

July 2007

## **POSITION PAPER**

.....  
**Review of the EU Emissions  
Trading Directive (2003/87/EC) and the  
Linking Directive (2004/101/EC)**  
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**Climate Change WG  
Flexibility Mechanisms SG**  
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In line with its mission, EURELECTRIC seeks to contribute to the competitiveness of the electricity industry, to provide effective representation for the industry in public affairs, and to promote the role of electricity both in the advancement of society and in helping provide solutions to the challenges of sustainable development.

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### **Review of the EU Emissions Trading Directive (2003/87/EC) and the Linking Directive (2004/101/EC)**

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### **Climate Change WG Flexibility Mechanisms SG**

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## POSITION PAPER

### Review of the EU Emissions Trading Directive (2003/87/EC) and the Linking Directive (2004/101/EC)

July 2007

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## Key Messages

### Introduction

The main requirement for the Union of the Electricity Industry – EURELECTRIC, representing the European Electricity Industry, in the review of the EU ETS is that greater predictability be provided around the boundary conditions which set the long-term price of an EU Allowance. Our key concerns itemised below reflect this need.

### 1. Cap-setting

EURELECTRIC favours an EU-wide top-down approach towards setting the overall EU ETS cap. This requires:

- A transparent mechanism to derive the cap from the overall EU greenhouse gas emission targets;
- A transparent mechanism to distribute the cap between Member States or trading sectors as the case may be; and
- A transparently defined trajectory towards the derived cap.

There should be equitable burden sharing in setting the cap for the trading and the non-trading sectors. The electricity industry should not be unduly disadvantaged *vis-à-vis* other sectors as all economic sectors must engage in reducing greenhouse gas emissions if EU targets are to be achieved.

### 2. Auctioning

Should increased levels of auctioning be applied in future trading periods, EURELECTRIC favours a well-signalled transition with the level of auctioning harmonised at EU level. Auctioning should include all trading sectors. Provision should be made to allow sectors justify on competitive grounds why they should not be subject to a common level of auctioning. Issues on auctioning that need to be clarified comprise:

- Redistribution of the auctioning revenues in a manner that does not result in market distortions;
- Linkages with other policies; and
- The organisational aspects of EU-wide auctioning (i.e. frequency, administration, etc).

To avoid distortions, EURELECTRIC supports the proposal for a Regulation on auctioning as contained in the proposed Directive on the inclusion of aviation in the EU ETS.

### **3. Differentiated allocation**

EURELECTRIC is opposed to any allocation methodology that discriminates against the electricity sector. However, we acknowledge that certain sectors exposed to international competition may require some level of protection until such time as a global emissions trading regime is established.

### **4. JI and CDM**

The existing JI and CDM mechanisms must be integrated into the post-2012 international framework as they are fundamental to achieving the EU's emission reduction goals and engaging developing countries in a global emissions reduction process. To facilitate cost-effective investment decisions, companies should have full and flexible access to the credits generated by the Kyoto mechanisms. EURELECTRIC opposes the setting of quantitative and qualitative restrictive "caps" on the use of such credits.

Should a restriction be imposed then it should be harmonised at EU level and set in a practical and transparent manner and should be inversely proportional to the severity of the cap. In this context, EURELECTRIC proposes that any limit on the use of JI and CDM be set as a EU-wide requirement on operators to surrender a minimum percentage of their compliance requirement in the form of EUAs within the compliance period.

### **5. Linking to schemes outside the EU**

EURELECTRIC is supportive of linking the EU ETS to similar emissions trading schemes outside the EU. To avoid market disruption any linkage must be well-signalled. However, there are fundamental conditions that should be fulfilled before any linkage, e.g. broadly similar concept (i.e. cap and trade), design and price setting mechanisms and monitoring, reporting and verification procedures that result in a similar level of accuracy in emissions recording. Simplification of the design and harmonisation of the rules underpinning EU ETS would also facilitate linkage.

### **6. Benchmarking**

On benchmarking, we believe that there should be simple and harmonised EU rules on how to allocate allowances. Key principles to allocate allowances through benchmarking are: the promotion of investment in technologies that reduce greenhouse gas emissions; to take into account security of supply issues; and promoting fair treatment of all operators.

