouse Gas Emissions from Ships and the Marine Environment Protection Committee, the IMO endorsed an approach that does not require maritime sector emissions to peak as soon as possible and fails to put the sector on an emissions reduction pathway that is consistent with the Paris Agreement goals.

The European Commission, along with other regional and national governmental institutions, must fill the void created by IMO inaction. Accordingly, we urge the Commission to include within the ETS the GHG emissions from maritime voyages that originate in the EU, so to “ensure the sector contributes to the emission reductions needed, in accordance with EU’s international commitment to economy-wide action under the Paris Agreement.”

Innovative Low-Carbon Projects & Carbon Capture

CATF welcomes the exploration of how low-carbon and carbon removal investment could be incentivized via carbon contracts for difference. CATF encourages the European Commission to include carbon capture and storage – particularly for industrial applications and blue hydrogen production – as well as direct air capture and storage technologies in this definition as low-carbon investments. In particular, carbon contracts for difference could provide tailored investment incentives and risk reduction for these technologies, and deliver projects in the near-term.

CATF also encourages to assess the ability to design carbon contract for difference within the scope of the Innovation Fund, which could also include potential evaluation of regional structural and economic advantages of certain low-carbon projects.



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A reformed ETS will be useful in providing policy certainty and stability, particularly with the ETS as a driver for investment in not fully commercialized advanced energy technologies. Cross-border CO₂ transportation for permanent storage needs to be enabled by including all options of transportation including pipelines, ships, trucks, barges, trains.

These assessments should be tied directly to evaluations of how a carbon border adjustment mechanism could impact hard-to-abate industrial sectors.

Free Allocations and CBAM

As explained in CATF's submission to the Carbon Border Adjustment (CBAM) consultation, a CBAM must be intended to replace the current free allocation of certificates under the ETS. Moreover, current pricing levels are too low to drive transformative changes of the economy, including the deployment of advanced energy technologies. While a CBAM could be a potentially useful tool to diffuse climate action and lower carbon leakage, it needs to be accompanied by and also enable a strengthening of the ETS, as well as the availability of policy mechanisms to incentivize investment in innovation. This is particularly important to allow investment in highly innovative technologies such as blue hydrogen and carbon capture and storage.

Other: The ETS and Methane

As the EU looks to reform and amend the ETS, there has been some discussion of including methane in the ETS. CATF strongly discourages the Commission from doing this. Traditionally methane would be added to the "single basket" of pollutants covered by the ETS. Under a "single basket" approach, the EU must determine the global warming potential (GWP) of methane, in terms of CO₂e. This creates challenges in implementing because the Commission would be forced to make a determination of the appropriate time horizon over which the GWP is determined, and that determination has complex implications:

- A higher GWP for methane, in line with more recent scientific assessments and more consideration of near-term impacts, reduces the need for near-term CO₂ mitigation.
- Counter-intuitively, under a decarbonization policy, a higher GWP for methane can also slow down methane abatement in the near term.

Using the 20-year GWP may be appropriate in certain frameworks; however, in decarbonization programs, using a high GWP to determine CO₂-equivalency could have unintended consequences.

First, using the 20-year GWP would result in very high credit to investments to reduce methane, at the expense of investments to reduce CO₂. For example, under a market-based approach, if a polluter reduces one ton of methane emissions, which is counted as 86 tons of CO₂e (based on the 20-year GWP in AR5) rather than 34 tons of CO₂e (based on the 100-year GWP), that polluter will have effectively avoided an obligation



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to reduce 52 tons of CO₂ emissions. We expect that, particularly if the 20-year GWP is adopted, many polluters could seek low-cost methane emission reductions at the expense of making the CO₂ reductions needed to address climate change in the longer term.

Using a higher GWP for methane, such as the 20-year GWP, results in a second problematic and counter-intuitive outcome: it potentially extends the timeframe over which methane pollution is eliminated. Applying the higher GWP of methane increases the total emissions (in CO₂e) in the baseline year, which can allow polluters to reduce smaller volumes of methane (which are counted or credited at a higher value of CO₂e) to comply with the overall emissions reduction obligation, especially in the initial years. In other words, using the higher GWP for methane can shrink the actual size of the methane reductions in early years. Meanwhile, using the higher GWP for methane will certainly delay actions to reduce CO₂.

Other: Guarantees of Origin

Guarantees of Origin (GOs) for renewable and low-carbon hydrogen should be fully recognized in the EU ETS as a means to demonstrate consumption of these gases.

Conclusion

CATF is grateful for the opportunity to provide feedback on the ETS revision. CATF suggests that the ETS will be one of the most important policy mechanisms for delivering on the European Union's climate goals, and emphasizes the importance of evaluating how investments in low-carbon and advanced energy technology projects can be incentivized through the ETS. CATF is looking forward to the Commission's policy options, and is open to discussing any suggestions in this submission in detail.

Sincerely,

A handwritten signature in black ink that reads 'Kurt Waltzer'.

Kurt Waltzer
Managing Director
Clean Air Task Force