RepowerEU Market Stability Reserve Proposal

A Eurelectric position paper

August 2022

Eurelectric represents the interests of the electricity industry in Europe. Our work covers all major issues affecting our sector. Our members represent the electricity industry in over 30 European countries.

We cover the entire industry from electricity generation and markets to distribution networks and customer issues. We also have affiliates active on several other continents and business associates from a wide variety of sectors with a direct interest in the electricity industry.

We stand for

The vision of the European power sector is to enable and sustain:
- A vibrant competitive European economy, reliably powered by clean, carbon-neutral energy
- A smart, energy efficient and truly sustainable society for all citizens of Europe

We are committed to lead a cost-effective energy transition by:

investing in clean power generation and transition-enabling solutions, to reduce emissions and actively pursue efforts to become carbon-neutral well before mid-century, taking into account different starting points and commercial availability of key transition technologies;

transforming the energy system to make it more responsive, resilient and efficient. This includes increased use of renewable energy, digitalisation, demand side response and reinforcement of grids so they can function as platforms and enablers for customers, cities and communities;

accelerating the energy transition in other economic sectors by offering competitive electricity as a transformation tool for transport, heating and industry;

embedding sustainability in all parts of our value chain and take measures to support the transformation of existing assets towards a zero carbon society;

innovating to discover the cutting-edge business models and develop the breakthrough technologies that are indispensable to allow our industry to lead this transition.

Generation & Environment Committee
WG Climate Change & Decarbonisation
WG Financial Regulation & Market Integrity

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Eurelectric opposes the RePowerEU proposal to release surplus EU ETS emission allowances from the Market Stability Reserve back to the carbon market

Eurelectric is a staunch supporter of the Green Deal, the energy transition and the EU ETS as the most central climate policy tool for the decarbonisation of the EU economy. In addition, we are firmly committed to near-term solutions that get Europe off Russian fossil fuels on to a more secure, decarbonised domestic electricity supply. However the headlined proposal by the European Commission runs counter to such aims.

We ask the European Parliament and the European Council to reject the European Commission's proposal to release a very large amount of surplus EU ETS allowances from the Market Stability Reserve (MSR). We furthermore request the European Commission to assess alternative financing means which would not negatively impact its flagship EU climate policy. Just like other legislative proposals, it should also be accompanied by a proper Impact Assessment and be subject to a public consultation with all relevant stakeholders.

The proposed measure:

1. **Risks destabilising the carbon market and investor confidence**
2. **Runs counter to the RePowerEU and the Green Deal objectives**
3. **Does not necessarily entail increased funds for the transition**

1. Destabilising the carbon market and investor confidence

Reinjecting around 250 million allowances (EUA) up to 2026 would disturb the market, particularly given the ad hoc nature of the proposal and uncertain amount of allowances to be released.. In fact, the EUA price already dropped by more than 10 % when the proposal was made. In addition, such a decision would create a first move towards arbitrary use of the EUA stored in the MSR and jeopardise confidence in the market, as market participants and investors would expect this type of ad-hoc measure to reoccur in the future.

The advantage of the MSR is that it gives predictability in the carbon market through clearly defined rules and that it is totally volume-oriented, which makes it particularly suited for a cap-and-trade policy like the EU ETS. Since its introduction in 2019, the MSR has removed very large quantities of structural over-supply of EUAs that emerged from previous trading periods and contributed to the EU ETS policy inducing a more robust carbon price signal. The MSR is therefore paramount to maintain EU ETS efficient functioning.

Today, more than three years after it was established, the MSR continues to withdraw EUAs from the supply because the market surplus is still above the agreed thresholds. In such a situation, adding more supply of EUAs through a near-term policy intervention would be highly contradictory and undesired from a market perspective.

Indeed, the MSR operates through legally pre-defined and volume-based rules, whereby it absorbs EUA above a certain level and returns them back to the market below another threshold. This predictability enables market participants to predict the EU ETS allowance cap trajectory and plan their investments in low carbon technologies in the most efficient way.

This position paper represents the views of Eurelectric's membership, except for the Polish Electricity Association (PKEE).

2. Runs counter to the RePowerEU and the Green Deal objectives

Re-injecting allowances from the MSR that were destined for invalidation as from 2023 will increase the scope for fossil fuels consumption and weaken the EU carbon price signal. In addition, it would counteract some of the key reforms of the ongoing legislative process on the EU ETS and MSR revision. Some of these reforms would have to be enhanced even further to compensate for the impact of this measure. For instance, it is important to consider that re-injecting allowances from the MSR into the market will lead to an increase of the surplus over the next few years.

Supplying more allowances to the market above the agreed MSR threshold would lead to an increased over-supply.. In consequence, it would limit the incentive to decarbonise the EU economy in line with the Paris Agreement's goals and have a negative impact on strongly needed revenues for Member States. Then looking further ahead, a higher total amount of EUAs in circulation could trigger the MSR more and lead to an even sharper increase of the carbon price at the end of the period. Such a politically driven market volatility would not benefit the EU ETS.

