Role of Supply Chain Emissions in Decarbonization and Compliance

16/03/2021

ERCST

European Roundtable on Climate Change and Sustainable Transition

Project objectives

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- In view of the growing importance of addressing supply chain emissions, ERCST has embarked on an exploration of the main issues and options regarding how to identify and measure these emissions, and **what role they should play in the transition to a low-carbon future**

- ERCST started by exploring a broad range of issues and is now focusing on the following:
  - How, if at all, can emission reductions be incentivized for Scope 3 emissions?
  - How, and under what circumstances, can these incentives increase flexibility for those that have existing (Scope 1) compliance obligations? and
  - How can methodological challenges – such as attribution and accounting of supply chain emissions and their mitigation –be seen and understood? (“Someone’s Scope 3 emissions are someone else’s Scope 1 emissions”)

Previous workshops

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- The forthcoming synthesis note builds on two workshops with stakeholders and complementary desk research

- **Workshops with stakeholders**
  - **1st Workshop (07.12.2020):** key actors from different industry sectors, such as cement, chemicals, steel, oil and gas, and other industry associations concerned with tackling Scope 3 emissions from their business activities
  - **2nd Worksop (26.01.2021):** larger group of stakeholders, including government representatives, consultancies, think tanks, etc.

Structure of the paper

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1. **Supply chain emissions: an opportunity for mitigation**
    - Why supply chain emissions matter in a low carbon world
    - Two case studies: supply chain emissions in the plastics and biofuels sectors
2. **Conceptual and methodological issues**
    - Measurement and attribution of supply chain emissions
    - Additionality, accounting and allocation of benefits for supply chain emission reductions
3. **Incentivising supply chain emissions reductions**
    - Current voluntary and compliance frameworks
    - Potential policy options to incentivise reductions: inclusion under the EU ETS, operationalisation of Art.24a of the EU ETS Directive, new market-based instrument, and other approaches
4. **Overlap and synergies**

1. Supply chain emissions: an opportunity for mitigation

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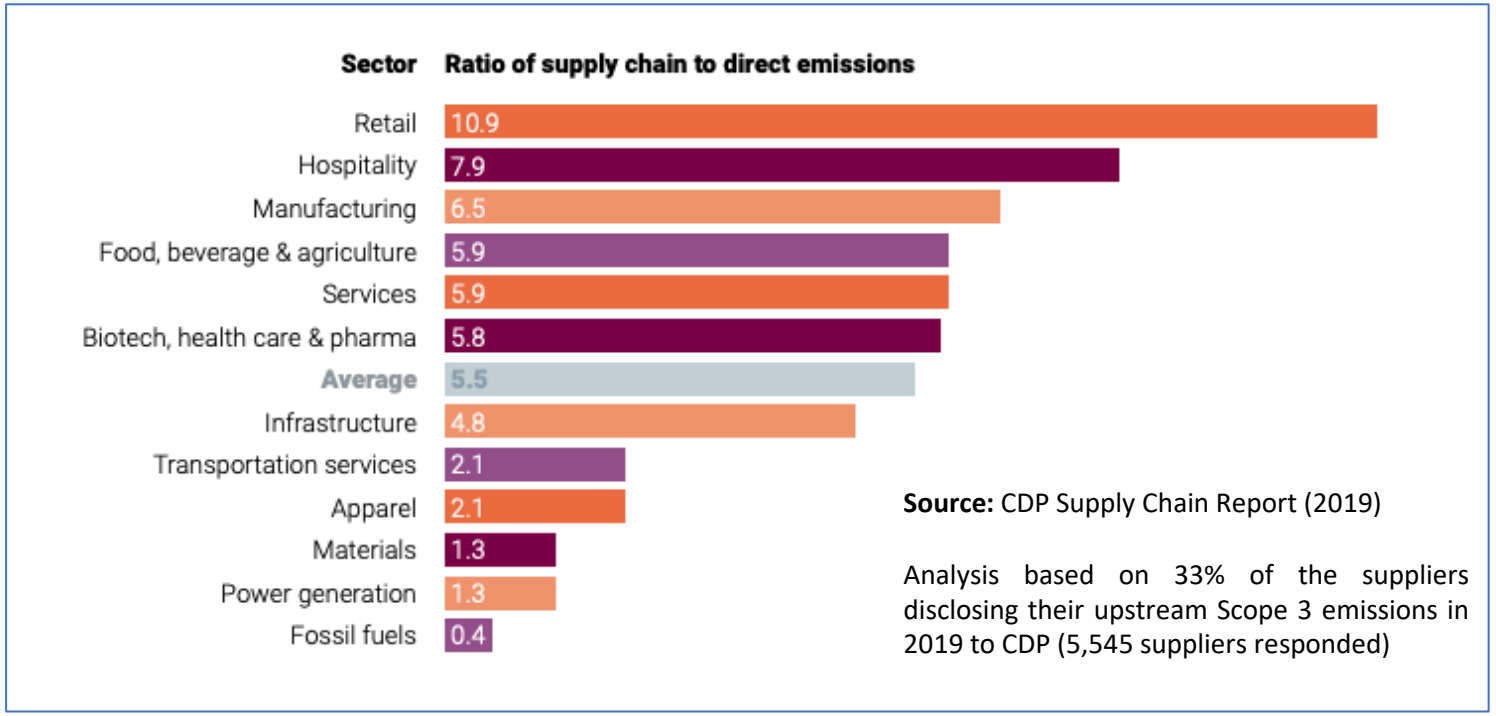
- *This section of the synthesis note lays out the context and rationale of thinking about supply chain emissions, acknowledging the mitigation potential as well as the methodological and other trade-offs described in more detail subsequent sections*
- A company's supply chain emissions (Scope 3) are on average 5.5 times larger than its Scope 1 and 2 emissions (source: CDP 2019)