### **7. New entrants and closure of installations**

There should be an EU harmonised approach on new entrants and closure of installations, including clear definitions of both. We underline that it is only within the framework of a long-term strategy that it will be possible to deal with, and ensure consistency between, installation closures and new entrants.

### **8. Carbon capture and storage**

Carbon Capture and Storage (CCS) projects should be explicitly recognised within the EU ETS and CO<sub>2</sub> captured at the plant and verified as stored in an approved geological formation should be recognised as non-emitted. However, the Directive should not be used as an investment instrument to bring any specific technology to the market such as CCS or any other low or zero-carbon technologies. A well-designed and transparent market that gives long-term visibility on allowance prices will determine the level of support for CCS.

### **9. Release of data**

Given the potential impact on the market, specific provisions should be made in the Directive regarding the time and manner of release of verified data by Member States and the Commission.

### **10. Final NAPs**

Provisions should be made for National Allocation Plans, as finally approved by the Commission, to be published. Each published final plan should include a list of allocations to all individual installations. A summarised English language version of each final plan should also be published and/or available online.

\* \* \*



## **1. More Consistent Application of Current Scope & Expansion of the Scope**

### **1.1 Expansion of EU ETS to other sectors and gases & Unilateral inclusion of additional activities and gases**

- EURELECTRIC supports the inclusion of other gases and sectors in the emissions trading scheme based on the following principles:
  1. No significant distortion of the market price (to avoid economic shock for operators and traders).
  2. Cost-effectiveness. Included sectors must have realistic alternatives to reduce emissions. This is a fundamental requirement of trading systems. If absent then other policy instruments are required.
  3. Accuracy of measurement. Emissions must be capable of being measured with the same level of accuracy as applies to those already in the trading system and be subject to the same level of monitoring, reporting and verification.
  4. Internal organisational capacity to actively engage in the market.
  5. Other policy instruments would be less effective.
  6. Avoid the use of multiple instruments to achieve the same policy objectives (e.g. taxes and emissions trading).
- For structural reasons, including national / EU taxation regimes, policies and measures other than trading should be applied in certain sectors such as road transport.
- Confidence in the long-term stability of the EU ETS is critical to delivering investment by existing participants. Factors which need to be considered in expanding the scope include impacts on the efficiency and transparency of the scheme, the ability of newly introduced installations to deliver reductions, the implications for existing and new participants and the robustness of emission data needed to establish reference emission profiles and demonstrate compliance.
- Unilateral inclusion by Member States of sectors and gases should be addressed in the same manner. Inclusion should not result in a significant distortion of the European market (i.e. allowance prices).
- Under all circumstances, the expansion to new sectors and gases needs to be well-signalled to the market (i.e. with several years' notice given) with clear timescales for inclusion, comprising guidelines on the basis for allocation and information on baselines and caps.

- In any case, sectors not covered by the EU ETS should be addressed with the same level of ambition, in terms of emissions reductions, as those in the trading scheme.
- The manner of the proposed inclusion of other sectors and gases within the ETS, such as aviation, should not result in different legal frameworks for compliance and in different monitoring, reporting and verification procedures. The legal implications for compliance purposes in different Member States of such arrangements should be considered in detail.

## **1.2 Streamlining the application of the current scope & Improving cost-effectiveness as regards small installations**

- EURELECTRIC supports a common definition of combustion installation or a common threshold for EU ETS inclusion, so as to limit competition distortions amongst Member States and increase allocation predictability. It is essential that similar combustion installations are treated in the same way in each Member State.
- The definition of combustion installation should be further clarified. For consistency and simplification purposes, we propose the definition of “*combustion plant*” as in the Directive on Large Combustion Plants (88/609/EEC as amended by 2001/80/EC): “*Installation: any technical apparatus with a rated thermal input exceeding 20 MW (except hazardous or municipal waste installations) in which fuels are oxidized.*”

In principle, and mainly for competitive reasons, all installations, small or large, within the same sector should be included in the emissions trading scheme to avoid market distortions and perverse incentives. In line with this, the most appropriate option would be to keep small installations in the EU ETS, but subject to simplified monitoring, reporting and verification requirements. However, if Member States decide to opt-out small installations, the threshold for opting-out should be harmonised at EU level, ideally based on emission volumes (although this could lead to some installations’ positions changing on a year to year basis). However, those small installations which would be opted-out should be subject to equivalent emission reduction measures as those installations inside the EU ETS.

