EU ETS Reform

EURELECTRIC recommendations for trilogue negotiations

June 2017

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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EURELECTRIC Recommendations for the EU ETS Trilogue Negotiations

The interinstitutional negotiations on the reform of the EU ETS reform between the European Commission, the Council and the European Parliament are now in full swing. EURELECTRIC would like to use this opportunity to reiterate its key messages and urge policymakers to speed up the decision-making process. We believe that the extensive debate on the design parameters of Phase IV of the EU ETS over the course of the last two years should be finalised swiftly, particularly given the broad alignment between the institutions on key aspects of the current reform. As Phase III of the EU ETS is nearing its end, investors across Europe are eagerly waiting to receive legal certainty and clarity over the shape of the EU ETS post-2020, in order for them to be able to take informed decisions on low-carbon investments.

Legal certainty and clarity are particularly needed in the power sector, where investments take, on average, several years from early conception, planning and obtaining relevant permits, through to the construction phase, right up until the final delivery of projects. With the ongoing discussions on the Effort Sharing Regulation threatening to slow down the pace of EU ETS discussions further, there is a risk that the required level of certainty over the future design of the EU ETS will come too late to take informed investment decisions before the commencement of Phase IV of the EU ETS. Furthermore, seven legislative proposals included in the Clean Energy Package create additional layer of uncertainty which investors in the power sector are currently facing. Finalising the EU ETS negotiations therefore becomes increasingly urgent.

To allow for a cost-effective low-carbon transition of the power sector EURELECTRIC supports increasing the level of ambition to ensure a robust carbon price signal throughout the course of Phase IV. EURELECTRIC supports both short and long-term measures to strengthen the EU ETS by temporarily increasing intake rate to 24% from 2019 until at least 2023 and continues to urge policymakers to increase the LRF to 2.4% to guarantee long-term predictability of the system. The EU institutions should enable an increase of the LRF as soon as possible to bring the EU ETS in line with the EU's long-term climate objectives. As cancellation of allowances proposed by the Council and Parliament can also contribute to the long-term predictability and credibility of the system EURELECTRIC supports that it is carried out in a predictable and rules-based manner.

In order to mitigate an increase in the ETS allowance price and associated additional compliance costs for the electricity sector in those Member States with low GDP/capita levels, on the basis of the most recent data facing a relatively higher share of the burden, as a result of increased ambition, EURELECTRIC supports a proportional increase of Article 10c derogation and Modernisation Fund. According to our analysis, these measures would have a limited impact on the EUA prices and would not undermine the ETS allowance price curve, which as a result of an increased LRF to 2.4% and doubling of the MSR intake rate to 24% would still be much higher than proposed by Commission (see Annex for ICIS analysis).

Furthermore, with the publication of the Clean Energy Package at the end of 2016, European policymakers are currently considering the coherence and potential negative interactions of the various targets and instruments under the EU's 2030 Climate & Energy Framework. This discussion is currently taking place while the negotiations on reforming the EU ETS are not yet concluded. In this context, EURELECTRIC reiterates its call to ensure consistency between different policies and measures, which is in line with the spirit of developing a well-functioning and effective Energy Union. The additional measures proposed by the European Commission in the Clean Energy Package, if not addressed properly, may have a negative impact on the functioning of the ETS. EURELECTRIC would therefore like to draw policymakers' attention to the need to not only strengthen the ETS, but also to protect the ETS system, while also fully acknowledging the benefits that a strengthened ETS will have on the achievement of other EU policy targets.

EURELECTRIC's key asks from the current EU ETS Reform remain the same and have been relayed to all three EU institutions on previous occasions. However, in order to provide constructive input to the ongoing trilogue negotiations we would like to present our recommendations for policymakers with hope that a swift agreement between all three EU institutions can be found to guarantee legal certainty quickly, increase ambition in line with the EU's climate objectives and ensure fair and balanced EU ETS reform.

