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European Commission

Directorate General for Climate Action

Head of Unit B1,

16th October 2012

RE: DG Climate Action consultation on a future amendment of the Commission Regulation (EU) No 1031/2010 (Auctioning Regulation)

Dear Ms. Slingenberg,

Shell welcomes the opportunity to respond to this consultation from DG Climate Action. We have set out our views regarding the key issues for your consideration.

We support the proposals, made by the Commission, to backload allowances in the third phase of the EU Emissions Trading Scheme (ETS) as a short term action to improve the functioning of the EU ETS and restore its credibility. Furthermore, we call on the Commission to bring forward longer term structural measures to strengthen the scheme in order to deliver on its dual objective of meeting GHG reduction targets, while incentivizing investment in low carbon technologies.

1. Background

Shell is one of the largest independent oil and gas companies in terms of market capitalisation, operating cash flow and oil and gas production. Europe is a key region for Shell where we continue to explore for, produce, and refine oil and gas into the building block of many everyday consumer products. Shell is an energy intensive company exposed to international competition and we support the mechanism established in the ETS Directive to protect exposed industries. At the same time, we are a key actor in developing low emission technologies, such as renewable fuel technologies and carbon capture and storage (CCS).

2. General Approach

As recognised by the IEA[1], carbon pricing is the key element of a least cost response to reduce emissions, and an emissions trading scheme is an effective policy mechanism to introduce a carbon price. Shell supports the EU ETS as the flagship instrument, within the EU energy and climate policy framework, for delivering emission reductions at lowest cost to the economy, and providing the necessary price signal for the development of low-emissions technology.

3. Current challenge of the EU ETS

[1] (C. Hood 2011).Summing up the parts: Combining Policy Instruments for Least-Cost Climate Mitigation Strategies, IEA information paper

The market that has developed as a result of the ETS is unlike other commodity markets, in that it is an artificial construct with a fixed supply of allowances determined by the desired emissions cap. Supply cannot naturally adjust when major changes to the system take place, such as in the current economic circumstances.

Shell supports the two primary objectives of the EU ETS:

1) to meet the GHG emissions reduction target; and,

2) to impose a certain level of ambition on the covered sectors to catalyse the transition to a low-emission economy.

If those sectors undergo an unexpected macro-level change, so too should the ETS to ensure that this level of ambition is maintained. Otherwise, there is no incentive for any underlying technological improvement because demand reduction hits the system. A similar argument could also be made for the case of a macro change that significantly increases demand, where the economic penalty on the system would otherwise become disproportionately burdensome. Supply-side measures to enable such a baseline change, in exceptional circumstances, are now required in the EU ETS.

4. Supporting technology demonstration

The EU ETS is intended to play a key role to advance technologies that will enable emissions reductions[2] whilst maintaining economic growth. It will provide funds for the demonstration of carbon capture and storage (CCS), and innovative renewable energy technologies through the NER 300, provided for in Directive 2009/29/EC. This instrument was intended to become a key enabler to stimulate the construction and operation of up to 12 CCS demonstration plants, unanimously supported by the 2007 Spring Council.

5. Number of Allowances to be backloaded

A much lower than expected CO2 price has substantially reduced the value of the NER 300, undermining the EU's ambition to demonstrate the technologies needed to meet the decarbonisation objectives for 2030 and beyond, and strengthen the potential and competitiveness of European technology.

The number of allowances to be backloaded should be enough to restore the ambition level, or scarcity, originally intended. Shell therefore supports the backloading of at least one billion allowances[3] from the early years of Phase III (2013–20) as the only short-term option available.

6. International competitiveness

[2] as described in the staff working document, accompanying document to the proposal for a Directive of the European Parliament and of the Council amending Directive 2003/87/EC so as to improve and extend the EU greenhouse gas emission allowance trading system, Impact Assessment which states an objective of the EU ETS is"*Contributing to transforming Europe into a low greenhouse-gas-emitting economy and creating the right incentives for forward looking low carbon investment decisions by reinforcing a clear, undistorted and long-term carbon price signal*"

3 Justification: According to DG Climate (reference, among others, presentation on Sept 27 http://ec.europa.eu/clima/news/articles/news_2012092801_en.htm), at the end of 2011, the surplus of allowances within the system, was over 950 million allowances and is expected to increase this year and next. Furthermore, we recognize the views expressed (opinion) in the ENVI Committee on Energy Efficiency which called for the withholding of 1.4 billion allowances to restore the price mechanism to levels envisaged in the impact assessment, and to maintain incentives for investments in energy efficiency measures and low carbon energy technologies in installations covered by the ETS.

Shell recognises the need to protect European industry from potential carbon leakage. We support the current safeguards under the EU ETS whereby sectors deemed to be at significant risk of carbon leakage are given a transition period through the allocation of free allowances up to at least 2020, and incentives for energy efficiency encourage industry to become more cost-competitive.

Shell supports that sectors deemed to be at significant risk of carbon leakage continue to be protected and the system of free allocation of allowances is maintained.

7. Longer term structural measures

Policy makers should also consider longer term structural measures so that the ETS can deliver an effective framework for investment to 2030 compatible with the EU climate and energy aspirations. Shell would propose the following measures:

1) Establishing an auction reserve price for Phase IV of the EU ETS, thereby giving a long-term carbon price signal and providing companies some certainty over the return on investment in abatement technologies. This would remove the need for EU Member States to act unilaterally in this direction.

2) A swift agreement on a single GHG emission reduction target for 2030 which positions the ETS as the primary policy tool of long term change in the energy sector. The policy framework should ensure that overlapping policies are tested for alignment and to prevent conflicting objectives and higher costs. This would include the progressive removal of competing measures which seek to determine the energy mix rather than allowing the EU ETS to drive investment.

8. Conclusion

Without immediate reform, the EU ETS is in danger of losing its role as the principal tool for the EU to meet its energy and climate goals, and providing an example that inspires others to take action internationally. Alternative frameworks are likely to result in higher costs of abatement and or fragmented rules at Member State level, resulting in sub-optimal energy sector investment decisions for years to come and potentially increased costs. A strengthened EU ETS would continue to encourage other jurisdictions outside of Europe to introduce compatible schemes which gives industry the flexibility of market-based approach and a cost efficient mechanism to reduce emissions.

Backloading allowances, from Phase III of the EU ETS, is a necessary short term measure to restore credibility to the system and send a signal to investors that ETS will be the primary policy tool in energy and climate policy. Furthermore, longer term structural reforms are also required and Shell urges the Commission to bring forward such proposals.

I hope these comments are helpful. If you require any further information, please do not hesitate to contact me on +32 2 256 75 08 or by email: ivan.martin@shell.com.

Yours sincerely,

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