## **1.3 Carbon dioxide capture and geological storage activities**

- Carbon Capture and Storage (CCS) projects should be explicitly recognised within the EU ETS Directive.
- CCS installations should receive allowances on the same conditions as similar non CCS installations, and CO<sub>2</sub> captured at the plant and verified as stored in an approved geological formation should be recognised as non-emitted.

- It must be ensured that under Phase III it is possible to separate those projects / installations that were opted in as a whole under Phase II. This is due to the current understanding that most CCS projects will in the future involve several different actors along the chain. When different actors are involved, it is crucial that not all responsibilities and liabilities rest with the capture plant, but they are allocated at the proper place in the chain. Clarity should also be provided on this issue as early as possible.
- The EU ETS should not be used as an investment instrument to bring any specific technology to the market such as CCS or any other low or zero-carbon technologies. The long term CO<sub>2</sub> price signal should stimulate, or not, investments in CCS, renewable, nuclear, CCGTs, etc.
- A well-designed and transparent market that gives long-term visibility on allowance prices will determine the level of support for CCS.
- A number of issues will need to be considered in detail within the review of the Directive, in particular definitions of installations and which activities across the carbon capture to storage chain will require permits under the requirements of the Directive. In addition monitoring, reporting and verification obligations will require further clarification.
- To what extent CCS will be treated in the EU ETS largely depends on the general approach to allocation post 2012.
- Support for research, development and demonstration at an industrial scale on CCS plants is essential to assess the potential of this technology.

#### **1.4 Emission reduction projects within the Community**

- In principle, it is more advantageous to invest in Europe rather than outside Europe in projects that result in emissions reductions for equivalent cost. Domestic projects can contribute to meet future ambitious emissions reduction targets by reducing / offsetting emissions in the non trading sectors, e.g. transport, renewables, agriculture and waste.
- Current information on the use of domestic projects is limited. Consequently, the efficiency of using such a system to regulate emissions should be carefully assessed (e.g. through pilot schemes). It should be ensured that projects are additional to current and planned Member States' domestic policies to meet emission reduction goals, including the need for national inventories to record these projects consistently and to avoid double counting of emissions reductions between offsets and EU allowances. It would be also essential to provide a consistent monitoring, reporting and verification system.

## 2. Robust Compliance & Enforcement

### 2.1 Monitoring and Reporting

- EURELECTRIC considers that the revised Monitoring and Reporting Guidelines (MRG) provide an improved basis for monitoring and reporting emissions in the framework of the EU ETS. We would not support the development of a Regulation on Monitoring and Reporting because it would remove flexibility in dealing with complex issues, in particular small installations. We believe, therefore, that the existing approach based on MRG is adequate. However, there is still room for improvement, in particular on the following areas: 1) interpretation of cost-effectiveness; 2) definition of site boundaries; 3) consistency in the approach to small installations; 4) implementation of uncertainty assessments; and 5) harmonised approach towards the use of non-accredited laboratories. Furthermore, the development and implementation of any revision needs to be well-signalled and should be linked to the commencement of subsequent phases, not during a phase.
- The Commission and Member States should seek a harmonised approach by competent authorities towards monitoring and reporting of emissions by ensuring a consistent implementation of the MRG across Member States. We suggest that the Climate Change Committee is the appropriate body to co-ordinate this issue.
- It is critical to agree on a common definition of installation. As a result of the 1<sup>st</sup> ECCP meeting, we observe that there is scope for further improvement and that this should be done in full consultation with relevant stakeholders.
- From a strategic perspective, EURELECTRIC is concerned that if overly stringent requirements for accuracy are set, the Guidelines have the potential to *de facto* exclude any future inclusion of other gases or sectors (as foreseen in the Directive) given the substantially greater uncertainties known to be associated with emissions of non-CO<sub>2</sub> greenhouse gases. The levels of accuracy being sought are not proportionate in terms of the overall level of accuracy applicable to Member States' national inventories.
- Whilst we consider that monitoring and reporting of greenhouse gas emissions is essential to the success of the scheme, the Guidelines contain demands of accuracy and uncertainty analysis which may lead to unjustifiable high costs. As set out in the revised MRG (cf. under Definitions, Section 2(4)(a)), monitoring and reporting costs per tonne of CO<sub>2</sub> should not exceed 1% of the average value of an EU Allowance.