Item	Commission (15.07.2015)	Parliament (15.02.2017)	Council (28.02.2017)	EURELECTRIC preferred option
Ratio split: auctioning/free allocation	**57%/43%**	57%/43% (reduced to 52%/48% if cross-sectoral correction factor applied at any time during the Phase IV period);	57%/43% (reduced to 55%/45% if cross-sectoral correction factor applied at any time during the Phase IV period);	**Commission** (transition towards full auctioning should remain an underlying principle)
Linear Reduction Factor	2.2%	2.2% (with an optional review upwards to **2.4%** but no earlier than 2024);	2.2%	**Parliament** (but allow for the possibility of an earlier increase of ambition)
Paris Agreement review clause	None	Within six months of the global stocktake in 2023 Commission shall submit a report assessing the need to **adjust the Union's climate action accordingly** accompanied by a legislative proposal, if appropriate.	The Commission shall report following each global stocktake agreed under the Paris Agreement, in particular with regard to the need for additional policies and measures necessary for GHG reductions in the EU, and may make a proposal to **amend the Directive as appropriate**.	**Parliament/Council** (but leave a possibility for an earlier increase of ambition open)
Market Stability Reserve – intake rate	No change to the approved intake rate of 12% p.a.	Doubling the intake rate to 24% per year in 2019-2022, which can be continued **until market equilibrium is restored**	Doubling the intake rate in **2019-2023** to **24%** per year (until at least the MSR review decision due by 2024);	**Parliament/Council** (support structural measures which help to address oversupply)
MSR – cancellation of allowances	Not envisaged	**800 million allowances in 2021**	**Cancellation of all allowances held in MSR from 2024** onwards above the total number of allowances auctioned during the previous year subject to MSR review as the Commission may by 2023 propose an alternative solution.	**Parliament/Council** (support and ensure that cancellation is carried out in a predictable and rules-based manner)

Item	Commission (15.07.2015)	Parliament (15.02.2017)	Council (28.02.2017)	EURELECTRIC preferred option
Policy Overlaps	Not envisaged	A **report on the functioning of the EU ETS** by the Commission each year **addressing the interaction of the EU ETS with other policies** with attention to the volumes of emissions reductions, the cost effectiveness of such policies, and their impact on supply-demand balance of the EU ETS, accompanied by proposal aiming at increasing transparency of the carbon market.	Not envisaged	**Parliament** (support periodic assessment of the impact of overlapping policies and measures on the EU ETS to enable taking informed decisions in the future)
Innovation Fund	400 million allowances for financing, among others, RES and CCS innovation (no CCU)	**600 million allowances** for financing, among others, RES, CCS and CCU innovation	400 million allowances for financing, among others, RES, CCS and CCU innovation	**Parliament** (support increased funding for clean technology innovation)
New Entrants Reserve	Unallocated allowances (250M from the MSR + an estimated 145M further unallocated allowances from phase III) to be used to feed the Phase IV New Entrants Reserve.	400 million **allowances from the overall Phase IV cap** shall be set aside for new entrants and significant production increases.	Unallocated allowances (250M from the MSR + an estimated 145M further unallocated allowances from phase III) to be used to feed the Phase IV New Entrants Reserve.	**Parliament** (support measures, which help in addressing oversupply)
Article 10c derogation	Public bidding above €10 million threshold;	Public bidding above €10 million threshold;	**Public bidding above €15 million threshold;**	**Council** (support increasing the threshold to €15 million in accordance with the EC Regulation No. 651/2014)

Item	Commission (15.07.2015)	Parliament (15.02.2017)	Council (28.02.2017)	EURELECTRIC preferred option
Article 10c derogation	**No emission performance standard** criteria to exclude modernisation of existing coal or gas plants as ETS is market based and technology neutral instrument	Emission performance standard criteria excluding modernisation of existing coal plants and most of OCGT and CCGT plants (except for state-of-art CCGT)	No emission performance standard criteria to exclude modernisation of existing coal or gas plants	**Commission/Council** (ensure a robust governance which guarantees full transparency and investments in line with the objectives of the Directive without top down command and control measures; investments shall not interfere with the functioning of the internal market, respect competition and prioritise modernisation of generation, grids and efficiency improvements)
	Full financing of an investment	Co-financing of up to 75% of the investment	**Full financing** of an investment	**Commission/Council** (support full financing of eligible investments to guarantee compensatory nature of derogation)
	Only 2013 as a reference year	Possibility to **use 2014 reference year**	Only 2013 as a reference year	**Parliament** (support eligibility on the basis of the most recent data)
	No possibility to transfer allowances	Possibility to **transfer 10c allowances to the Modernisation Fund**	No possibility to transfer allowances	**Parliament** (increased flexibility can allow more investments in line with the objectives of the Directive)

