

Reform of the EU ETS

A EURELECTRIC statement

May 2016

EURELECTRIC is the voice of the electricity industry in Europe.

We speak for more than 3,500 companies in power generation, distribution, and supply.

We Stand For:

Carbon-neutral electricity by 2050

We have committed to making Europe's electricity cleaner. To deliver, we need to make use of **all low-carbon technologies**: more renewables, but also clean coal and gas, and nuclear. Efficient electric technologies in **transport and buildings**, combined with the development of smart grids and a major push in **energy efficiency** play a key role in reducing fossil fuel consumption and making our electricity more sustainable.

Competitive electricity for our customers

We support well-functioning, distortion-free **energy and carbon markets as** the best way to produce electricity and reduce emissions cost-efficiently. Integrated EU-wide electricity and gas markets are also crucial to offer our customers the **full benefits of liberalisation**: they ensure the best use of generation resources, improve **security of supply**, allow full EU-wide competition, and increase **customer choice**.

Continent-wide electricity through a coherent European approach

Europe's energy and climate challenges can only be solved by **European – or even global – policies**, not incoherent national measures. Such policies should complement, not contradict each other: coherent and integrated approaches reduce costs. This will encourage **effective investment to** ensure a sustainable and reliable electricity supply for Europe's businesses and consumers.

EURELECTRIC. Electricity for Europe.

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This Statement on the Reform of the EU ETS is being published in support of [EURELECTRIC's Position Paper](#) on the EC legislative proposal to revise the EU Emissions Trading Scheme Directive, published in November 2015.

KEY MESSAGES

- EURELECTRIC's members are committed to delivering a carbon neutral power supply in Europe by 2050, and to ensuring a competitively priced and reliable electricity supply throughout the integrated European energy market.
- We believe that the European power sector's commitment to decarbonise electricity generation, together with the electrification of key sectors, such as heating, cooling and transport, will make a major contribution to help Europe meet its climate change targets.
- The smooth transition towards a low-carbon economy is best facilitated through a clear, reliable carbon price signal that will allow industry to invest in an efficient and sustainable manner.
- EURELECTRIC supports a strong EU ETS as the cornerstone of the EU's energy and climate policy. We support the EU ETS as a key driver for market-based investments in low-carbon electricity generation. In our view, this is the best way to underpin the provision of affordable, reliable and sustainable electricity supply to support the EU economy.
- EURELECTRIC supports the revision of the annual linear reduction factor to 2.2% for Phase IV of the ETS (2021-2030), which is consistent with the at least 40% greenhouse gas emissions reduction target under the agreed 2030 Climate and Energy Framework. We however recognise that this trajectory would place the EU at the lower ambition end in its longer term decarbonisation ambition for 2050.
- The free allocation of allowances for certain ETS sectors should be continued in Phase IV. We support the explicit definition of the share of auctioning in the Commission's proposal which states that this should not be reduced when compared with Phase III.
- Ensuring a smooth transition towards a decarbonised economy will require appropriate measures for energy intensive sectors as well as those Member States with carbon intensive economies. Developing appropriate compensation mechanisms for different industries (such as the electricity industry in countries with a different starting point and lower GDP/capita) are a precondition to mitigate the direct impacts of an increased carbon price on the competitiveness of energy intensive industry and the economies of eligible Member States.
- The revised ETS Directive should incorporate suitable provisions to enable future adjustments to the EU ETS to reflect any possible increase in EU climate ambition resulting from the UNFCCC 5-yearly global ambition review cycle, thus ensuring that the EU is able to participate fully and constructively in efforts to meeting the agreed Paris climate goals. It should include provisions to ensure that the EU keeps all options open for increasing its climate ambition in due course.
- EURELECTRIC believes that options to strengthen the EU ETS should be assessed in terms of their effectiveness, efficiency, impact and timing in delivering cost-effective emissions reductions in the EU, consistent with the Paris Agreement objectives and the actions of our global competitors. We particularly believe that the consideration of any such measures should ensure that energy and climate policies are guided by the need to maintain a strong European dimension.

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EURELECTRIC's Commitment to Decarbonisation

The European electricity sector believes that achieving the decarbonisation objectives agreed in the Paris Agreement is essential to guarantee the long-term sustainability of the global economy. EURELECTRIC's members are committed to delivering a carbon neutral power supply in Europe on this timescale, and to ensuring a competitively priced and reliable electricity supply throughout the integrated European energy market.

This commitment to decarbonise electricity generation, together with the electrification of key sectors, such as heating, cooling and transport, will make a major contribution to help Europe meet its climate change targets. Electricity is on track to becoming a carbon neutral energy carrier and, if used more widely, will open the door for many more positive changes, spill-overs in sectors which currently have no prospect of becoming fully sustainable.