## 2.2 Compliance

- There is a need to distinguish technical non-compliance issues, for example late submission of verified emissions reports or errors in such reports, from the obligations to surrender allowances under the Directive. Such technical non-compliances should be addressed within the domestic regulatory regime of each Member State.
- Where incorrect data in the registry has been identified as a consequence of an error in the verified report, provisions should be made for registries to reflect the necessary adjustments.
- Given the potential impact on the market, specific provisions should be made in the Directive regarding the time and manner of release of verified data by Member States and the Commission.
- Operators should only be required to release verified emission data once annually.
- Provisions should be made for National Allocation Plans, as finally approved by the Commission, to be published. Each published final plan must include a list of allocation to all individual installations. A summarised English language version of each final plan should also be published and/or available online.
- While confirming that, in principle, there should be no interference by the Commission or national authorities in the market, EURELECTRIC believes that, as in Phase I, the Directive should continue to recognise that *force majeure* situations may still arise.
- The penalty level in Phase 2, i.e. 100 €/tCO<sub>2</sub>, is more than adequate, given the price signals that are being produced by the market. Therefore, there should be no increase in the penalty level for subsequent phases.

## 2.3 Verification

- It is important that there is a basis for harmonised verification procedures and standards across Member States, which would contribute to a level playing field. There should be a common approach to verification, mutual recognition of verifiers between Member States and consistency in the interpretation of what constitutes one tonne of CO<sub>2</sub> across Member States. Therefore, EURELECTRIC supports the development of a Regulation on Verification and on the accreditation of verifiers.

### 3. Further Harmonisation & Increased Predictability

#### 3.1 Cap-setting: EU-wide or national caps

- EURELECTRIC favours an EU-wide top-down approach towards setting the overall EU ETS cap and apportioning this to Member States or sectors. In particular, EURELECTRIC believes it is fundamental that the Directive defines the criteria to determine the EU ETS cap in a transparent manner, i.e. the maximum total number of allowances in the market. Such an approach should minimise distortions between Member States and create a level playing field across European companies. Some criteria to be taken into account when calculating the cap are: predictability (i.e. a long-term cap is needed with visibility of emissions reductions for 10-15 years); the degree of development of Member States; and security of supply.
- The key issues are: 1) a transparent methodology to derive the EU ETS cap from the overall EU greenhouse gas emission reduction targets and distribute it between Member States or trading sectors; and 2) a transparent trajectory towards the derived cap.
- There should be equitable burden sharing in setting the caps for the trading and the non-trading sectors. Furthermore, the electricity industry should not be unduly disadvantaged *vis-à-vis* other sectors, particularly in comparison with sectors that have a capacity to internalise costs similar to the electricity sector. All economic sectors must engage in reducing greenhouse gas emissions.

#### 3.2 Increased predictability

- It is important to recognise the distinction between a compliance period and a timeframe over which reduction targets and ETS rules may change. It is the latter elements which most affects predictability.
- The five-yearly repetitive process of issuing NAPs, between which both the quantum and methodology for allocation to individual installations may be substantially amended, represents an excessive risk for capital-intensive investments. The end result could be delayed or even cancelled investments. This creates a real risk for the security of electricity supply in the EU.
- For investment purposes, it is of the highest importance to understand as early as possible the rules governing the EU ETS from 2013 onwards.
- Predictability over successive periods is critical for investment planning and decision-making. Only in this way will the industry receive the right signals to invest in less carbon-intensive generation technologies.