Item	Commission (15.07.2015)	Parliament (15.02.2017)	Council (28.02.2017)	EURELECTRIC preferred option
Modernisation Fund	10 beneficiary Member States with GDP/capita below 60% EU average in 2013	10, 11 (or 12) beneficiary Member States with GDP/capita below 60% of the EU average in 2013/2014/2015 (including Greece and possibly Portugal) without any increase of the Fund	10 beneficiary Member States with GDP/capita below 60% EU average in 2013 with **special provision for Greece** to receive equivalent compensation	**EURELECTRIC position** for equivalent compensation for all countries with low GDP/capita to bring compensation on equal terms
	No emission performance standard criteria to exclude coal or gas	**Emission performance standard** criteria excluding coal and most of gas (except for state-of-art CCGT) and exclusion of new coal and investments increasing coal dependency.	No **emission performance standard** criteria to exclude modernisation of existing coal or gas plants	**Commission/Council** (ensure a robust governance, which guarantees investments in line with the objectives of the Directive without top down command and control measures)
	Governance by the Investment Board (10 beneficiaries, 3 non-beneficiaries, EC and EIB). In case of negative recommendation from the EIB financing of an investment only possible if 2/3 of the votes cast in favour (EIB and the beneficiary MS don't vote)	Governance in principle by the Advisory Board (3 beneficiaries, 3 non-beneficiaries, EC, EIB, EBRD). In case of negative recommendation from the EIB financing of an investment requires 2/3 of the votes cast (EIB and the beneficiary MS don't vote)	**Governance by beneficiaries** in case investments relate to RES, modernisation of networks, interconnectors, energy efficiency, high-efficiency cogeneration, district heating and electrification of transport. Otherwise an agreement from the Investment Committee needed – 10 beneficiaries, 3 non-beneficiaries, EC and EIB by 2/3 majority vote (EIB and the beneficiary MS don't vote)	**Council** (ensure a robust governance, which guarantees investments in line with the objectives of the Directive; investments shall not interfere with the functioning of the internal market, respect competition and prioritise modernisation of generation, grids and efficiency improvements)
	No increase of compensation envisaged in case of increase in ambition	Increased compensation for the power sector obligating **beneficiary Member States to transfer their solidarity mechanism allowances** into their national envelope under the Modernisation Fund.	No increase of compensation envisaged despite an increase of ambition	**Parliament** (support for the increase of compensation for the power sector in the low GDP/capita Member States)

Item	Commission (15.07.2015)	Parliament (15.02.2017)	Council (28.02.2017)	EURELECTRIC preferred option
Increase compensation for power sector in Member States with GDP/capita below 60% EU average via the Article 10c derogation and the Modernisation Fund	Not envisaged	Not envisaged	Not envisaged	**EURELECTRIC adopted position** Increase the Article 10c derogation between 40%-80% and the Modernisation Fund between 2%-4% to mitigate an increase in the ETS allowance price and associated additional compliance costs for the power sector in all Member States with low GDP/capita levels on the basis of the most recent data facing a relatively higher share of the burden as a result of increased ambition. This would not undermine the CO2 price curve, which under the LRF 2.4% and 24% MSR intake rate scenario would still be higher than that proposed by the Commission (see Annex).

EU ETS Reform – EURELECTRIC recommendations for trilogues

- Ambition Level:
  - Ratio split to be maintained as close to the Commission's original proposal as possible (Commission)
  - LRF should to be increased beyond 2.2% as soon as possible (Parliament)
  - Paris review clause to allow increasing the level of ambition (and LRF) after the first global stocktake in 2023 – Parliament/Council
  - MSR intake rate increased to 24% in 2019 until at least 2023 (Parliament/Council)
  - MSR cancellation of surplus allowances to increase the long-term level of ambition to be carried out in a predictable manner and through a rule-based approach (Parliament/Council)

- Increase compensation for power sector in Member States with low GDP/capita
  - Increase the Article 10c derogation between 40%-80% and the Modernisation Fund between 2%-4% to mitigate an increase in the ETS allowance price and associated additional compliance costs for the power sector in all Member States with low GDP/capita levels on the basis of the most recent data facing a relatively higher share of the burden as a result of increased ambition. This would not undermine the CO2 price curve, which with LRF 2.4% and 24% MSR intake rate would still be much higher than proposed by Commission (see Annex).