1.1 Why supply chain emissions matter in a low carbon world

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Global level

- **Growing momentum** to reach **net-zero** emissions by mid-century
- **Heterogenous process** and **asymmetrical abilities** to reduce emissions throughout supply chains
- In a world in which mitigation is lagging behind committed targets and time is of the essence, tackling supply chain emissions **can meaningfully accelerate decarbonization**
- Emission reductions along the supply chain can be challenging and come at a cost; **catalysing this potential will require incentives:**
  - **'Soft' incentives** from shareholder pressure and evolving consumer demand (TCFD, SBTi, etc.)
  - Even though soft incentives have an important role to play, they will likely not trigger the full potential for supply chain emission reductions: **that requires policies**

1.1 Why supply chain emissions matter in a low carbon world (2)

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EU level

- **In the EU**, the forthcoming Climate Law and the intermediate mitigation target for 2030 make clear to corporations that **all emissions will need to tend towards zero in the longer term,** and if they are not already regulated now, they will eventually be
- In other words, the **opportunity space for voluntary commitments** will decline and at some point **have to disappear** in a net zero world
- There is currently **no systematic approach for supply chain emissions** in EU climate policy
- Legislation currently governing EU climate ambition is primarily **focused on Scope 1 emissions**, and to **some extent on Scope 2 emissions** (e.g. through requirements for energy efficiency improvements or renewable energy targets)

1.2 Two case studies: plastics and biofuels

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This section of the synthesis note will discuss the potential emission reductions that supply-chain actions can generate by addressing:

- *What supply chain emissions are;*
- *The scale of emissions they represent relative to Scope 1 emissions for selected sectors;*
- *Whether or not they are already addressed through constraints on Scope 1 emissions of other actors;*
- *What actions companies are taking or could take to address these supply-chain emissions.*

2. Conceptual and methodological issues

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- *This section of the synthesis note explores the issues around measurement and attribution of supply chain emissions, as well as the concerns of additionality, accounting and allocation of benefits for supply chain emission reductions*

2.1 Measurement and attribution of supply chain emissions

- *This subsection looks into how supply chain emissions can be measured and attributed to a specific entity*
- Measuring supply chain emissions can be a challenging task, with often fragmented supply chains distributed across different countries and from Tier 1 to Tier n suppliers
- Not many companies measure and disclose their entire Scope 3 emissions, and when they do, they are often forced to rely on unreliable data or industry average emission factors

2. Conceptual and methodological issues (2)

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2.2 Additionality of supply chain emission reductions

- *This sub-section explores the additionality of supply chain emission reductions*
- **Incentives only make sense if these reductions would not otherwise happen**, or are already required from another emitter as Scope 1 or 2 emission reductions
- This has been a **controversial and methodologically intractable concept** that emerged in baseline-and-credit approaches (e.g. CDM, Art 6.4 of the Paris Agreement)

2. Conceptual and methodological issues (2)

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2.3 Accounting for supply chain emission reductions