- For investment, it is important to have a clear price signal for the next 10-15 years. There are no long price signals on coal and gas markets, but fundamental models can be used to project price trends. Therefore, it would be sufficient to have in place a solid framework with clear rules, that would enable companies to model allowance market forward price trends.
- The key requirement of operators in the EU ETS is to have predictability around the boundary conditions which set the long-term price of a carbon allowance, specifically: 1) the Regulatory framework; and 2) the Political framework. Acknowledging that carbon prices (as with any other commodity) will vary, operators nonetheless must have some basis on which to develop models to predict long-term carbon price tendencies.
- Certainty concerning the Regulatory Framework requires: 1) Well-signalled changes in the total quantum to be allocated and; 2) A consistent methodology, or well-signalled changes in the methodology, of allocation. Well-signalled means that the end point can be seen 10-15 years in advance. In the context of the Energy Package, this means knowing now how the -30% / -20% to 2020 targets translate to the ETS sectors and also what additional targets (and their ETS component) are considered for 2030 and 2040 in the context of the 60%-80% reduction objective by 2050.
- Certainty concerning the Political Framework requires: 1) Long-term predictability on the use of JI/CDM; 2) Well-signalled intentions to provide support to other fuels / technologies / energy sources that may offset relative costs (stranded asset issue); and 3) Well-signalled intentions concerning the transition to auctioning.
- These factors ultimately drive the level of scarcity of allowances for the trading sector – which determines the price of these allowances. This scarcity has three components: 1) The trajectory of the cap on ETS emissions (allowances released to the market) to 2020 and beyond - this must incorporate also the inclusion of new sectors; 2) the level of access to JI and CDM; and 3) linkages to other markets.
- Given the above, the key issues for EURELECTRIC are:
  1. The trajectory of the EU ETS cap to 2050. In its most straightforward form this could be an annual reduction rate, which could be linked to international climate change agreements.
  2. Guaranteed level of access to JI and CDM (acknowledging that CDM will gradually disappear as developing countries take binding commitments). Ideally this should be full unrestricted access to credits from all approved projects. Any restriction must be inversely proportional to the severity of the EU ETS cap.



3. Known conditions for linkage of the ETS to other emissions markets. This includes similar design concepts in both markets and that the allowance units are equivalent i.e. the same Monitoring, Reporting and Verification standards.
4. Common auctioning requirements across the EU and a known transition path to auctioning. This may include some sectors moving at a different pace than others and achieving auctioning earlier. The simplest way to provide for this could be an annual increase in the amount of allocation auctioned.
5. Subjecting all the above to “Regulatory Impact Assessment” for competitiveness impacts on a sector-by-sector basis.

If the level of auctioning increases then the actual methodology for distributing allowances and the manner in which new entrants and plant closures are treated are of a secondary order of importance.

### **3.3 Allocation methodologies & Options for auctioning and benchmarking**

- There are different views within the electricity industry on the method of allocation to use after 2012. Regardless of the method chosen, there will be distributional effects.
- The EU ETS rules should be harmonised across the EU to foster a truly European market. However, it might be difficult to achieve this in one step. Therefore, at least, there should be harmonised allocation methods, e.g. the same share of free allocation in all Member States.
- Future allocation methods need to be part of a stable long-term EU ETS framework which promotes investor confidence and underpins a transition to low carbon power generation.
- Should increased levels of auctioning be applied in future trading periods, the electricity industry would favour a well-signalled transition.
- Auctioning should not be limited to the electricity sector, but include all the trading sectors which internalise the costs of allowances in their product price. Other sectors need to provide a robust justification on competitive grounds why they should not be subject to the same level of auctioning as the electricity sector.
- It is of key importance that the level of auctioning is harmonised at EU level. Otherwise, there would be a strong imbalance between the different industries’ competitiveness across the EU.
- Issues on auctioning that need to be clarified comprise: 1) redistribution of the auctioning revenues in a manner that does not result in market distortions; 2) linkages with other policies, such as removal of CO<sub>2</sub> taxes; and 3) the organisational aspects of EU-wide auctioning (e.g. frequency, administration, etc).



All these aspects favour a fully assessed approach before an expansion of auctioning, which takes the learning aspects of these issues into account.

- To avoid distortion of the EU ETS market, EURELECTRIC supports a proposal for a Regulation on auctioning as identified in the proposed Directive on the inclusion of aviation in the EU ETS.
- On benchmarking, we believe that there should be simple and common EU rules on how to allocate allowances. Key principles to allocate allowances through benchmarking are: the promotion of investment in technologies that reduce greenhouse gas emissions; to take into account security of supply issues; and promoting fair treatment of all operators.
- Should benchmarking be applied in future trading periods, the electricity industry would favour a well-signalled transition.
- It is of key importance that sectoral benchmarks are harmonised at EU level. Otherwise, there would be a strong imbalance between the different industries' competitiveness across the EU.

