

## **GDF SUEZ answer to the public consultation on ETS structural measures**

GDF SUEZ welcomes the opportunity to answer the European Commission's consultation on a sustainable solution to the growing imbalance between supply and demand, which requires structural changes to the EU ETS.

GDF SUEZ is deeply committed to taking action on climate change. The Group believes that the EU ETS should play a central role in EU energy and climate policy. As a principle, the Group supports **EU-wide harmonized approaches**, such as the EU ETS. The EU ETS constitutes the right instrument to ensure emissions reductions in European industry at the lowest cost. It is furthermore an important driver for the modernisation of the EU economy, through directing investment and innovation to low carbon technologies.

**However, GDF SUEZ believes that the EU ETS currently faces at least three major problems that require urgent solutions:**

- An short-term problem, caused by the oversupply due to an over-allocation of free allowances to industry in a context of economic crisis, a lack of coordination with other policies (like energy efficiency and renewable energy), and the impact of CER and ERU restrictions in phase 3 leading to a massive influx of offset credits for compliance in phase 2. Due to all these factors, there are no market incentives anymore for low-carbon investments.
- A longer term issue, caused by the lack of a long term target and the related milestones beyond 2020, and in particular, no emissions reduction objective for 2030.
- A structural problem, as the supply of allowances is fixed upfront while demand fluctuates along many different factors, including dependence on other policies (i.e. renewable, energy efficiency, etc...), and the global economic situation.

### **1 GDF SUEZ Key Messages**

1. GDF SUEZ supports the definition, as soon as possible, of **emissions reductions targets for 2030**, in line with the Council agreed targets for 2050, both for the global economy and the ETS sectors. As a reminder, the low carbon economy roadmap suggests global reductions in 2030 of -40% to -44%, including -54% to -68% for the power sector, and -34 to -40% for the industrial sector. GDF SUEZ supports this trajectory towards 2050.

2. These targets should be transposed to the ETS sectors through a **strengthening of the Linear Reduction Factor (LRF)** to about 2.3%, as soon as legally feasible, noting that the current LRF of 1.74% will not bring the ETS sectors to the 2050 target.
3. But as the previously stated measures take time to be implemented, GDF SUEZ supports a short-term measure to **set-aside at least 1200 Mt CO<sub>2</sub> EU allowances** to reinforce the effect of the back-loading of EU allowances, which it advocated in the previous consultation. Surplus of EU allowances is estimated to be around 2 000 Mt already, so the larger amount of allowances from this surplus that would be set-aside, the better. GDF SUEZ believes that failure to take this quick measure will lead to a final collapse of the ETS market and a multiplication of ad hoc national measures.
4. More broadly, GDF SUEZ believes that, at the end of the day, the **extension of the ETS to other sectors** (like the heating and cooling, and transport sectors) is consistent with the 2050 roadmaps and a low-carbon economy, and therefore should be seriously envisaged by the European Commission.
5. GDF SUEZ also supports a better alignment of all climate related policies, such as the energy efficiency and renewable energy policies with the ETS, taking also into account the evolution of the global economy. This should notably translate in a **supply adjustment mechanism**, i.e. an adjustment of the **quantity** of allowances delivered to the market to take into account the impact of the various other policies, while at the same time aiming at the predefined emissions cap.
6. In case none of these measures were adopted, a **carbon price floor** should be envisaged at EU level to provide investors with the necessary certainty.

## 2 GDF SUEZ detailed comments on the EC carbon market report

As mentioned in the previous consultation, GDF SUEZ supports a temporary “back-loading” of allowances (1,2 billion tonnes or more), given the current surplus estimated at about 2000 Mt. But we consider that this measure is not sufficient to stabilize the market functioning in the longer term and give an efficient low carbon investment signal. It will be a first step in the right direction only if it is urgently followed by more permanent and structural measures as a part of a more comprehensive package including long term targets. That’s the reason why GDF SUEZ welcomes the carbon market report, published in November 2012 by the European Commission. In this report, the Commission has identified six options, any of which could potentially correct the surplus of allowances:

- a) Increasing the EU’s greenhouse gas emissions reduction target for 2020 from 20% to 30% below 1990 levels;
- b) Retiring a certain number of phase three allowances permanently;
- c) Revising the 1.74% annual reduction in the number of allowances to make it steeper;

- d) Bringing more sectors into the EU ETS;
- e) Limiting access to international credits;
- f) Introducing discretionary price management mechanisms such as a price management reserve.

GDF SUEZ notices that some of these so-called “structural measures” subject to consultation are in fact already targeted at the 3<sup>rd</sup> (2013-2020) trading period, while more structural reforms are also needed in view of trading phase 4 (post-2020).

As previously mentioned, and even though the carbon market report is silent about this, GDF SUEZ believes that specific structural measures can only be evaluated in a **long term framework** on their capacity to achieve the long term targets. Therefore, GDF SUEZ welcomes the announced **publication of a green paper on the 2030 framework** in 2013, in which we expect strong support for an ambitious level of emissions reduction objective in 2030 **in view of 2050 targets**. This long term commitment should also support the price of CO<sub>2</sub> through the banking feature included in the EU ETS. Therefore, GDF SUEZ hopes that long term issues will be tackled in the near future and that the short-term proposals will be duly complemented by more structural measures, with an impact assessment clearly showing their benefits.