EURELECTRIC believes that market-based mechanisms such as carbon markets are the most cost-effective and efficient tool for mitigating greenhouse gas emissions and stimulating investments in low carbon technologies and energy efficiency. Only the combination of an effectively reformed EU ETS and improved EU electricity market design can lead to sustainable and credible carbon price signals to drive investments to mature low carbon technologies. The smooth transition towards a low-carbon economy is best facilitated through a clear, reliable carbon price signal that will allow industry to invest in an efficient and sustainable manner.

EURELECTRIC has therefore consistently supported a strong EU ETS as the cornerstone of the EU's energy and climate policy. We support the EU ETS as a key driver for market-based investments in low-carbon electricity generation. In our view, this is the best way to underpin the provision of affordable, reliable and sustainable electricity supply to support the EU economy. The EU ETS ensures technological neutrality and it is also the only climate policy instrument for the electricity sector that is implemented in an EU-wide manner and is consistent with the internal energy market in the Energy Union.

Developments in the EU ETS

Up to 2020, the ETS sectors will deliver the greenhouse gas (GHG) emission reductions required under the Phase III cap. We are convinced that through its cap and trade approach, and after a successful completion of the proposed reform, the ETS can also ensure compliance with the GHG emission reduction objectives for Phase IV, as contribution from these sectors towards achieving the current EU's agreed climate targets for 2030. However, there is currently a serious lack of confidence among many policymakers, stakeholders, investors and market participants in the ability of the ETS to deliver long term EU decarbonisation objectives by underpinning low carbon investment.

The economic crisis, overlapping energy and climate policies and objectives, and the greater than anticipated use of offsets, has resulted in lower than forecast emissions, decreased demand for ETS allowances and the resulting oversupply, which has led to a depressed carbon price. The Market Stability Reserve (MSR) will be introduced from 2019 onwards and will enable the gradual decrease of the oversupply of allowances and will reduce the risk of future oversupply. However, the current surplus of allowances is so large that many projections of market analysts indicate that it will take significant time for the MSR to bring this down and thereby deliver a more balanced market with a strengthened carbon price. The pursued stability band will indeed most likely not be reached until the second half of the next decade.

The ETS has therefore not yet sent the necessary price signals to trigger a fuel switch in the energy sector or to incentivise low carbon investments, as had been hoped. As a consequence, most Member States have been considering nationally-based initiatives as alternative drivers for fuel switching and low carbon investments. These could provide more certainty for investors at the national level, but not at a European

level, thereby inevitably reducing the effectiveness of the EU ETS as a cost-effective European-wide mechanism through complex and overlapping carbon pricing.

These developments run the risk of

- undermining the EU ETS in delivering the long term EU climate & energy policy goals;
- delivering emissions abatement in a less economically efficient manner;
- distorting the internal electricity market, making its achievement more challenging and increasing the cost of transforming and even maintaining the energy system.

This situation leads to the achievement of our climate and energy targets more expensively across the EU as a whole, thereby weakening public support for the transition. A strong EU ETS system is thus an essential element in order to avoid further fragmentation of EU climate policy through national measures, and to facilitate further market integration.

EU ETS reform

In the context of the current proposal from the European Commission to review the EU ETS Directive for Phase IV, we support the revision of the annual linear reduction factor to 2.2% for Phase IV of the ETS (2021-2030), which is consistent with the at least 40% greenhouse gas emissions reduction target under the agreed 2030 Climate and Energy Framework. We however recognise that this trajectory would place the EU at the lower ambition end in its longer term decarbonisation ambition for 2050.

EURELECTRIC also believes that the free allocation of allowances for certain ETS sectors should be continued in Phase IV. We support the explicit definition of the share of auctioning in the Commission's proposal which states that this should not be reduced when compared with Phase III. We believe that the carbon leakage list should be focused to cover only those sectors which are clearly exposed to such risk. The list should be revised periodically to take account of economic and technological developments (keeping in perspective the final objective of full auctioning of allowances for all sectors as well as efforts made at the international level by other countries in achieving the global decarbonisation objectives).

In the light of recent discussions on the Commission's proposal, EURELECTRIC is convinced that the discussions on the current ETS reform should focus on efforts to strengthen the EU ETS to ensure that it is the key policy instrument to deliver decarbonisation and low carbon investment in Europe's economy in the short, medium and longer term. This should be done by:

- Learning from the implementation of the previous Phases of the ETS by ensuring that adjustments can be made to address the full impact of overlapping EU and national policies that undermine the EU ETS;
- Ensuring the MSR is capable of addressing the surplus of allowances currently in the system, and that unallocated allowances at the end of Phases are moved to the MSR;
- Preventing allowances from the MSR being placed back on the market within Phase IV for any other reason than explicitly stated in the Directive. Allowances from the MSR should be auctioned in a manner that does not endanger the stability of the market.
- Accelerating the electrification of other sectors of the EU economy: Using electricity for transport and heating and cooling would not only cost-effectively reduce greenhouse gas emissions, but it would effectively cap the emissions of these sectors by *de facto* bringing them under the EU ETS, besides bringing health, environmental and other benefits.

