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Brussels, 22 February 2013

Ref: Answer to the consultation on structural options to strengthen the EU Emissions Trading System – by CEPI, transparency register nr. 72279144480-58

Dear Sir/Madam,

CEPI aisbl - The Confederation of European Paper Industries, is a Brussels-based non-profit organisation regrouping the European pulp and paper industry and championing industry's achievements and the benefits of its products. Through its 18 member countries (17 European Union members plus Norway) CEPI represents some 520 pulp, paper and board producing companies across Europe, ranging from small and medium sized companies to multi-nationals, and 1000 paper mills. Together they represent 25% of world production. Almost all of the CEPI members take part in the EU Emission Trading System, with 900+ EU ETS permits totalling 37 Mtonnes of CO_2, 2% of EU ETS coverage.

CEPI hereby submits its reaction to the consultation on structural options to strengthen the EU Emissions Trading System. CEPI is a registered organisation in the transparency register (nr. 72279144480-58).

As there is no formal questionnaire in the stakeholder consultation request, our reaction consists of this letter *and* the attached position paper. Although the Commission carbon market report is listed as background document, CEPI strongly feels a structural ETS review needs to bring a structural solution to EU's competitive position. We have therefore made a broader analysis of the problem than issues around carbon price only and propose different options than the six options listed in the carbon market report alone.

CEPI calls upon the European Commission and member states to thouroughly think through structural changes to the EU ETS, instead of a short time fix.

The EU ETS functions and meets its goal: to reduce GHG emissions by 20% by 2020 compared to 1990 level. There is a market, there is compliance and there is verification. The EU's 2020 targets are set to be met at least cost.[1] **Any structural review shall only be implemented after 2020**, unless a global agreement is reached.

With respect to the options on the carbon market report: we have the following short reactions on the different options:

1. *Increase of the EU GHG target to 30%.*

The conditions for increasing the 2020 target are set in the legislation and the mandate to the Commission to change the 2020 target has to come from Head of Governments. We have understood that the EU target of 20% only moves to 30% when an international binding climate change agreement is reached. As these pre-requisites are not there, the Commission would be exceeding its powers if it would propose to increase the 2020 target to -30% within the context of the EU ETS review.

2. *Retiring a number of allowances*

Retiring allowances from the market pushes carbon and electricity prices upwards. This means increasing compliance costs and energy costs. At a time where Europe is far from recovery from the financial crisis, with difficult access to capital, with the energy prices gap growing between Europe and the rest of the world, retiring allowances will stop investments, push for the relocation of industries outside Europe, and exacerbate the impact of the financial crisis for EU citizens.

3. *Early revision of the linear reduction factor*

A pre-2020 revision of the linear reduction factor requires the re-opening of the whole ETS directive, as it impacts the allocation of free allowances as well. This will be an ex post adjustment, creating further confusion for industry. The linear reduction factor already decreases free allocation in the benchmarks by -1,74% per year, matching an unprecedented efficiency improvement. Changes to the linear reduction factor for industry can only start after 2020 and only when either a global agreement is reached or significant breakthrough technologies become available.

4. *Extension of the scope*

It is not clear what this measure is expected to deliver. New sectors will bring in the system the related emissions. But, beside marginally increasing energy costs – thus increasing governments' revenues, it is not clear how this move would promote investments in low-carbon technologies or address any issue raised in the carbon market report.

[1] Directive 2003/87/EC establishes a scheme for greenhouse gas emission allowance trading within the Community in order to promote reductions of greenhouse gas emissions in a cost-effective and economically efficient manner.

5. Access rules to international credits

Access to international credits is already limited, therefore it is not clear what this proposal would add to the status quo. Concerning Least Developed Countries, as their emissions are quite marginal in comparison with the EU's, allowing a credit from those countries doesn't seem to have any major impact on the status quo within the EU.