- *This subsection explores the issues of double counting and corresponding adjustments*
- By definition, one actor's Scope 1 emissions are Scope 3 emissions for a number of other actors
- More than one actor could claim credit for Scope 3 emission reductions, and currently there are no clear guidelines on how this attribution should take place
- Under the Paris Agreement, mitigation action taken by a Party other than that where emissions occurred render the issue of double counting central

2.4 Allocating the Benefits of Supply Chain Emission Reductions

- *This subsection tackles the question on who gets credit for supply chain emission reductions and how the allocation is determined/negotiated*
- While attribution of emissions is one issue, the issue that ERCST identifies as being critical for catalyzing reductions is how to attribute emissions reductions as a Scope 3 reduction in a supply chain

3. Incentivising supply chain emissions reductions

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- *This section of the synthesis note outlines the existing voluntary and compliance frameworks for reducing supply chain emissions and provides an overview of the possible policy options for incentivising reductions*

3.1. Steps for reducing supply chain emissions

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Understading the supply chain
Its characteristics beyond Tier 1 suppliers

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Identifying emission sources
Carried in conjunction with suppliers and end-users

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Measuring emissions
GHG Protocol Corporate Value Chain Standard and ISO 14064-1 Standard

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Reporting emissions
Company level, national level (UK SECR, FR Bilan GES, etc.), voluntary initiatives (CDP, etc.)

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Setting targets
Company level, voluntary initiatives (SBTi)

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Designating abatement measures and reducing emissions
More efficient supply chains, switching suppliers, improving circularity, carbon offset projects, removals, etc.

3. Incentivising supply chain emissions reductions (2)

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3.2.1 Voluntary frameworks

- *This subsection highlights the main voluntary frameworks and incentives linked to supply chain emissions that arose as a response to the lack of compliance/regulatory frameworks*

Voluntary frameworks/initiatives	Function
GHG Protocol Corporate Value Chain (Scope 3) Standard	*Accounting and measurement*
ISO (International Organization for Standardization) 14064-1 Standard	*Accounting and measurement*
Small and medium-sized enterprises (SMEs) Climate Hub	*Accounting, measurement and setting targets*
Carbon Disclosure Project (CDP)	*Disclosure and reporting*
Science Based Targets Imitative (SBTi)	*Setting targets*
Task Force on Climate-related Financial Disclosure (TCFD)	*Financial Disclosure*
PAS 2060 (by British Standards Institute)	*Standards*
ISO/WD 14068 Carbon neutrality	*Standards*
Race to Zero by the UNFCCC	*Coalition and network of net zero init.*

3.2.2 Compliance frameworks

- *This subsection shows the mandatory national reporting schemes where Scope 3 emissions guidelines are provided, but considered as a voluntary category to monitor and report*
- UK Streamlined Energy and Carbon Reporting (SECR), France *Bilan d'Émissions de GES Grenelle II Law n°2010-788 Art. 75*, *Transition Energétique pour la Croissance Verte 2015-992 Art. 173* , Australia National Greenhouse and Energy Reporting Act 2007 (NGER Act), Non-financial reporting directive (NFRD)

3. Incentivising Supply Chain Emissions Reductions (3)

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3.3 Policy Options

- *This section explores the possible policy options for incentivising supply chain emissions reductions and poses questions on who is best-situated to incentivize reductions, who should be the subject to the incentive or framework and how the incentive can be provided*
- Incentives for Scope 3 emission reductions, including but not limited to:
  - Including Scope 3 emissions in the EU Emissions Trading System
  - Operationalizing Art. 24a of the EU ETS Directive (Domestic Offset Projects)
  - New market-based instrument in a non-covered sector (e.g. waste), could be linked to EU ETS
  - Creating a market for low-carbon products
  - Making credit ratings dependent on emission performances
  - Expanding companies' reporting obligations
  - Subsidies

4. Overlap and synergies

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- *This section delves into the potential overlaps and synergies with existing (voluntary/regulatory) frameworks*
- Some examples of these are:
  - Risk of double counting and other types of overlap with voluntary commitments (e.g. SBTi) and carbon markets;
  - Potential impacts, linkages and overlaps with existing climate policies and regulations at different governance levels need to be considered, e.g.:
    - Impacts on division and the EU ETS and the Effort Sharing Regulation (ESR);
    - Linkages with a) Carbon Border Adjustment Mechanism (CBAM), b) consumer charge, c) circularity contributions, d) Sustainable Finance Taxonomy and Delegated Act, e) market for low carbon products;
    - Overlap with national obligations, incentives and other climate policies.