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## **Vattenfall’s response to the Commission’s proposal to change the timing of auctioning emission allowances (EUAs) in Phase III of the EU Emissions Trading Scheme**

On 25 July 2012, the Commission published a legislative proposal for changing the auctioning time profile for the 3rd phase of the EU ETS which runs from 2013 to 2020. The aim of the measure, often referred to as an “auction set-aside” or “backloading of auction volumes”, is to address the existing (and still growing) surplus of allowances (EUAs) in the EU ETS and to “improve the functioning of the carbon market”. More concretely, the idea is to postpone a subset of the EUA volume which was originally intended to be auctioned in 2013-2015 and instead add it onto the volumes to be auctioned in 2018-2020.

As one of the largest energy suppliers and emitters of CO<sub>2</sub> emissions in Europe, Vattenfall has set before itself very ambitious targets of reducing its CO<sub>2</sub> emissions, both in the 2020 and 2050 perspective, in order to reduce our CO<sub>2</sub> emission footprint and to contribute to reaching the EU’s long-term climate objectives. However to make this possible, Vattenfall is dependent on a predictable and efficient long-term regulatory framework and a level playing field between operators which are active in the same market. Moreover, if the EU’s political objectives for the energy sector shall be met in a consistent and cost-efficient manner it is also necessary to make much more use of the internal energy market and better coordinate the policy framework in place to drive the overall transition.

### **Vattenfall’s key messages**

#### ***The EU ETS should become the key driver for delivering on the EU’s decarbonisation objective***

Vattenfall is convinced that the EU ETS is capable of delivering very deep cuts in CO<sub>2</sub> emissions and considers that it should be the principal instrument to promote low-carbon measures towards the EU’s long-term decarbonization objective. The EU ETS creates a uniform price on CO<sub>2</sub> emissions and ensures that the overall emissions are capped on a level which is consistent with the adopted targets. Moving towards a greater utilization of the EU ETS as one of the most cost-effective climate policies will become even more important when the required efforts increase and become more costly to society. In order to ensure the central role of the EU ETS policy, at least two main prerequisites have to be met: i) the society’s ambitions of reducing GHG emissions must be properly reflected in the EU-wide allowance cap and ii) the EU ETS must be protected against overlapping EU and national policies which erode the CO<sub>2</sub> price signal.

***A permanent set-aside is more predictable and meaningful than a simple backloading***

The Commission's proposal for backloading the allowances to be auctioned during Phase III will not alone have any sustained effect on the market. A price impact will only occur if the market participants expect that the backloaded allowances will not be supplied to the market at a later stage but rather cancelled by a subsequent decision. In contrast to backloading, which is only postponing the auctioned volumes within Phase III, a permanent set-aside would have immediate effect and create less uncertainty in the carbon market. If backloading is carried out in line with the Commission's proposal it must always be with a view to cancel the backloaded EUAs as soon as the political procedures allow. Otherwise the measure will not only have a doubtful effect but also leave the market in a greater state of uncertainty. Preparations for a permanent set-aside should also be linked to a structural reform of the EU ETS aimed at clarifying and improving its long-term role in the EU's future climate and energy policy.

***Regular interventions in the EU ETS cap-setting should be avoided***

A permanent mandate for policy makers to intervene in the market is not needed and would only undermine the credibility of the EU ETS as a market instrument. This does not however preclude that the auctioning volumes in Phase III become subject to a unique recalibration in order to account for previous irregularities and to allow the EU ETS policy to retain its role as the leading instrument for long-term decarbonization.

The current surplus in the market is a result of several cumulating causes of which some are of momentary nature. Economic cycles themselves can be properly handled by a cap-and-trade policy featuring long-term targets and will even out themselves in the longer term. Overlapping regulations which weaken the EU ETS could be handled more carefully when setting up the post-2020 policy framework and should not require repeated fixes in the cap.

***Discussions on a long-term structural reform for the EU ETS should start now***

Vattenfall stresses the importance of undertaking a structural reform of the EU ETS and a permanent set-aside instead of a simple backloading. The structural reform must bring forward in particular intermediate climate targets for 2030 (and 2040) in line with the EU's long-term decarbonisation objective and a corresponding adjustment of the annual cap reduction factor which determines the EUA cap. When the new allowance cap trajectory is set the remaining balance between demand and supply of allowances should be subject to a permanent set-aside. Before determining on the figures a substantiated impact assessment needs to be carried out by the Commission. To avoid incoherent climate and energy policy in a broader sense, the whole process leading up to a post-2020 framework - including renewables and energy efficiency - needs to be handled in a single and coordinated context.

Although the backloading proposal has been promoted as to "buy time" for preparing a long-term review of the EU ETS there is a risk that it could result in a more stretched-out period of uncertainty if the more substantiated discussion and progress on a structural reform of the EU ETS is delayed. A decision on backloading must not postpone the structural reform, including the adoption of a permanent set-aside, since that is a necessary continuation not only from a market perspective but also with respect to the signal it would send to the negotiations on a global climate regime towards 2015.