### **3.4 New entrants and closures of installations**

- There should be an EU harmonised approach to, and definition of, new entrants and plant closures so that distortions of the market are minimised or eliminated.
- The definition for new entrant should be refined. The Directive links the definition of new entrant to the notification of the Plan to the Commission. But, because the plans are not notified at the same time, the status of new entrant varies across Member States. According to the definition of "new entrant" (cf. Art. 3 (h)) "*a change in the nature or functioning or an extension of the installation*" is appropriate to define a "new entrant". Therefore, it would be useful if the European Commission and the Climate Change Committee clarified what kind of "changes" would be valid.
- Due to longer allocation periods foreseen, it is necessary to clearly define the stage at which a new entrant would develop into an incumbent.
- In principle, in terms of free allocation, new entrants should not be disadvantaged relatively to existing plants so that the EU ETS does not act as an obstacle to investment.
- As an economic incentive for technology shift, allowances from a closed installation should remain valid until the end of the trading period, e.g. following closure in 2010, an installation would retain its allocated allowances until 2012. Such an approach would avoid the distortions that have arisen as a result of the differing interpretations of "plant closure" which have been adopted by Member States.

- We underline that it is only within the framework of a long-term strategy that it will be possible to deal with, and ensure consistency between, installation closures and new entrants.

*Note: comments in this section are only relevant where there is free allocation.*

### **3.5 Impacts on electricity prices**

- Since 2005, the marginal cost of generating electricity has to take into account the price of CO<sub>2</sub> allowances. The valuation of assets in the long and short term, including dispatch decisions and investments in new capacity, is impacted by the value of CO<sub>2</sub>.
- However, emissions trading is but one among many factors that influence electricity markets and prices. Changes in fuel prices, in the dynamic supply / demand balance, in weather and in other factors including capital cost and regulation, combined with the completion of the liberalised electricity market, also have significant impacts on electricity prices.
- By making carbon-intensive generation more expensive, emissions trading affects dispatch orders and thus encourages an increase in low-carbon intensive generation. This is the basic intent of the emissions trading scheme. In doing so this also reduces the subsidies required to make renewable generation competitive in the electricity market.
- Both the Long Run Marginal Cost (i.e. LRMC) and the Short Run Marginal Cost (i.e. SRMC) must be considered in the context of the need to recover the capital cost of investments in the market. Clearly, the EU ETS is meant to drive future investments and the consequence is that prices must rise. This is a consequence both of the immediate impact on the marginal cost of operating plant, but also because of the need to recover the new investment costs associated with driving down the carbon intensity of the electricity sector.
- Authorities should therefore refrain from intervening in the market. Efficient electricity and emissions markets will send the right short and long term signals for generators and customers. There should be no interventions that would alter the key principles of the emissions trading scheme or the liberalisation of the electricity market, both of which have been agreed in EU Directives. Timetables have been set, emissions trading started in 2005 and full EU electricity market opened in July 2007. Solutions that ignore market principles, such as price caps, additional taxation on carbon-free generation sources or removing the cost of carbon from electricity markets, will inevitably introduce long-term distortions, and may even remove the incentive for companies to invest in low carbon technologies.

## 4. Linking Up Globally to Tackle Climate Change

### 4.1 Key elements for linking the EU ETS with third countries' ETS

- In general, EURELECTRIC is supportive of linking the EU ETS to similar emissions trading schemes outside the EU. To avoid market disruption any linkage must be well-signalled.
- However, there are fundamental conditions that should be fulfilled before any linkage. In our opinion, the most important include the need for:
  1. The markets to be linked to have sufficient maturity to avoid instability.
  2. Broadly similar concept, design and price setting mechanisms (i.e. cap and trade, equivalent penalty costs for non-compliance, etc).
  3. Monitoring, reporting and verification procedures that result in a similar level of accuracy in emissions recording.
- Simplification of the design and harmonisation of the rules underpinning EU ETS would also facilitate linkage.