6. Discretionary price management

CEPI is firmly against further efforts to manipulate the carbon price. These measures would substantially alter the nature and functioning of the ETS and would require complex institutional changes. It goes without saying that a price floor would require also a price cap. And these would have to take into consideration the impact on competitiveness that carbon pricing has on the whole range of sectors covered by the ETS.

In summary, CEPI believes other options than listed in the Carbon market report are needed and sufficient time should be allowed for a proper and informed debate, implementing any changes decided upon only after 2020.

Kind regards,

Marco Mensink
Deputy Director General

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A structural ETS review needs to bring a structural solution to EU's competitive position

22 February 2013

CEPI calls upon the European Commission and member states to thouroughly think through structural changes to the EU ETS, instead of a short time fix.

1. **The EU ETS functions and meets its goal**: to reduce GHG emissions by 20% by 2020 compared to 1990 level. There is a market, there is compliance and there is verification. The EU's 2020 targets are set to be met at least cost.[2]

2. Any structural review shall only be implemented after 2020**, unless a global agreement is reached.**

3. Any future climate change and energy policy needs to deliver a long term perspective within a global context**, bringing long term targets within reach in the most cost effective and economically efficient manner. This does not include the ETS only, but the total package of policies adressing industries global competitiveness and the risk of carbon leakage, energy markets, environmental issues and climate change.**

4. The EU ETS in itself cannot deliver on innovation, although the climate needs breakthrough technologies in industries concerned. **The ETS can however deliver double dividend by spending its revenues in the right way.**

5. Structural changes need to take into account that the economic and political landscape has drastically changed since 2009**, where the EU has fundamentally reduced its competitive position. The global competitive position of the EU economy and industry has to be the basis for any proposals for change.**

For these reasons, the options in the carbon market report do not bring such a structural view. The six options in the report all show short term fixes to set a certain carbon price. They do not yet reflect structural changes to the EU ETS for after 2020.

A structural rethinking is needed.

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[2] Directive 2003/87/EC establishes a scheme for greenhouse gas emission allowance trading within the Community in order to promote reductions of greenhouse gas emissions in a cost-effective and economically efficient manner.

<u>**What are the main problems today?**</u>

1. **The situation has dramatically changed.** When the EU ETS was designed, we expected a global agreement on climate change, so that carbon abatement curves in Europe would have started with fuel mix changes in the power sector, followed by low hanging fruit such as efficiency improvements in industry, until finally carbon capture and storage. Today, the abatement curve above no longer applies: the economic crisis, the differences in prices of energy between Europe and the rest of the world, the huge increase in renewables in Europe, the lack of global international agreement and the unilateral EU actions, all give a different setting to the ETS then when it was initially designed. This has to be taken into account in any review.

2. **The ETS has been given too many functions and is expected to deliver all in the short term.** The problems raised in the carbon market report have to do with the multiple expectations on the functions of the carbon market. Currently the carbon price is expected to bring renewable energy to the market, create global carbon markets, stimulate low-carbon technologies and make sectors invest, etc. Delivering on all at the same time is simply not possible.

3. **Too many laws conflict and interact with the EU ETS**. Other legislations continuously interfere with the carbon market, lowering the need for allowances thus lowering the carbon price – the Energy Efficiency Directive, the Renewable Energy Directive, the Industrial Emissions Directive, national support schemes (e.g. the German Energiewende) etc. Particularly with renewable energies, where investments take place independently of carbon prices set by the EU ETS.

4. **The ETS holds too many differences and sectors inside**. The interests of and drivers of the power sector do not resemble those of the electricity and heat consumers in Europe – the industrial carbon leakage base. The power sector has full pass through, the marginal pricing system, long term investment cycles, no exposure to international competition.

5. **Too many regulatory interventions hamper investments**. Participating companies are weary of all the changes made to the system, particularly when 2013 allocations are not even known. Every time a change in the regulatory framework is announced, investments freeze until the regulatory framework is finally defined. This in itself has become an obstacle to investments.

