



Laughing all the way to the (carbon offset) bank: collusion between DG Enterprise and business lobbyists

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Plans to exclude some offsetting projects from the EU's Emissions Trading System, due to be formally approved this month, have been watered down following lobbying by big business. Corporate Europe Observatory has obtained documents which show that BusinessEurope, the International Emissions Trading Association (representing carbon traders), the chemical lobby group CEFIC and some big companies such as Enel, lobbied DG Enterprise to sabotage DG Clima's proposals. The business groups found an ally in DG Enterprise. The ban will prohibit industrial gas offsets, which currently account for more than half of the available credits and are bought by European polluters as an alternative to cutting pollution at home.

DG Clima initiated a proposal to ban the use of emission credits from projects to destroy the refrigerant gas, HCF-23, and a by-product of nylon production, N₂O, at the end of 2010. The credits are generated under the Kyoto Protocol's Clean Development Mechanism and the projects targeted have been heavily criticised as a source of credits.

According to the proposal now before the EU Parliament, which was approved by Member States in January 2011¹ and which is scheduled to come into force in mid-April, offsets will be allowed until the end of April 2013 (as opposed to the original date proposed, 1st January 2013). This delay is crucial from industry's perspective as it means they can flood the market with a greater number of these bogus credits, avoiding real action to cut emission.

Scandalous offsets

Under the Kyoto Protocol, parties are given the option to offset emissions produced in their own countries by buying credits from projects in developing countries under the so-called Clean Development Mechanism, (CDM) or in other industrialised countries under Joint Implementation (JI). Those

projects are supposed to reduce equivalent emissions in those countries. The CDM is the world's biggest offset mechanism, generating credits which companies and countries can buy to offset their own emissions, known as CERs.

The CDM has been widely criticised because of the negative social and environmental consequences of many of the projects, and because it allows companies in the North to avoid making the necessary emission cuts, while remaining locked in to fossil fuel economies. What is worse, in many cases it has been demonstrated that the claimed reductions in developing countries would have happened anyway, which results in a net increase of emissions, as it allows companies in the North to avoid reducing emissions while taking credit for something that would have happened anyway. Companies covered by the EU ETS, are the largest buyers of offset credits worldwide².

CDM projects designed to destroy industrial gases from refrigeration and nylon-production have been particularly criticised. HCF-23 is a by-product from the production of the refrigerant gas HCFC-22, which is due to be phased out under the Montreal Protocol. It is

11,700 times more potent a global warming gas than CO₂, so for every ton of HFC-23 destroyed you get 11,700 CERs. As destroying HFC-23 is quite cheap, project developers can make huge profits from selling CERs. According to CDM-Watch and the Environmental Investigation Agency, the HFC-23 CERs produced by 2012 will be worth almost 6 billion euros, but the real cost of destroying them is just 80 million euros³. With only 19 HFC-23 projects registered, they represent about half of the credits from all CDM projects issued to date⁴.

Nitrous oxide (N₂O) from adipic acid, a by-product of nylon production, has a global warming potential 310 times greater than carbon dioxide (CO₂). Although 90% of these emissions have been destroyed voluntarily over the last decades, nitrous oxide projects registered under the CDM can get credits for the 100% of the abatement. This has led to a shift in production to developing countries so that they are entitled to CDM revenues. The result is a net increase of emissions. There are four adipic acid projects registered under the CDM, projected to deliver more than 161 million credits by 2012, representing about one in five of the credits for all CDM projects issued to date⁵.

Offset credits from industrial gas projects accounted for 84% of the offsets used within the ETS in 2009⁶. These credits are mainly bought by power producers as an alternative to cutting their own greenhouse gas emissions. And because so many of these credits are generated, they flood the market, and ensure that the price of CERs remains low, making offsetting cheap.

Protecting investors: IETA

DG Climate announced its intention to act on the scandal of industrial gas offsets last summer, amid growing criticism of the EU Emissions Trading System, if the United Nations body responsible for the CDM did not take appropriate measures. IETA, the carbon traders lobby group, was quick to sound a warning. IETA's President Henry Derwent sent a letter to Climate Commissioner Connie Hedegaard on 24 August 2010 requesting a meeting and complaining that "largely as a result of decisions taken or expected by the EU, market confidence in the CDM is at very low ebb"⁷. In the letter, IETA demanded that

any restrictions must not be retroactive, and should be based on objective criteria, a thorough impact assessment and early stakeholder consultation.

