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## **E.ON Position**

# **on review of the auction time profile for the EU Emissions Trading System**

**Düsseldorf, 15. October 2012**

### Position

- **The EU ETS has to be developed as the leading instrument to achieve the EU 2050 climate targets. Other policy instruments, such as renewable energy and energy efficiency policies should be aligned with and supported through the ETS.**
- **A reduction in the amount of EUAs to be auctioned in the 3<sup>rd</sup> trading period has to be part of a structural, long term review of the ETS which should aim at tightening the cap to deliver both mid-term targets for 2030 and long term targets for 2050, while increasing the linear reduction factor as soon as possible.**
- **Back-loading is only sensible as a first step towards long-term reform. Any return of back-loaded volumes should therefore be planned to occur as late as possible in order to allow for sufficient time to thoroughly discuss the necessary revision of the ETS directive.**



## General Remarks

E.ON supports the EU Emissions Trading System (ETS) as the leading instrument for the transformation of the EU energy system for a future low-carbon economy: the ETS should provide long term investment signals for innovative low carbon technologies and it should trigger the use of existing, already competitive, carbon abating technologies, such as fuel switching or onshore wind. Although offshore wind is still more expensive than onshore, we expect to see cost reductions of 40 percent at our own offshore facilities in the years ahead. Therefore we welcome the discussion started by the EU Commission on the review of the auction time profile for the EU ETS as a necessary first step to revitalize the ETS. However, any discussion on the auction time profile has to be part of a wider process of restoring the EU ETS as *the* leading instrument to reach European climate targets as set out in the EU Carbon Road Map 2050.

The EU will achieve its climate targets up to 2020, but is in danger of falling seriously behind after that because the investments needed to get to the next level are not being made today. To provide the necessary regulatory certainty to incentivize those investments, we suggest reaffirming the EU's commitment to the 2°C target by formally adopting the EU 2050 roadmap. We further suggest deducing from this an interim reduction target for 2030. And we suggest revising the ETS directive accordingly, in particular by adjusting the linear reduction factor.

The EU abatement goals for 2020 and beyond are defined by a reduction factor of 1.74% p.a. The revised 2030 goals – deduced from an 80-95% reduction target for 2050 as foreseen in the current EU 2050 roadmap – would require a minimum reduction factor of 2.6% p.a. between 2020 and 2030. The high cost for such a steep increase in the trajectory should and could be avoided by adjusting the trajectory earlier. For example, if the trajectory were to be aligned with the EU long term targets in 2013 this could be met with relatively modest efforts and a reduction factor of only 2.2%.

Back-loading of EUAs should be perceived as a way to achieve such an early adjustment of the EU ETS. Without short-term intervention through back-loading, the process of EU ETS reform is unlikely to be implemented for a number of years, and we will experience a prolonged period of low EUA prices. This creates the likelihood of a "lost decade" for decarbonisation of the European economy, during which the EU ETS would provide no signal for investment in low-carbon technologies.

As long as it is expected to be permanent, a swift and decisive recalibration of the EU ETS will increase certainty in the market by reducing the oversupply of allowances. It will also be regarded as a positive sign of policy-makers' commitment to the ETS. In a politically-grounded market such as the EU ETS, this is crucially important since it allows market participants to take a long-term view. An increase in the confidence of market participants in the long term robustness of the EU ETS would significantly increase the cost-effectiveness of the system by facilitating long-term decision making.

The precise volume at which back-loading of EUAs has an effective impact on the market depends on a number of uncertain factors. These include economic growth, the buying and selling behaviour of market participants and the level of confidence in the market that the back-loaded volume will eventually be cancelled. Therefore, if the volume of back-loading implemented is derived from long term carbon reduction targets, rather than e.g. a carbon price considered "desirable", the measure will be taken as a signal of political commitment to the EU ETS, and as a result will have positive consequences for the robustness of the system.



## **Coherence of EU climate policies**

The EU's 20-20-20 goals lack coherence: the abatement targets of the EU ETS directive do not currently reflect the achievements of EU renewable energy sources and energy efficiency policies. In future, the growth of renewable energy sources and the efficient use of energy should be promoted primarily by the carbon price set within the EU ETS, and by measures financed through EUA auction revenues.

Thus the current back-loading proposal should be part of a broader legislative process. Unless the current proposal is not – and is not explicitly designed to be – a first step only, and is followed by a revision of the ETS Directive and a harmonisation of RES support schemes within EU member states, it will remain a fragment.

## **Specific Remarks**

### ***Proposed amendment of EU Directive should be clarified***

The proposed wording of the amendment of Directive 2003/87/EC does not serve the purpose of legal certainty. The term “appropriate” adaption and “orderly functioning market” have to be further defined and clarified to provide a clear, transparent and coherent justification for any potential future market intervention.

### ***Proposed amendment of EU Regulation to determine the auction volumes should be strengthened***

The proposed amendment of Regulation No 1031/2010 to determine the volumes of greenhouse gases to be auctioned does not support long-term EU climate protection goals. The proposal to reduce the auction volumes in 2013 – 2015 is in principal the correct approach. But any calculation of price impacts of a back loading of 600 – 1.200 million EUAs is highly uncertain due to the anticipated behaviour of market participants (i.e. power sector buying and industrial sector selling).

Without accounting for the impact of the behaviour of market participants on the supply / demand balance, most analysts predict a peak cumulative oversupply of around 2Gt (in line with the Commission's calculations) although they predict that this will diminish at different rates. The actual length after accounting for power sector hedging and industry banking however may be significantly smaller.

Furthermore the system is likely to be highly sensitive to the back-loading volume chosen. Altering this volume by a couple of hundred million EUAs could make the difference between an ineffective measure and an unacceptable high EUA price. The range of back-loading volumes that would produce an ‘acceptable’ rise in the EUA price may be relatively small and difficult to pinpoint. Frequent market interventions to mitigate the effect of preceding interventions would destroy the trust of market participants in the ‘orderly functioning’ of the market. This would be the worst possible consequence of intervention.



Given the uncertain market response to any suggested back-loaded volume, the determination of the volume should be governed neither by a perceived length in the system nor by a certain EUA price level. It should be governed by the political and environmental aim of the ETS as such: the 2°C target.

The proposed back-loading is certainly a market intervention and as such can lead to diminished trust in the overall trading system. Hence it is essential, that the EU Commission will make their decision background as transparent as possible and furthermore clarifies, that it is a one-off measure, i.e. market participants should be sure, that this type of intervention will not occur frequently. Furthermore, the EU Commission should make clear, that national interventions in the EU ETS by the member states will certainly not help to keep the EU ETS as a robust European solution.

***Proposed amendment of EU Regulation for legal required re-entry of the auction volumes should be changed.***

Existing ETS legislation appears to require a return of back-loaded EUAs since the ETS Directive does not explicitly provide for any permanent cancellation procedure. Therefore a provision to cancel actually back-loaded EUAs in the current proposal has to bear in mind potential structural changes in the coming ETS directive review. To reduce market uncertainties and to accommodate future discussions on the ETS review, the proposed year for a return of back-loaded EUAs to the market should be 2020. Furthermore, the amount of EUAs for a very late re-entry has to be considered in the calculation of auctioned EUA in 2020ff.