3. Does not necessarily entail any increased funds for the transition

Establishing a financial target introduces more uncertainty to the ETS. For the first time, the EU ETS supply would become a function of the carbon price. The lower the EUA price is, the more EUA need to be auctioned to raise the Commission's desired €20 billion with ever decreasing returns with each allowance released. This would create a vicious circle reducing the overall auction revenues for all allowances, and hence redistributing funds from MS, European Economic Area countries and linked markets (i.e. Switzerland). This would exacerbate the investment gap needed to reach the EU's climate targets.

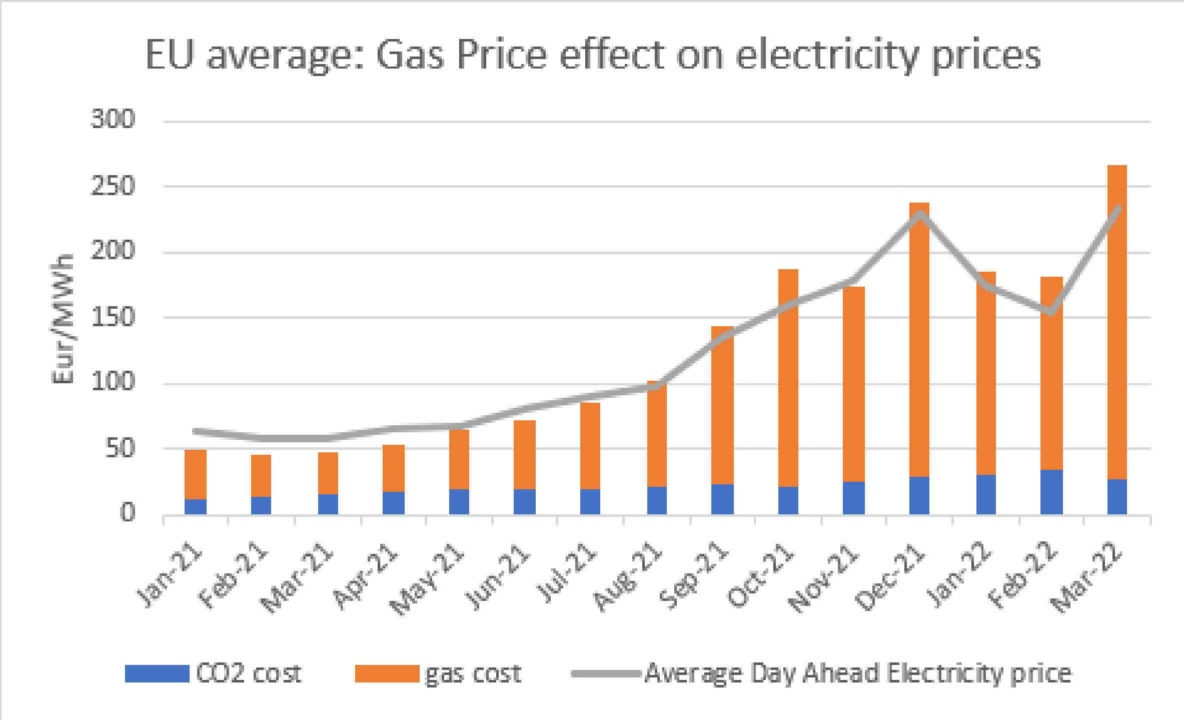
We recognise and understand the need to finance an accelerated shift away from Russian gas while protecting consumers, but this specific proposal would have too many negative consequences as outlined above and represent an unwise use of the MSR mechanism. Such a change would damage the carbon price signal provided by the EU ETS and undermine the efforts to decarbonise the EU's economy and to reduce external dependency of fossil fuels.

We thank you for your consideration and remain at your disposal to clarify any of the above elements.

About the MSR-proposal and what impact do CO2 prices have on the final end-customer price:

The RePowerEU package aims at enhancing the EU's energy sovereignty and accelerating the energy transition. According to the Commission, this plan entails additional investment needs of €300 billion, of which €20 billion are proposed to be generated by the auctioning of surplus allowances held in the Market Stability Reserve (MSR) of the EU Emission Trading Scheme (ETS). At current EUA prices, raising €20 billion would require the auctioning of around 250 million allowances from the MSR until 2026. These allowances (EUA) would otherwise have been subject to a permanent invalidation as from 2023 according to the provisions agreed upon the revision of the EU ETS Directive in 2017.

The following graph depicts what impact CO2 prices have on average on electricity prices. CO2 prices have had a much smaller impact on electricity prices in the EU compared to gas. Gas prices have had roughly seven times the impact on electricity prices compared to CO2.



Source: Ember Climate & Eurelectric Power Barometer

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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