Before the Commission's proposal was published in late November 2010, it was not clear when the ban would come into effect, but rumours pointed to 1st January 2013. Business set out to delay that date. Under the ETS, companies can surrender credits for 2012 (the end of the second phase of the ETS) until the end of April of 2013. So by moving forward the date of the ban, companies would be able to take full advantage of the bogus credits. According to carbon trading analysts, Point Carbon, a ban from 1 January could mean 30-100 million fewer offsets than a ban at the end of April 2013⁸.

To have been effective, the ban would have to have been introduced by at least January 2013.

Industry's insistence on not having a ban before the end of April conveniently ignored the fact that the problems with these industrial gases have been known about for a long time. Indeed the Commission could have chosen to act before. Companies were also aware, and some chose not to invest on those credits. Those which kept buying these bogus credits knew the risk and took investment decisions which have already brought them gains. There is no reason why they should be allowed extra time.

Failing to shift DG Clima, business realised that it would be more effective to put their demands to DG Enterprise, even though the proposal had come from DG Clima. DG Enterprise did not hesitate to take the side of the business lobbyists. This is not unusual. During the review of the third phase of the ETS, another important piece of climate legislation, DG Enterprise was instrumental in blocking the original proposal to auction permits for manufacturers, many of which will instead get permits for free⁹.

As Simone Ruiz, a lobbyist for IETA explained: "During a consultation within the EC, DG for Industry and Entrepreneurship gave a negative opinion on the proposals on qualitative restrictions put forward by DG

Climate Action,”¹⁰.

In November 2010, Ruiz predicted that the intervention of DG Enterprise would result in the date moving to 1st of May, rather than 1st January, and she explained that DG Enterprise wanted more compromises from DG Clima but would focus on the issue of moving the date forward¹¹.

Enel-Endesa, at home at DG Enterprise

Former Enterprise Commissioner Gunter Verheugen was always known for his close links to industry, and his successor, Antonio Tajani is following in his footsteps. Tajani was a former press secretary for Italian Prime Minister Silvio Berlusconi, and he appears to have taken Italy's national interests to heart in this case, defending the interests of Enel Endesa, the giant Italian energy company which is 30% owned by the Italian government. CEO has obtained through the Freedom of Information Regulations documents which show the closeness of Enel and DG Enterprise. Formal position papers by Enel were sent to Commissioner Hedegaard, to members of the European Parliament and of course to DG Enterprise. But Tajani's Cabinet enjoyed an even closer relationship with Enel.

In a letter dated 2 November 2010, Roberto Zangrandi, Enel's European Affairs person, contacted Tajani cabinet-member Antonio Preto¹² for a friendly chat about how to deal with a problem. Zangrandi complained that “I can not tell you much because as I told you DG Clima has put up its defenses and isn't letting anything out”¹³ He explained that the worst case scenario for his company would be if all credits were banned from 1st January 2013. In more formal complaints to DG Clima and the Parliament Enel argued that this was to ensure the legal certainty of the CDM, but in this letter Zangrandi explained the reality that this “translates in a difference for our portfolio of at least 20 million credits with a significant value”. Giuseppe Montesano, head of environmental policy at Enel, confirmed that the company has a pre-2012 CER portfolio of 185 million units and a pre-2020 of 200 million¹⁴.

According to the NGO Sandbag, which has monitored the use of offsets by European companies, Enel surrendered 4.3 million HFC-23 CERS in 2009, 40% of all of Italy's

HFC-23 credits¹⁵. At the same time Enel has an interest in seven of the HCF-23 projects generating credits, so it is making huge profits from selling the CERs.

In its lobby of the Parliament, Enel suggested that the Commission was bypassing the UN body responsible for the CDM and should refrain from acting. “It is critical to trust the system and the procedures of the UNFCCC and CDM in order to ensure the integrity and credibility of this mechanism,” Zangrandi wrote in a letter to MEPs¹⁶.