Given the above, it seems clear that an EU ETS review will be needed by 2017, as already inbuilt in the law, to be implemented from 2020 onwards. We therefore welcome an early discussion on structural measures, but we strongly oppose to any pre-2020 review of the ETS. The discussion on ETS is in practice a discussion on how to meet the carbon targets beyond 2020. The system used and the price resulting are a secondary, however important debate.

<u>Therefore CEPI proposes to</u>:

6. **Start the ETS review from the perspective of competitiveness and industrial policy.** The ETS has become a general issue for competitiveness. The additional costs per se have an impact when there are no constraints on operators in other countries, being more or less carbon intensive does not matter. **ETS should prevent investment leakage not only carbon leakage**. The definition of loss of market share to less carbon intensive installations needs to be changed.

7. **On this basis, rethink the entire policy package, not only the EU ETS,** cleaning up the overlap between the many tools in place now**.**

8. **Implement structural changes after 2020, and only once.** Investments are hampered by too many changes. To give investment certainty there should be no further changes to the system that are implemented before 2020. 2013 already sees a planned massive overhaul of the EU ETS with new allocation rules. 2014 already has uncertainty with the proposed re-evaluation of free allocation to the industry (the carbon leakage list). The back-loading proposal changes the rules again, announcing even more changes ahead. Regulatory uncertainty becomes a barrier to investments in the EU.

9. **Make clean divisions between ETS and other legislation and avoid overlap.** There is a special reference linking the ETS directive with the IED. This shall be changed – no special reference shall be made to energy efficiency measures in IED permits and BREFS when the installations are also under the EU ETS.

10. **Break the link between electricity generators and industrial installations inside the ETS.** The link between the share of industry and electricity generators, via the linear reduction factor, needs to be broken – change is needed. Structural solutions to the ETS directive are only possible when Article 10a5 is removed. As long as the industry cap changes with the linear reduction factor and the link between power sector and industry sector is not broken (by removing this article), structural solutions accommodating both sectors are not possible. This will result in a system where the carbon price is set by the shortage in the power sector, but in a much more clear way than today.

11. **Remove the C-factor, and only have a linear reduction factor.** When allocations have taken place based on the benchmarks and historic production there shall by principle NOT be a C-factor. Article 10a5 should be removed. This will bring fewer credits to auctioning.

12. **Not change the linear factor.** The EU can only change the linear reduction factor when either there is a global agreement or a major technological breakthrough is achieved.

13. **Limit changes, also to the carbon leakage list.** There shall be a Carbon leakage list review only once per period, before the start. Article 10a13 shall therefore be changed. Every 5 years creates a huge uncertainty for investments.

14. **Neither backloading nor set aside credits. Set aside destroys economic value.** The EU Commission proposals for a structural set aside of EUA, following the temporary backloading, are an unnecessary destruction of economic value and growth potential. If decided to set aside allowances for future use, one could look at ways of securing credits in a permanent buffer, which allows for flexibility, and use them as a tool for both future growth and innovation funding.

15. **Use the revenues from the ETS to help drive innovation.** All auctioning and unused new entrant reserve credits shall be spent on development of breakthrough technologies for the sectors covered by the EU ETS and on providing support to enable these sectors to cope with the challenges of a low carbon economy while maintaining their international competitiveness.

16. **Improve the position of industrial CHP**. The ETS directive when decided upon purposely made no distinction in electricity produced and used on industrial sites and market electricity produced by power companies. The fact that there is no free allocation to any electricity production has devastating impacts on industrial CHP.

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The Confederation of European Paper Industries (CEPI) is a Brussels-based non-profit making organisation regrouping the European pulp and paper industry and championing this industry's achievements and the benefits of its products.

Its collective expertise provides a unique source of information both for and on the industry; coordinating essential exchanges of experience and knowledge among its members, and with the industry stakeholders. Through its 19 member countries (17 European Union members plus Norway and Switzerland) CEPI represents some 550 pulp, paper and board producing companies across Europe, ranging from small and medium sized companies to multi-nationals, and 1000 paper mills. Together they represent 25% of world production.
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