EDP response to the European Commission's public consultation on the review of the auction time profile for the EU Emissions Trading System

The European Commission put forward a public consultation on the amendment of Regulation (EU) No 1031/2010 to determine the volumes of greenhouse gas emissions allowances to be auctioned in 2013-2020. This Regulation follows up on Directive 2003/87/EC which determines the timing, administration and other aspects of auctions within the scope of the European carbon market.

EDP congratulates the European Commission (EC) for involving all stakeholders in this public discussion. These initiatives are crucial to open and transparent policy-making.

EDP's view on the short and long term reform to EU ETS

In regard to the issue at stake in this public consultation, EDP believes that the current imbalance between supply and demand in the EU Emissions Trading System (EU ETS) does not provide a sufficiently strong price signal for investment in decarbonization (both through clean technologies and energy efficiency) across the EU. This is mainly due to a structural design flaw of the EU ETS based on the fact that the market supply is fixed up-front (the "cap"). That is, there is no pre-defined mechanism to adjust supply to demand shocks, leading to excessively long periods until the market recovers balance. The backloading of allowances under proposal by the EC does not provide by itself the needed structural adjustment, as it merely reprofiles the total stock of allowances. However, it does act as a short term quick-fix in the current context of extreme imbalance. Coupled with this short term solution, EDP supports the definitive removal of allowances from the EU ETS as it is viewed as a more structural approach to solving the problem of excess supply.

Current weak carbon price signal from the EU ETS

As published in May 2012, annual surplus allowances have increased significantly from 2008 to 2011, reaching an accumulated value of 955 million surplus allowances in 2011 (in 2011 alone, surplus allowances grew by 450 million). As outlined in the EC Staff Working Document 234, an even higher addition of surplus allowances is expected for 2012 and 2013:

- Remaining new entrants reserves from phase 2 will come into the market (estimated 100 million allowances in 2012);
- EIB is selling phase 3 allowances to generate funds for the NER300 program (estimated 350 million allowances until the end of 2013);
- Supply of CER and ERU could increase until the end of 2012 because many are not eligible for the EU ETS from 2013 onwards.

On the demand side, slow economic recovery in the EU should not significantly increase the need for allowances.

These supply and demand dynamics thus lead to an expected increase in surplus allowances which will almost inevitably lead to a weakening of the carbon price signal given by the EU ETS. This discourages investment in decarbonization and leads to high uncertainty, and hence risk.

In practice, a carbon price that is not high enough to motivate emissions reductions (through fuel switching, investments in clean technologies, energy efficiency, innovation, etc.), acts simply as a burden to the European economy, penalizing competitiveness, without any environmental benefit.

The EU ETS has a structural design flaw – supply does not adjust to demand

One of the main principles of an efficient market is that supply can adjust to demand shocks. Since the EU ETS is built around an up-front definition of market supply (yearly number of allowances that will come into the market – the "cap"), it has no built-in mechanism to adjust to demand shocks such as the one Europe is currently facing given its economic situation. Therefore, the weak price signal in the market will persist during a long period discouraging investment.

Backloading allowances is a short term quick-fix that should be coupled with long term structural measures (definitive set-aside)

It is EDP's view that backloading allowances is a quick-fix that would provide a carbon price increase in the short term. However, structural measures that address the EU ETS' design flaws must be considered for the long term. Given the current demand shock, a definitive adjustment to EU ETS supply would be a structural solution. Therefore, backloading allowances as a short term measure coupled with a definitive set-aside would provide a credible and predictable long term price signal to stimulate decarbonization investments.

In regard to the volume of reduction of allowances in the 2013-2015 period, EDP strongly favors the large change scenario suggested by the EC in the Staff Working Document 234 (550 million in 2013, 400 million in 2014 and 250 million in 2015). EDP sees this as the minimum reduction that would credibly bring total surplus allowances below 1 billion in 2015 and sustain a credible carbon price in the short term which, at a minimum, should promote coal to gas switching in power generation.