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Reaction to the proposed EU ETS review

The EU Emissions Trading System (ETS) is Europe's most effective decarbonisation tool: emissions in ETS sectors have fallen by ~50% since 2005 – largely thanks to the power sector – while the EU economy grew by ~30%. This proves that a well-functioning carbon market can drive decarbonisation while supporting growth.

With the review of the system now in full swing, the priority should be clear: **preserve a predictable and robust carbon market, while updating it in a balanced way to reflect new economic and geopolitical realities.** Against this background, Eurelectric proposes three priorities for the ETS review:

1. **A predictable, meaningful and sustainable carbon price** – ensure a strong investment signal for decarbonisation and electrification while avoiding excessive volatility and safeguarding market stability.
2. **An ETS that anchors industrial policy** – mobilise ETS revenues and carbon leakage tools to support industrial transformation, electrification and competitiveness in Europe.
3. **A socially just transition** – implement a people-focused ETS2 backed by strong enabling policies and funding, and ensure a geographically balanced transition through an updated Modernisation Fund.

The Commission proposal largely offers a balanced way forward by offering significant flexibility to energy-intensive industries. However, the proposal goes to the very limit of the 2040 climate target agreement, e.g. by fully factoring in the ETS-sectors' share of international credits up front. **To preserve a meaningful carbon price that continues to spur investment towards the 2040 target and does not penalise frontrunners, the system's ambition must be increased compared to the Commission proposal.**

This paper aims to support the co-legislators in preserving this balance by setting out Eurelectric's core recommendations on the proposal.

What to keep

1. **50% ETS1 revenue recycling and ambitious Investment Booster, Industrial Decarbonisation Bank & Innovation Fund** to support ETS1 decarbonisation (Art.10(3), 10cb, 10cc, 10cd, 10ce*).

Why: Strengthens the link between carbon pricing revenues and decarbonisation investments, supporting the sectors that actually pay for it and prioritising electrification where cost-effective solutions already exist.
Note: Transparent reporting is crucial to ensure Member States spend *all* ETS1 revenues on climate- and energy-related purposes. Funding instruments should be easy to access, subject to pragmatic requirements, efficient to administer and focused on delivering real emissions reductions, especially when using "first-come, first-served". They should ensure fair access to capital across regions, including through EUA ringfencing, and for SMEs, mid-caps and new entrants.
*All articles refer to Directive 2003/87/EC unless otherwise stated.

2. A **more progressive, rules-based, volume-based Market Stability Reserve** anchored in market fundamentals (Decision (EU) 2015/1814, Art. 1(5,6)).

Why: It enhances system predictability and ensures the reserve remains responsive to actual market conditions as the ETS evolves.
Note: A volume-based, non-political mechanism for the intake and release of allowances is crucial for market certainty. The MSR should be able to balance both over- and undersupply in the market.

3. **Permanent domestic technological removals** to complement emissions reduction (Art. 9c).

Why: It provides additional flexibility to market participants – including the power sector – on the path to climate neutrality and helps scale net-negative technologies.
Note: Keep focus on high-integrity, permanent removals (CDR). Nature-based removals must remain outside the ETS framework due to permanence concerns and the 'like-for-like' principle.

4. **Indirect cost compensation** (ICC) to level electro-intensive industries' playing field (Art. 10a(6)).

Why: ICC protects industrial competitiveness and prevents carbon leakage when electricity mixes are not yet fully decarbonised and CBAM is not fully operational.
Note: Greater harmonisation of ICC level and use across the Single Market is needed.

5. Maintain **targeted, conditional free allocation (FA) that incentivises investment in Europe**, including for **district heating** (Art. 10a(1,1a,3a,3b,3c,3d,3e,3f), 10b(4)).

Why: FA should remain until CBAM is fully operational and help support investment certainty in the meantime. Allowances received for free must better align with credible decarbonisation efforts in Europe.
Note: Conditionality design must stay investable – acknowledging differences in facility lifetimes, recognising existing Climate Neutrality Plans, availability of enabling conditions, and avoiding administrative complexity. Electrification and clean PPAs must be recognised as eligible investments.

6. **Implement ETS2** instead of reopening it, supported by early and targeted ETS2 revenue use.

Why: ETS2 must be implemented carefully to provide regulatory certainty and predictability for Member States, investors and consumers at a time when Europe is facing the largest fossil fuel price crisis in history, supported by adequate protection for vulnerable and highly exposed stakeholders.