Appropriate Compensation Mechanisms and Updated Rules for the Use of ETS Auctioning Revenues

EURELECTRIC believes that ensuring a smooth transition towards a decarbonised economy will require appropriate measures for energy intensive sectors as well as those Member States with carbon intensive economies. Developing appropriate compensation mechanisms for different industries (such as the electricity industry in countries with a different starting point and lower GDP/capita) are a precondition to mitigate the direct impacts of an increased carbon price on the competitiveness of energy intensive industry and the economies of eligible Member States. The ETS reform should therefore ensure more stringent requirements for the use of revenues from auctioning of allowances and partial free allocation. Both should be geared to be used for climate change and energy related purposes, compensation mechanisms and the modernisation of energy infrastructure to ensure a sustainable low carbon transition.

Against this background, EURELECTRIC also fully supports the establishment of the Modernisation Fund, which we believe should be controlled primarily by the beneficiary Member States. We also support the revised mechanism for the free allocation of allowances for the promotion of energy system modernisation which should guarantee low carbon investments in eligible Member States that are fair, cost-efficient and effective.

Follow up to the Paris Agreement

Furthermore, we believe that in light of the outcome from COP21 in Paris, the EU must assess, in the context of the ambition mechanism, its contribution towards the achievement of the global long-term goals in the Paris Agreement. Whilst the Paris Agreement is an important step, it is clear that much more needs to be done in policy terms to get emissions down to the cost efficient pathways to hold the global average temperature increase to well below 2°C above pre-industrial levels. A clear emissions gap exists between the objectives agreed in the Paris Agreement and the current decarbonisation scenarios and commitments of the EU and other parties to the UNFCCC.

For the sake of investor predictability in the medium to longer term, EURELECTRIC therefore calls for the EU to carry out a timely study of all options to bring the EU's decarbonisation ambition under the 2030 Climate and Energy Framework, as well as under the 2050 decarbonisation scenarios, in line with the ambition of the Paris Agreement as part of the EU's expected contribution to the UNFCCC 5-yearly global ambition review cycle.

Against this background, we believe that the revised ETS Directive should incorporate suitable provisions to enable future adjustments to the EU ETS to reflect any possible increase in EU climate ambition resulting from the UNFCCC 5-yearly global ambition review cycle, thus ensuring that the EU is able to participate fully and constructively in efforts to meeting the agreed Paris climate goals. It should include provisions to ensure that the EU keeps all options open for increasing its climate ambition in due course.

Various stakeholders, including several Member States and Members of the European Parliament, have already come forward with possible options to strengthen the EU ETS in the light of the Paris outcome. A number of other stakeholders have at the same time stressed the need not to introduce further modifications to the ETS at this point in time.

EURELECTRIC believes that these options to strengthen the EU ETS should be assessed in terms of their effectiveness, efficiency, impact and timing in delivering cost-effective emissions reductions in the EU, consistent with the Paris Agreement objectives and the actions of our global competitors. We particularly believe that the consideration of any such measures should ensure that energy and climate policies are guided by the need to maintain a strong European dimension.

Options that could be the most effective in terms of impact and timing include, among others,

- strengthened design parameters of the MSR;
- an increase of the linear reduction factor beyond the proposed 2.2%;
- an appropriately designed EU-wide price control mechanism combined with the functioning of the MSR;
- an improved governance process where impacts of other European and national policy measures on the ETS are assessed.

EURELECTRIC believes that such options should be considered and assessed, and, although we do not currently have a position on any of these options, we will continue to analyse and explore the possible challenges and benefits for the electricity sector and the EU economy as a whole which such measures may involve.

EURELECTRIC pursues in all its activities the application of the following sustainable development values:

Economic Development

▶ Growth, added-value, efficiency

Environmental Leadership

▶ Commitment, innovation, pro-activeness

Social Responsibility

▶ Transparency, ethics, accountability



Union of the Electricity Industry - EURELECTRIC aisbl
Boulevard de l'Impératrice, 66 - bte 2
B - 1000 Brussels • Belgium
Tel: + 32 2 515 10 00 • Fax: + 32 2 515 10 10
VAT: BE 0462 679 112 • www.eurelectric.org
EU Transparency Register number: [4271427696-87](https://ec.europa.eu/transparency/regexpert/?s=details&id=4271427696-87)