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European Commission
Directorate-General Climate Action
Unit B.1 – Implementation of ETS

Response to the European Commission public consultation on structural options to strengthen the EU Emissions Trading System

Position of the
Polish Association of Professional Heat and Power Plants
to the document
Report from the Commission to the European Parliament and the Council
The state of the European carbon market in 2012

In light of the ongoing consultations of the reform of the European Emissions Trading System EU ETS which consists of various options leading to the improvement of EU ETS, the Polish Association of Professional Heat and Power Plants hereby presents its comments.

General remarks

- The EU ETS system has been established for the purpose of reducing emissions by 20% to 2020 which target complies with the energy-climate package 3x20 whereas the quantity of allowances available in successive clearing periods has been designed to enable the achievement of this target. The surplus of allowances that occurred on the market of CO_2 emission trading means that emissions are below the assumed target and that, according to the analysis presented in the Report from the Commission to the European Parliament and the Council "The state of the European carbon market in 2012" (COM(2012)625final), the status of the allowance surplus on the market shall be maintained until 2020 and shall amount to an approximate two billion CO_2 emission allowances which represents more than 30% of the emission reduction in

2020 i.e. grossly above the assumed target without EU ETS intervention on the market. Therefore, it is not necessary to intervene in the EU ETS emission trading market as it fulfils its purpose by actually reducing emissions, even beyond the required target.

- The surplus of emission allowances results from a lower emission of CO_2 caused by the breaking economy following the financial crisis and by business efforts that contributed to emission reductions. During the economic slowdown, low CO_2 allowance prices provide industry with lower fees for CO_2 emissions which helps maintain the competitiveness of the EU economy towards economies of countries not operating emission trading systems. Once the economic situation in the European Union improves, the oversupply of emission allowances created during the breaking economy will quickly be consumed whereas the prices of CO_2 emission allowances will rise to a level that will drive the development of low-emission technologies.

- Upholding the currently valid quantity of allowances contributes to low CO_2 allowance prices at the onset of phase 3 which, however, will be compensated by an increase of emission allowance prices at the end of the period, particularly when information on phase 4 will be made public.

- The argument presented in the Report that an increase of allowance prices may increase state budget income is unacceptable since this income would be achieved at the additional expense borne by the industry while the ETS system is meant to reduce emissions not support state budgets.

- Changes on the EU ETS market may undermine its credibility. Once the EC changes the rules governing the emission trading market, this will serve as a precedent for similar actions in the future. There is also the risk of serious speculative fluctuations of CO_2 emission allowance prices since it cannot be predicted how the market will react to the retirement of allowances. This would hinder business operation in view of difficulties in budget planning that takes into account the cost of emission allowance procurement.

- In the enclosed analysis, the EC does not take into account the additional impact of demand from the Australian market which, according to plans, will be fully integrated with the EU emission trading system by 2018 while the Australian industry sector is already able to acquire emission allowances in forward contracts for 2015. Furthermore, an analysis is yet to be made of the impact of the ban effective from 1 January 2013 that prohibits the use of international credits from N_2O reduction projects, HFC-22, HFC-23, or the ban on using credits from countries which have not signed a continuation of the Kyoto protocol to 2015, which will also limit the supply of emission allowances on the EU ETS market.

- Another cause of concern stems from information available from the EU ETS market that emission allowances could be permanently retired which would lead to a price rise and further encumber company budgets that are already coping with the impact of the crisis and a drop of demand for offered goods.

Comment to pt. 3 "A review of the auction timetables as the short term measure"

- A change of the auction timetable of 900 million EUA introduces unnecessary disturbance on the EU ETS market as it will not change the balance of emission allowances in phase 3 for which the emission oversupply is estimated at 2 billion EUA. What is not auctioned in the first three years of phase 3 will be returned to the system in the years 2019-2020. This gives rise to unnecessary changes in the appraisal of emission allowances on the market which in turn can cause unpredictable consequences at the end of phase 3 when the allowances return to the market and their prices may drop below the current values.

- According to the Report, the auction timing changes should be introduced before phase 3 starts. As it is currently known, this measure is unrealistic. What more, it is estimated that regulations related to "backloading" will not apply before the beginning of 2014. Therefore, it is difficult to foresee the impact of deferred "backloading" in the EU ETS market as the period between the retirement of allowances and their return to the market will be shorter.

- The planned reintroduction to the market of retired CO_2 emission allowances after 2017 may lead to another serious allowance price drop caused by the oversupply of allowances on the market should the breaking economy in the EU continue. Therefore the EC may in the upcoming years attempt to introduce successive legislative changes purporting to permanently cancel retired allowances from the market which would be equivalent to increasing the reduction target. The future price drop will deteriorate the profitability of energy projects related to clean technologies and will once again undermine investor trust in the long-term credibility of ETS.

Comment to pt. 4 "Options for structural measures"

Clauses 4.1, 4.2, 4.3

- The introduction of options a), b) and c) is related to an increase of the reduction target which is against the currently adopted reduction target and the energy-climate package. We suggest that the changes related to increasing the reduction target be introduced in phase 4. The EC should prepare a framework for the next emission allowance trading period as soon as possible thereby enabling ETS market participants to plan the necessary investments to achieve a more ambitious reduction target in an optimal and economic way.

Clause 4.6

- Discretionary price management mechanisms are unacceptable in the case of the EU ETS system which was established as a free market system in which the CO_2 emission allowance price would be shaped by supply and demand, itself meant to be an effective means of reducing greenhouse gases. The option suggested by the EC would transform the system from a free market mechanism to a mechanism shaping a quasi-market where the CO_2 allowance price is the product of political and administrative decisions and may be prone to interest group lobbies.

Conclusion

The economic effects for companies implied by the proposals presented in the Report "The state of the European carbon market in 2012" as well as the lack of explicit criteria for ETS system operation in phase 3 (including a lack of final decisions on the allocation of free allowances for heat and derogations for electricity) clearly prove that no limitations should be introduced in the scope of the quantity of allowances available on the emission trading market to 2020 in respect to already effective conditions. A different path should be construed to drive the increase of emission allowance prices e.g. through the development of global emission trading.

The suggested changes to the rules governing the carbon dioxide emission trading market presented in the Commission's report represent a serious interference in the already operational clearing phase thereby presenting a considerable risk to the entire economy caused by legal uncertainty. The Commission proposal worth considering consists of the idea to extend the EU ETS reach to other sectors that consume fuel e.g. transport, which may provide considerable emission reductions and an improvement of efficiency.

Furthermore, a revision of EU ETS should take into account the targets stipulated in other regulations such as the energy efficiency directive (EED) and the Directive on the promotion of the use of energy from Renewable Energy Sources (RES).

In light of the breaking economy and the lack of global agreements, a revision of the climate policy is necessary in the scope of postponing issues related to carbon dioxide emission reductions.

In view of the above, any interference in the EU ETS market at the present time is unjustified. Proposals of structural changes should be broadly discussed among participants while such changes should be based on an analysis of the effects implied by the proposed regulation.

Yours faithfully

Director

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