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**Consultation on structural options to strengthen the EU Emissions Trading System**

**RWE's response**

**– as of 20 February 2013 –**

1. General Appraisal

RWE appreciates and supports the EU's initiatives to reduce emissions from greenhouse gases (GHG) and welcomes the EU Commission's initiative to readjust the ETS. The **ETS is and should continue to be the key instrument for meeting Europe's GHG abatement targets.** Its market-based design safeguards economic efficiency in the emission reduction process. It sets the right incentives for investments in low-carbon technologies on the path to the envisaged low-carbon future. A well-designed ETS ensures undistorted competition and a level playing field for all market participants and for all low carbon technologies alike.

The **ETS is well established and fully functional**. Carbon prices adequately reflect actual scarcity. The current surplus of allowances and the corresponding low prices are a consequence of slowed economic activity and the accelerated growth of renewables capacities driven by generous subsidies and not caused by structural deficiencies. Low carbon prices indicate that there is little need for additional abatement measures to meet current GHG reduction targets, and help the depressed economy to recover. This demonstrates the reliability of the ETS as it reflects macro-economic conditions appropriately. Most importantly, it needs to be stressed that the environmental goals are still being met – regardless of a prevailing market price which many see as too low.

Recently the Commission has started a consultation process to discuss six different options to reform the ETS. Their aim is to strengthen the integrity of the system. While RWE fully supports any reasonable effort to keep the ETS as the long-term instrument of choice, we doubt that the implementation of discretionary measures before knowing about the longer-term framework is a sensible sequence. Instead, RWE emphasizes the **need for long-term carbon targets within the ETS**. The choice of appropriate measures can only follow as a second step. Under no circumstances should a single discretionary measure be implemented without being embedded in a political decision on long-term ETS-targets ideally within an economy-wide, long-term GHG framework.

All reform **efforts should aim at strengthening the integrity and reliability of the ETS**. It must remain the primary tool for climate protection in Europe. RWE is convinced that comprehensive and farsighted adjustments are necessary to secure the ETS' credibility and to maintain a stable planning environment.

In principal, policy makers should decide on targets of climate policy first, and be aware that the decision on respective amendments of the ETS is subsequent and subject to that decision. Furthermore, it would be very helpful to initiate a single, coherent and finite process of EU climate policy decisions including the ETS reform. This would maximize transparency and predictability for the EU economy.

To strengthen the ETS, two basic conditions are to be met:

1. The ETS' targets must be brought in line with the EU's policy goals as laid down in the Energy Roadmap 2050, for instance. From RWE's point of view, it is a key requirement to define a binding long-term carbon target. A reduction path to 2050 with intermediate targets for e.g. 2030 and 2040 will define the right horizon for low-carbon investment decisions and long-term planning.
2. The **ETS and all other European and member states' initiatives on GHG abatement, such as the promotion of renewables and energy efficiency, need to be harmonized**. Other instruments and other carbon initiatives both undermine the integrity of the ETS and cause a considerable rise in costs for climate protection. The ETS is the cost-efficient instrument for GHG abatement. RWE is convinced that carbon price signals generated by an undistorted ETS will incentivize significant investment in mature renewable energies without any further subsidies. Hence, all subsidy schemes for renewables may be phased out mid-term and be replaced by the ETS (although there may be a need for R&D support for emerging technologies). Meanwhile, **national targets for renewables must be aligned with the ETS cap-setting.**

Once long-term carbon targets for the overall economy are set, there needs to be a decision on effort sharing between the ETS sector and the other sectors to determine the longer-term ETS cap for 2030 and beyond. This process ought to prove a maximum extent of transparency and take into account the different abatement costs in the various sectors.

Subsequently, the contribution of offsets to achieve carbon targets needs to be defined. The Clean Development Mechanism (CDM) is a proven instrument for encouraging climate action in developing countries which have not yet a binding GHG reduction target. The CDM strengthens cost-efficient mitigation of GHG and has significantly supported climate protection outside Europe. Furthermore, it has raised awareness for climate protection particularly in developing countries and has triggered a significant financial and know how transfer. CDM bears the potential to create additional international market mechanisms, and to link international climate protection schemes. The more ambitious the European target, the larger the applicable CDM volume should be. However, decisions on off-sets should be taken in the context of a broader international framework.

Once the long-term ETS cap has been set, policy makers can focus on appropriate amendments to the ETS to outline the mitigation path, and the EU commission's six proposals should be evaluated comprehensively at this stage. **In RWE's opinion, long-term instruments fit best with a long-term target,** and any intervention should be focused on the post-2020 CP IV to avoid undermining investors' trust in the institutional framework. As a result of the banking mechanism, they will become effective and reflected in the carbon price already in CP III just after being decided.