## 2.1 GDF SUEZ preferred options:

1. **Option (c)**: GDF SUEZ supports the introduction of a **strengthened Linear Reduction Factor (LRF)** of about 2.3% to translate the global long term objectives for 2030 and 2050 in the ETS sectors. The current linear reduction factor (LRF) is set at 1.74%, and goes on “forever”. However, the current rate does not yield the expected reduction of 80-95% in 2050, and its revision is foreseen in the Directive with a view to a decision in 2025. GDF SUEZ believes this is too late: the LRF should be adapted earlier to adjust the amount of allowances up to, but also after 2020. However we understand that this option seems difficult to implement in the very short term.
2. **Option (b)**: Given the current state of the market, **GDF SUEZ supports a “one shot” permanent removal of allowances** (“set-aside”) to give an immediate signal for investors and restore confidence in the system. We are now facing the possibility of a collapse of the ETS market, and the introduction of multiple national measures and fragmented national markets working against the internal energy market, as can already be seen by the measures contemplated by some Member States. **GDF SUEZ therefore calls for a set-aside of an appropriate amount of allowances (at least 1.2 billion tonnes or even more, given the current huge surplus)**. This measure will help to ensure a balanced demand and supply in the carbon market and give correct signals for low carbon technology investments. The allowances removed from the market could be put in a reserve and either be re-injected in the market in case of strong economic growth before 2020, or cancelled at a later stage in the adjustment of the 2030 cap leading to a corresponding adaptation of the LRF. GDF

SUEZ believes that this set-aside option should be complementary to an increase of the LRF and would be more rapidly implemented through specific legislation.

3. **Option (d)** : GDF SUEZ supports the **extension of the scope of the EU ETS to other sectors**, in line with the low-carbon and energy 2050 roadmaps. This could happen through inclusion of e.g., the transport sector or the building heating and cooling sectors or other greenhouse gases. This will help solve the current competition distortions between large district heating systems subject to the ETS and individual heating systems which are not (yet) covered by a carbon tax. For this option, we would very much appreciate an in-depth dialogue with the European Commission as there are many technical and practical hurdles to solve in order to make this option turn into reality at the latest in the 4<sup>th</sup> trading period.

Furthermore, to have an impact, the new cap to be defined should take into account the existing surplus, and the different abatement possibilities of various sectors (possibly more for the power sector).

4. **Option (f): Discretionary price management mechanisms**: Two mechanisms are proposed by the Commission: **carbon price floor** and **supply adjustment mechanism (price management reserve)**.

Both proposals necessitate to define, as a pre-requisite, the level of the price targeted. In principle, the EU ETS is a **quantity-based market mechanism**, and is not supposed to be used to regulate carbon prices through administrative or political decisions.

Nevertheless we would support a **supply adjustment mechanism**, within certain bounds, to avoid the repetition of the current situation of oversupply of allowances. The EU ETS is the only market where supply is fixed once and for all, while the demand varies. Supply should be adjusted to economic conditions or policy changes having an impact on the EU ETS.

The criteria of such a mechanism would need to be known in advance (predictability) and transparent (visibility), and its management should be ensured by an independent authority based on well-defined and predictable criteria, with sufficient notice time, to prevent gaming and market manipulation for political reasons. Such an option, however, requires further study at practical and institutional level.

In case none of the above measures (c), (b), (d) were adopted, a **carbon price floor** should be envisaged at EU level to provide investors with the necessary certainty and avoid national, fragmented initiatives.

## 2.2 Less desirable options :

1. **Option a** : **Increasing the EU reduction target to 30% in 2020** seems **politically difficult to implement**, as this option has already been blocked in the Parliament and the Council in 2010 based on the following arguments (which are still valid):

- The 30% is subject to an agreement on climate change at the international level (which is still far removed)
- Increasing the target for the manufacturing sectors submitted to international competition may not be advisable regarding the economic crisis already impacting the European industry.

This would also imply a renegotiation of the global Union targets, in the ETS Directive (2003/87/EC) and the Effort Sharing Decision (406/2009/EC) – a long and painful process. In its previous analysis, the Commission had estimated that this would translate in an ETS cap of -34% instead of -21% (compared to 2005), and an effort of -16% rather than -10% for the non-ETS sectors. The main burden would be for the electricity sector. In any case, it seems very late to modify current targets and such a measure would not give a good signal to stakeholders on the visibility of European policies.

2. **Option e : Use access to international credits** : The Commission proposes a much restricted use of credits in the fourth period (after 2020), to reduce the allowances surplus, saying that they could play a smaller role in case of high carbon prices. However, this neglects the role of international credits in starting an international carbon market and developing a capacity in developing countries, e.g. in monitoring, reporting and verifying emissions, developing projects, etc. GDF SUEZ considers that the position of the EU on this issue should not prejudice the future developments of the International Agreements still under discussion.

Despite current concerns, it must not be forgotten that limitation of CO<sub>2</sub> emissions is a worldwide challenge and that we must aim at developing international mechanisms contributing to decrease emissions at the lowest cost.

Further, excluding the international offsets would almost surely kill this market (CERs are already trading at 0.35 EUR) and create difficulties in linking the EU ETS with other national or regional markets. When the offsets needed to act as a safety valve on prices would really be needed, they would not exist anymore.

Therefore, GDF SUEZ does not consider it is a viable solution.

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