In parallel to the internal battle within the Commission, some national governments were also trying to obstruct the ban. Italy but also the UK. According to the minutes of the UK Emissions Trading Group¹⁷, where the UK government met with various corporate representatives including from among others Lafarge, Tata Steel, Total, ExxonMobil, Cemex, RWE and ConocoPhillips, the chair confirmed there was a lot of pressure for the date to be changed to end of April 2013 to allow the credits to be used up to the end of phase II of the ETS (2012). The UK government was reported to have lawyers working to put pressure on the Commission.

Business Europe: revolving doors

The European employers' confederation, BusinessEurope, also lobbied to block the ban. Director General Philippe de Buck sent a letter to Commissioners Hedegaard and Tajani in October 2010 with a position paper on European Business Recommendations on EU policies for Climate and Energy¹⁸, opposing the plans to limit the use of credits from the CDM within the ETS.

BusinessEurope's top executives enjoy easy access to decision-makers, including Commissioners. But this access was made even easier during the lobby against the ban on industrial gas offsets. Just a month before BusinessEurope had recruited Marten Westrup as Advisor to their Industrial Affairs Committee (in charge of climate change). Westrup had been working for DG Enterprise for the last three years. Although normally BusinessEurope's communications with the Commission on climate change issues are done by industrial affairs director Folker Franz, with letters signed by de Buck, this time Westrup made the contacts, probably

with an eye on profiting from his relations with his recent colleagues.

Having worked in the Commission for three years, Westrup not only had plenty of personal contacts but also a thorough knowledge of the processes, including when and how it was most effective to intervene. In an email¹⁹ sent to DG Enterprise staff in charge of the CDM ban process in November 2010, Westrup referred to a good-bye drink in which they were together and expressed his wish to continue cooperation in his new capacity after three years at DG Enterprise. He forwarded a note from BusinessEurope on the plans to restrict offsets in the ETS. He explained that although an official version would be sent shortly to the cabinet by de Buck, he was sending it in advance as “We hope there is still time to consider this note before the ISC [Inter Service Consultation] ends. If not, it may be useful for the negotiations leading up to the adoption of the draft Decision.” This shows that BusinessEurope saw DG Enterprise as an ally, with common cause against environmental measures.

BusinessEurope asked the Commission to leave potential restrictions on offsets to the UN body responsible for the CDM and demanded that new restrictions were not to be introduced during phase III of the ETS (2013-2020), that restrictions should be retroactive and that companies should be allowed to bank all credits to phase III.

DG Enterprise pushes business lobby

Not only were corporate lobby groups enlisting DG Enterprise to help them oppose the ban on offsets, but DG Enterprise also asked business about their concerns regarding DG Clima's proposal. CEFIC, the European chemical industry association responded to this request by email²⁰ in October 2010 thanking DG Enterprise “For your request concerning CEFIC's opinion about restrictions on international credits...” CEFIC explained that “the industry is indeed very concerned about announcements made earlier by Commissioner Hedegaard considering unilateral measures potentially banning the access to these mechanisms.” Like the other industry groups, CEFIC asked that the measures should not be retroactive.

Industry got its way, date moved

When the Commission released its proposal²¹ ahead of the international climate negotiations in Cancún in late November 2010, DG Clima announced the start date for the ban as January 2013. But the combined pressure from within the Commission and from corporate lobby groups via their national governments resulted in the date moving forward at the final vote in the Climate Change Committee in January 2011 to 30 April 2013.

With the start date delayed, industry's principal demand had been fulfilled. Some estimates suggest it will result in more than 52 million extra credits entering the ETS market, roughly equivalent to Belgium's annual CO₂ emissions.

“While we welcome the outcome of today's vote, it's unfortunate that Member States were not entirely immune to pressure from a small group of investors who lobbied hard to extract as many concessions as possible throughout this process. Delaying the entry into force of the ban will open the door to an additional 52 million credits, equating to €676 million,” said Natasha Hurley from CDM Watch²². This is indeed a big number, considering that the third phase of the ETS (2013-2020) only imposes emissions reductions of 1.74% per year, which is 35.3 million tons (1 credit represents 1 ton).