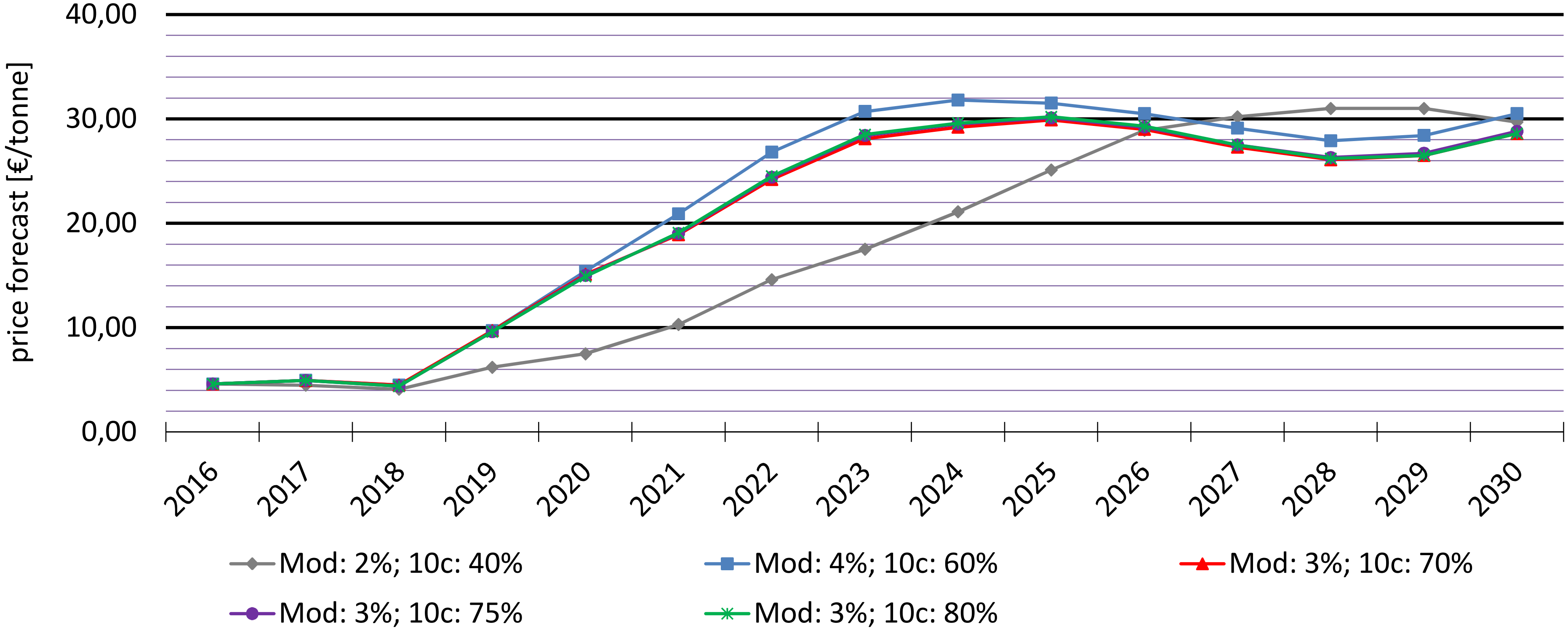
- Funds
  - Innovation Fund increased to 600 M allowances sourced from the entire cap and earmarked for RES, CCS and CCU, among others (Parliament)
  - New Entrants Reserve allowances should be sourced from Phase IV cap (Parliament)
  - Special provisions for Greece to commensurate with other low income Member States (Council)

- Article 10c derogation:
  - Calculation of 40% Member States' revenues to be used on the basis of 57%/43% ratio split, even if CSCF applied
  - National Investment Plans with public bidding above 15 M EUR threshold (Council)
  - No emission performance standard criteria explicitly impeding modernisation of existing gas/coal plants (Commission/Council)
  - Possibility to use 2014 as a reference year (Parliament)

- Modernisation Fund (Art. 10d):
  - Beneficiaries to be defined on the basis of 2013 GDP with 10 Member States (Commission/Council)
  - No emission performance standard criteria explicitly impeding modernisation of existing gas/coal plants (Commission/Council)
  - Governance by beneficiaries on the basis of the preferred list of investments (Council)
  - Increased compensation for the power sector by transferring the solidarity mechanism share into the modernisation fund (Parliament)

ANNEX

LRF 2.4% and MSR 24% intake rate in 2019-2023 results in a more robust carbon price signal even with an increase of Art. 10c derogation (60%-80%) and Modernisation Fund (3%-4%)*



Source: ICIS

Scenario assumptions

- Commission baseline scenario (grey line): LRF 2.2%, MSR 12% intake rate with 400|800m thresholds, Modernisation Fund 2%, Art. 10c derogation 40%
- EURELECTRIC position (coloured lines): LRF: 2,4%, MSR 24% intake rate from 2019-2023 with 300m|600m thresholds as of 2023, Modernisation Fund 3-4% of cap (sourced from auction share 57%), Article 10c volume thresholds 60-80% with Greece eligible for both Art. 10c and Modernisation Fund

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

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