What to change

1. **Uphold ETS ambition & market integrity** by preserving the LRF as the ETS backbone & introducing safeguards to maintain long-term scarcity. Avoid political interference with the LRF (Art.9, 9b, 9c).

Why: The proposal provides useful flexibility, but depends heavily on optimistic and uncertain assumptions – international credits, removals, MSR dynamics, etc. In addition, lower ETS1 ambition merely shifts decarbonisation costs to other sectors where emissions reductions are often more controversial and costly.
How: Adopt an LRF at the ambitious end of a credible pathway to -90% by 2040 and climate neutrality by 2050. Monitor the *effective* cap, including international credits, removals and MSR releases, and introduce proportionate safeguards if cumulative flexibility materially weakens ambition. **To improve investor certainty, the higher, more consistent LRF should not depend on international credit availability. For these reasons, the LRF after 2035 should be set up front and be higher than the proposed 1.7%.**

2. In principle, keep **international credits outside of the ETS. If used, only indirectly and as a safety valve, not a substitute** for EU decarbonisation within the ETS (Art. 9b).

Why: Using 260mn EUAs for international credits could weaken the ETS price signal and divert significant ETS revenues (~€40-45bn) away from European industrial transformation and electrification. EU industries shouldn't pay, through their EUA revenues, for competitors' decarbonisation outside the EU. If used nonetheless, int'l credits should be mutually beneficial, supporting both EU ETS decarbonisation and carbon pricing abroad.
How: Prioritise mitigation in the EU. In principle, Eurelectric does not support the use of int'l credits inside ETS nor the use of ETS revenues to fund int'l credits, if eventually purchased. If used, they must be used indirectly and be restricted to high-integrity credits only. If used, review well before 2033 and assess not only availability, but also cost-effectiveness, maturity, integrity and opportunity cost. Any revenues or EUAs set aside but not used for int'l credits should support ETS sectors' decarbonisation within the EU.

3. Ensure **permanent technological carbon removals deliver within the cap** (Art.9c, 14(1)).

Why: The cap rises by 250mn EUAs, without certainty on funding, future CDR availability or visibility on how these will be gradually integrated (amounting to 48mn EUAs auctioned by 2040).
How: Apply a strict "one-in, one-out" approach under the existing cap instead of an ex-ante cap increase. Address the funding gap (250+10mn EUAs might not suffice to buy 250Mt of CDR at expected cost levels). Extend self-generated CDR use from BioCCS to other permanent, CRCF-recognised CDR (at least DACCS) & allow limited, direct use by ETS operators for compliance of permanent CDR under the same "one-in, one-out" approach under the existing cap. Allow firms to use CDR at group level rather than only at installation level.

4. **Strengthen the Modernisation Fund** to match the scale of the required transition (Art.10d).

Why: The ETS must support a geographically balanced transition, while the Fund's expanded scope – incl. clean generation capacity, electrification, grids, storage – better reflects future system needs.
How: Increase the MF's size back to its current size of 4.5%. Updating the GDP reference period should not exclude current beneficiaries. Ensure faster, more predictable project approval with multi-year funding.

What to add

1. Support **regulatory certainty** by providing earlier clarity on core decisions.

Why: Postponing crucial decisions only undermines investor certainty and delays the transition.
How: Settle the most consequential choices – e.g. international credits & corresponding LRF adjustments, FA conditionality – in primary legislation. Accelerate secondary legislation and reporting timelines.

2. **Article 29a** must also be a credible **safeguard against exceptional price drops** (Art. 29a).

Why: A rules-based mechanism capable of addressing extreme and unjustified price movements – including price drops - reduces the risk of discretionary market intervention and improves investor certainty.
How: Review the activation criteria in a limited way to make the mechanism more responsive, balanced and symmetric for *exceptional* upward and downward price movements. Activation could be based on a rolling average EUA price deviating beyond a predefined threshold from the average price over the preceding rolling 12-month reference period. Article 29a must not result in a de facto price corridor. Instead, interventions should remain exceptional and be subject to a clear limit on their frequency within any rolling 12-month period.

3. Introduce **safeguards to invalidation rule repeal** (Decision (EU) 2015/1814, Art. 1(5a)).

Why: Risk of MSR build-up that results in market oversupply and undermines the carbon price.
How: Support the ENVI position that retains the MSR invalidation rule at an MSR volume of 650mn EUAs.