However, the industrial gas offsets surrendered during this four extra months must relate to emissions 'reduced' before January 2013. Credits from industrial gas projects will from that point be banned in the ETS. Despite industry efforts, companies will not be allowed to bank²³ any of these surplus credits to comply with the ETS in its third phase.

But companies can get around this and bank the banned offsets indirectly, by surrendering as many of them in advance of the ban. In phase II (2008- 2012) a far larger number of CERs are allowed to be surrendered than have been as yet. And there is nothing to stop companies from handing in industrial gas credits now, while holding over a larger number of the other permits which they are allowed to bank for phase III.

Although the Commission will not release the amount and type of credits surrendered in 2010 until May 2nd, analysts have already predicted that companies are expected to have used more carbon offsets for 2010 than previously. According to Kjersti Ulset from Point Carbon, the EU ETS participants are expected to surrender nearly 50% more than in 2008 and 2009²⁴. "The ban of certain project types from 2013 compliance and onwards is expected to encourage more compliance use of this credits for 2010," Ulset explained.

Another important point is that the Commission's ban will only apply to EU ETS sectors (the ETS covers the largest static emissions sources, including power and heat generation, oil refineries, iron and steel, pulp and paper, cement, lime and glass production.) It is now up to Member States to extend (or not) the ban to sectors that are not covered in the EU ETS but that are covered by the national reduction targets under Kyoto (such as transport, buildings, agriculture and waste). Environmental groups are now campaigning²⁵ to pressure national governments to introduce national bans. So far, only Denmark and the UK have agreed.

European Commission: turning off the tap and opening the floodgate

DG Clima's plans were a positive step, but their motivation was not. It was not only the well-known scandalous nature of these bogus credits, which fuelled the critique of the CDM. The EU is keen to scale up carbon markets, to help create more cap and trade schemes around the world. The idea is to move from the CDM system, which is project-based, to a new mechanism that covers whole sectors²⁶. Shrinking the number of credits available (with the ban on industrial gas offsets) will help stimulate demand for other credits.

The ambition is to create sectoral crediting for big sectors such as steel, cement or aluminium. The idea is that if a given sector reduces emissions below an agreed target (below a business as usual scenario) it gets credits that can be sold in the international carbon market. Sectoral crediting in those sectors is also supported by the European steel and cement companies, which see it as a way of not losing competitiveness to companies based in countries such as China

or India. But until this is possible, the Commission has seen N₂O industrial gas offsets as a good opportunity to try the scheme.

The Commission has already announced²⁷ that some banned offsets from nitrous oxide adipic acid projects might be allowed in the ETS after the ban is in place. Thomas Bernheim, an official at DG Clima and a member of the UN body governing the CDM confirmed that the Commission is planning to launch a first trial on sectoral crediting for these industrial gases, through bilateral deals.

But expanding offsets mechanisms beyond the CDM is not a good idea as it risks not only reproducing but expanding the problems associated with it. Already the CDM is increasingly criticised due to the negative impacts on the poorer communities in the countries where projects are based. It is used mainly an escape route for companies in Northern countries to avoid reducing emissions at source. Jumping from a project basis (CDM projects are approved one by one) to a whole sector basis will eventually increase the number of credits and offer companies and countries in the North more opportunities to avoid reductions at source.

There is no reason to believe that the current problems with the CDM will be better addressed by scaling up mechanisms. Expanding the offer of offsets will prevent the much-needed structural changes to a low carbon world. As Carbon Trade Watch explained, "The net result is that offset tends to increase rather than reduce greenhouse gas emissions, displacing the necessity to act in a location by a theoretical claim to act differently in another one, offering polluting companies and financial consultancies the opportunity to turn stories of an unknowable future into bankable carbon credits. Carbon offsetting is as best a zero sum exercise"²⁸. However, to shut the door on the scandalous industrial gas credits is a good thing and it is very disturbing that corporate lobby groups can rely on DG Industry to fight the battle against environmental measures on their behalf. DG Enterprise should be held accountable for putting the interests of big corporations above any environmental or social concern.

With thanks to Oscar Reyes, Carbon Trade Watch and Natasha Hurley from CDM Watch for comments

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