



**EFET Response to EC Consultation on
Review of the Auction Time Profile for the EU Emissions Trading System**

16th October 2012

Executive Summary

- The EU Emissions Trading System (ETS) should remain the leading instrument to achieve the EU 2050 climate targets. Other policy instruments, such as national carbon tax regimes, renewable energy subsidies and energy efficiency policies, should be aligned with and supported through the EU ETS.
- The market for EU emission allowances (EUAs) is oversupplied largely due to the exceptionally strong recession. Although the EU ETS Directive offers a means to react to price spikes with a temporary increase of supply, it does not offer the means to restore scarcity by a temporary decrease of EUA supplies. EFET believes that such a mechanism should not be introduced into the EU ETS directive as it would increase the risk of regulatory interventions, which would create regulatory uncertainty. A reduction in the amount of EUAs to be auctioned in the 3rd trading period should rather be part of a structural, long-term review of the EU ETS, which should aim at tightening the cap to deliver both mid-term emission targets for 2030 and long-term targets for 2050, while adapting the linear reduction factor as soon as possible.
- Back-loading is only sensible as a first step towards a long-term reform of EU climate policies. Any return of back-loaded volumes should therefore be planned to occur as late as possible in order to allow sufficient time for a thorough discussion of the necessary revision of the EU ETS Directive.

General Remarks

EFET¹ considers the EU ETS to be the leading instrument for the transformation of the EU energy system and for the development of a low-carbon economy. The EU ETS has proved to be a successful mechanism for the cost-effective reduction of carbon emissions. It has set an international precedent and has encouraged many countries to set up their own emissions trading schemes.

Its fundamental role is to provide long-term investment signals for low carbon technologies and to trigger the use of existing, already competitive, carbon-abating technologies, such as fuel switching or onshore wind. Currently, however, it falls short of delivering on these objectives². 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 revitalising the EU ETS. Any discussion on the auction time profile, however, should be part of a wider action to enable the EU ETS – *the* leading instrument to reach European climate targets as set out in the EU Energy Roadmap 2050.

The EU is on track to achieve its climate targets up to 2020, but it is in danger of falling seriously behind after 2020, because the investments that are needed to get to the next level are not being made today. This is mainly due to regulatory uncertainty about the continuation of the EU ETS as such, the extent of regulatory intervention in the EU ETS, and its coherence with other EU climate policies, such as energy efficiency and renewable energy support schemes. To provide the necessary regulatory certainty and ensure the needed investments we suggest reaffirming the commitment of the EU to the 2°C target by formally adopting the EU Energy Roadmap 2050. We further suggest deducing from this an interim greenhouse gases (GHG) emission target for 2030 and an appropriately timed adjustment of the reduction factor.

To avoid unnecessary costs and reduce market uncertainty this adjustment should be implemented as soon as possible. EFET believes that the EU ETS Directive could and should be revised by 2016 at the latest. Without a swift and decisive EU ETS reform we will experience a prolonged period of low EUA prices, during which the EU ETS will provide no signal for investment in low-carbon technologies and the decarbonisation of the European economy will suffer from a significant loss of momentum. The reason for this is that the eventual 2030 goals – deduced from an 80-95% reduction target for 2050 as foreseen in the current EU Energy Roadmap – would require a minimum reduction factor of 2.6% p.a. between 2020 and 2030. Such a steep increase in the trajectory in combination with low EUA prices until the increased

¹ The European Federation of Energy Traders (EFET) promotes and facilitates European energy trading in open, transparent and liquid wholesale markets, unhindered by national borders or other undue obstacles. EFET currently represents more than 100 energy trading companies, active in over 27 European countries. For more information: www.efet.org.

² Fuel switching would currently take place at €40, avoidance costs are over €30 for onshore wind, over €60 for offshore wind, and €350 to €400 for solar. €30 is widely perceived to be sufficient to enable onshore wind to compete without subsidies. Although offshore wind is still more expensive than onshore, we expect to see cost reductions of 40 percent at offshore facilities in the years ahead.

reduction factor kicks in will provoke investments in carbon intensive businesses until 2020, while at the same time leading to an abrupt end of those after 2020.

We could and should avoid such a scenario by adjusting the trajectory earlier. For example, if the trajectory were to be aligned with the EU long-term targets in 2013 this could already be met with relatively modest efforts and a reduction factor of 2.2%.

Back-loading

As long as it is expected to be permanent, a swift and decisive recalibration of the EU ETS will increase certainty in the market. It will also be regarded as a positive sign of policy-makers' commitment to the ETS, which is crucially important in a market that is politically grounded. As a result, market participants would be able to make long-term decisions in a cost-effective way.

The proposed back-loading of EUAs will not be perceived as such a decisive recalibration because the precise volume at which back-loading of EUAs is effective depends on a number of uncertain factors. These include economic growth, the buying and selling behavior of market participants, and the level of market confidence that back-loaded EUAs will eventually be cancelled. The range of back-loaded volumes that would produce an 'acceptable' rise in the EUA price will be difficult to pinpoint. Frequent market interventions (or the rumours of such) to mitigate the effect of the respective preceding market intervention would completely destroy the trust of market participants in an 'orderly functioning' market and would be the worst possible result.

Therefore, if the implemented volume of back-loading is derived from long-term carbon reduction targets and is not driven by a short-term perspective, it will primarily be taken as a measure of political commitment to the EU ETS, which will have a positive effect on the robustness of the system. To achieve this, any intervention must explicitly be part of a long-term structural reform of the ETS, permanently reducing the supply of EUAs and not creating the need and risk of further regulatory intervention in order to keep prices at an 'acceptable' level.

Coherence of EU climate policies

Furthermore, coherence in the EU 20-20-20 goals is lacking: the abatement goals of the EU ETS Directive currently do not reflect the achievements of EU renewable energy sources and energy efficiency policies. In the 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 means generated through EUA auction revenues.

Conclusion

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 unless it is followed by a revision of the EU ETS Directive and a harmonisation of RES support schemes within EU member states, it will remain a fragment.



Given the uncertain market response to any suggested back loaded volumes, the determination of any volumes to be taken out of the system by way of a revision of the ETS Directive should neither be governed by a perceived length of 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 translated into an absolute cap of GHG emissions in Europe.

EFET is dedicated to the success of the EU ETS and we look forward to further discussions on how to define a robust and enduring way forward.