RWE's first-choice instrument to achieve a 2030 carbon target and to define the trajectory to 2050 is a higher annual reduction factor from 2021 onwards. This ensures that the target is met in a cost efficient way with no intervention in current market processes.

The proposed set-aside of allowances may complement a higher reduction factor, provided that it is a one-off measure that has been aligned with the 2030 carbon target and that it is part of a larger package in order to retain investors' trust and confidence in the long-term predictability of the ETS. Nevertheless, **RWE considers a set-aside dispensable for strengthening the carbon price** signal, since we consider the annual reduction factor and a set-aside as critically linked and interdependent: the sum of both should always lead to the same overall reduction. Provided that long- term targets for CP IV are defined, a higher reduction factor will already become effective in CP III by the banking mechanism in any case.

<u>2. Specific comments on the Commission´s reform proposals</u>

The second chapter of this paper is dedicated to RWE's detailed assessment of the Commission's six proposals. Generally speaking, none of the Commission's proposals perfectly mirrors the required long-term perspective. What is needed is a consideration of both long-term targets and the cumulative volume of allowances to be allocated from now onwards.

**Discretionary and isolated implementation of any of the proposed measures without being embedded in a long-term target setting is an ill-advised approach which RWE cannot support.**

a) Increasing the EU reduction target to 30% in 2020

The ETS Directive allows the 2020 EU carbon target to be increased from 20% to 30% provided other major non-EU emitters commit themselves to comparable efforts. RWE fully supports this provision. However, an adjusted 2020 target must be in line with the ETS's long-term targets**; isolated tightening of the 2020 target alone will be insufficient** to achieve its intended aim and must therefore be rejected. At present, the provision in the Directive would not apply as we have no valid indication that other countries are willing to commit to comparable climate action. Any unilateral tightening of the EU's carbon target therefore risks disadvantaging Europe's industry's global competitiveness, risks accelerating damaging carbon leakage and is therefore not supported by RWE.

b) Retiring a number of allowances in phase 3

RWE does not support the retiring of allowances as a stand-alone, discretionary measure. Market intervention to adjust market prices leads to uncertainty and undermines investment decisions. **The best approach is to adjust the linear reduction factor from 2021 onwards** (see option c)), and this should include consideration of the cumulative volume of allowances to be allocated over CP III and CP IV. Only as a part of this, it might be considered appropriate to retire some allowances or to not allocate an equivalent volume at the start of CP IV. It must not be used on a stand-alone basis for tightening the ETS cap.

c) Early revision of the annual linear reduction factor

**RWE prefers to adjust the annual linear reduction factor provided this is in line with long-term carbon targets**. Furthermore the adjustment should become effective after 2020. As a consequence of the banking mechanism this will lead to price effects in the earlier years. The current EU Directive defines carbon targets and a corresponding reduction factor. Any stand-alone intervention during the current CP III would significantly harm the integrity and credibility of the ETS.

d) Extension of the scope of the EU ETS to other sectors

**RWE supports the proposal to extend the ETS to additional sectors**, if this is part of a larger reform and the volume of certificates will be extended accordingly. Any enlargement broadens the choice in abatement options, may stabilize carbon prices, and improves liquidity in carbon trading. Allowances must be freely transferrable between all sectors covered. The Commission needs to start working on this topic now given the complex issues that will need to be resolved, if it is to be able to extend the ETS to other sectors by 2020.

e) Limit access to international credits

International offsets have provided a valuable first step in the transition towards a global carbon market. To restrict them would be counterproductive. It would impede the transfer of low-carbon technology to developing countries and would increase carbon costs within the EU. Notwithstanding, restricting offsets shall not be considered on a stand-alone basis. The amount of offsets allowed within the ETS needs to be in line with long-term ETS targets.

f) Discretionary price management mechanisms

The ETS is an instrument which is based on volume delivery at lowest cost. Prices are a secondary consideration and an output of the market. In consequence, **RWE opposes any kind of discretionary intervention** in the price-setting of the market (e.g. carbon open market policy, floor price) which exposes the ETS to the discretion of policy makers. It would contradict the very purpose of the ETS as a quantity-based market mechanism and would create new and fundamental problems for the functioning of the carbon market. Discretionary intervention in market-based carbon pricing will not only negatively affect the trust in the ETS. It also bears the constant risk of costly misjudgment as has been demonstrated in the past.