### 4.2 Linking the EU ETS to the flexible mechanisms of the Kyoto Protocol

- As a prerequisite, the existing JI / CDM mechanisms must be integrated into the post-2012 international framework as they are fundamental to achieving the EU's emission reduction goals and engaging developing countries in a global emissions reduction process.
- However, if the JI / CDM issue is not timely solved at international level, the EU needs to develop a provision to enable JI / CDM investments to be recognised in the next phase of the EU ETS.
- JI and CDM projects will play an important role in meeting the 20-30% greenhouse gas emissions reduction targets. The EU needs to start an evaluation process on the amount of offset credits that it may need for the period post-2012.
- Early certainty on such integration is required to ensure market stability and encourage continued investment in these project mechanisms.

### 4.3 Quantitative limits on JI and CDM and Qualitative restrictions on the use of offsets

- Capital intensive sectors require early certainty in relation to the future long-term use of JI and CDM in order to plan investments.
- In making large-scale investments to facilitate compliance with emission obligations, companies will evaluate new investment against long-term purchase of JI/CDM credits. In the circumstances of a known long-term carbon price signal, such decisions will tend to

favour investment in productive assets and place a natural economic limit on the use of JI and CDM.

- Consequently, to facilitate cost-effective investment decisions, companies should have full and flexible access to the credits generated by the Kyoto mechanisms JI and CDM. The setting of quantitative and qualitative restrictive “caps” on the use of such credits will undermine the overall environmental and economic effectiveness of the emissions trading scheme and will act to reduce the number of possible projects proposed by electricity companies. It also acts against the cost-efficiency principle set down in Article 3 of the United Nations Framework Convention on Climate Change (UNFCCC).
- In addition, imposing such restrictions for the period post-2012 in the absence of guidance from the UN on the future requirements for supplementarity, risks pre-empting negotiations on a post-2012 UN framework to replace the Kyoto Protocol.
- Furthermore, we consider that Member States in introducing and implementing the Linking Directive in their laws should do so in a harmonised fashion. There should be no restrictions on the types of projects considered eligible from one country to the other, beyond those temporarily established by the Directive itself, or on the use of CERs and ERUs issued under the Kyoto Protocol. This would ensure that further market distortions are avoided and allow the review of the Directive to incorporate all the possibilities and modalities contemplated for the project-based mechanisms in the context of the Kyoto Protocol and the UNFCCC.
- We believe that it is crucial that the barriers presently associated with electricity-based CDM projects be surmounted. To increase the uptake of these types of project, methodologies closer to business reality should be defined and concepts such as additionality should be clarified with the aim of assisting the CDM Executive Board in operationalising the concept.
- In particular, the bias against large scale projects must be addressed. This runs counter to the need of developing countries (and, in the case of JI, economies in transition) to put in place energy systems to meet their legitimate desire for sustainable development and the global environmental objective of maximising emission reductions. In addition, all projects permitted in the Kyoto Protocol should be eligible for compliance purposes within the EU ETS.
- Other project categories, such as LULUCF and CCS should also be part of the CDM post-2012. The inclusion of LULUCF may help address the geographical imbalance with Africa, where many projects within this category could be undertaken. The inclusion of CCS within the CDM should go ahead once all technical and scientific issues have been addressed. In this way, CCS would become available to developing countries, which will continue, or increase the use of fossil fuels in the future.
- If a restriction is to be imposed on JI and CDM then it should be harmonised at EU level and set in a practical and transparent manner, consistent with the level of ambition contained within the overall EU ETS, and the particular sector target, and which demonstrates the level of supplemental action to be undertaken by operators in the scheme. In this context, EURELECTRIC proposes that any limit on the use of JI and CDM be set as a EU-wide requirement on operators to surrender a minimum percentage

of their compliance requirement in the form of EUAs within the compliance period. Any restriction must be inversely proportional to the severity of the target.

- According to Decision 13 / CMP.1 (2005), banking of both CERs and ERUs has a quantitative limit of 2.5% of the overall assigned amount. To give companies the necessary certainty to develop their carbon procurement strategy, the EU ETS review should indicate the amount of CERs and ERUs that installations included in the trading sectors may carry over to the second phase of the Kyoto Protocol.
- To ensure consistency, EURELECTRIC proposes that a consolidated text be adopted incorporating the Emissions Trading and Linking Directives and, when adopted, the Directive on the inclusion of aviation in the EU ETS.

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