The Energy Partnership

THE EUROPEAN COALITION FOR RENEWABLE ENERGY AND GAS

Directorate-General Climate Action

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

Thank you for the opportunity to submit comments on the structural options presented in the report "The state of the European carbon market in 2012". The Energy Partnership welcomes the Commission's initiative in assessing the ETS, as well as the need to address structural problems that may have arisen over its first two phases.

About the Energy Partnership

The Energy Partnership is a unique alliance of companies from the energy sector that seeks to promote greater political and public understanding of the merits of a capability-based energy market and systems approach, focused upon the integration of renewables and gas. The founding partners are (Alpine Energie), DONG Energy, First Solar, GE and Shell. The European Climate Foundation has provided a fact-base for the coalition's deliberations and may contribute to future research.

General remarks

The decarbonisation transition of Europe's energy system is already underway and The Energy Partnership supports the EU's 2050 ambitions of 80-95% GHG emissions reduction.

To steer transformation towards decarbonisation, the 20/20/20 targets have historically provided energy companies and other investors with guidance on the trajectory to decarbonise the European electricity sector. However, the intended market guidance has been lost in recent years due to the economic crisis resulting in ever declining EU Emission Allowance (EUA) prices combined with the over-supply of free allowances to the market which has created a serious imbalance.

The EU ETS was designed to be the most cost effective means to reduce greenhouse gas emissions in line with the EU's 2050 climate target, whilst at the same time, creating incentives for investments in low-carbon technologies by reinforcing a clear, long-term carbon price signal. However, we are also seriously concerned by the long-term risks associated with this failure which will result in a lack of investment into the power sector and possibly a return to uncoordinated national schemes.
To give just a couple of examples of the adverse effects:

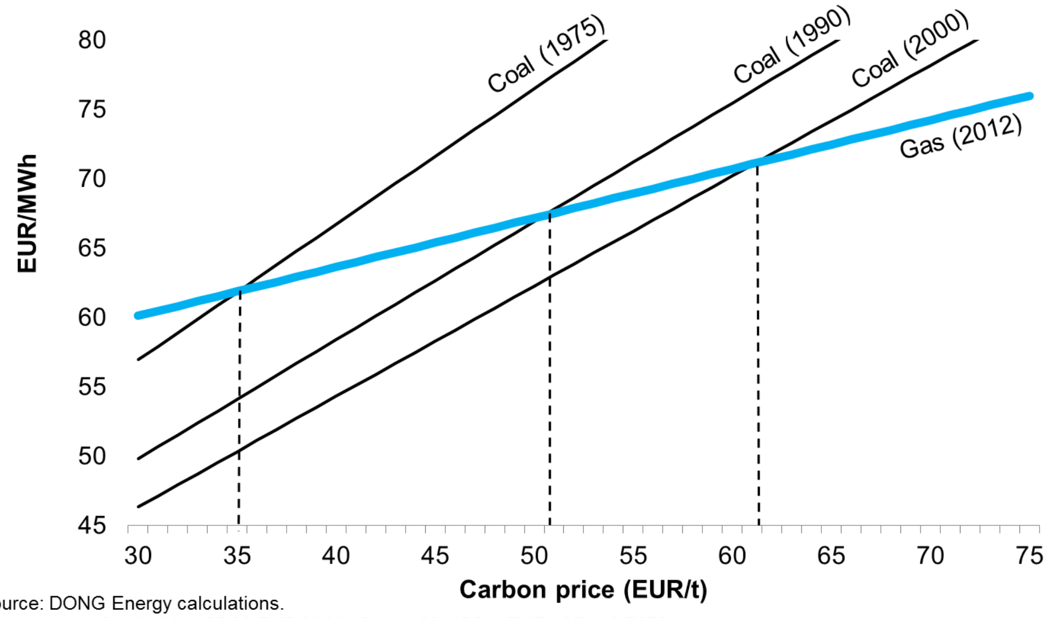
- It is expected that approximately €325 billion of additional investment alone in renewable energy sources will be required before the end of the decade. Consequently, a policy framework that provides long-term guidance to energy companies and investors is fundamental. Failure to provide long term guidance, will lead to a start-stop process, which is not a cost-effective way to reach the end goal.
- Another example: Gas-fired power is being squeezed out of the merit order all over Europe by coal-fired plants, and new coal plants are coming on-stream in Europe leading to more than twice as much CO_2 emission as if the power had been produced in gas-fired plants. This, in effect offsets the CO_2 gains from much of the production in renewables.

- Recently the NER300 program that supports innovation in renewable technologies and CCS has been adversely impacted by the low ETS price.

These developments result in insufficient or even counterproductive investments to reach long-term policy ambitions. Thus, it is urgent to get a policy framework in place beyond 2020. In the absence of such a framework, it is difficult to recommend a preferred option to strengthen the EU ETS.

However, the EU ETS poses an immediate challenge that needs to be addressed. A couple of numbers illustrate the challenge. In the conventional power sector, the EU ETS is currently too low to drive decisions on the short term (dispatch) and the long term (investment).

The dispatch case



Source: DONG Energy calculations.
Assumptions: Gas(LHV) = 25.99 EUR/MWh, Coal = 88 USD/t, EURUSD = 0.7673:

As can be seen from the figure the EUA price must currently be above 35 EUR/t for modern gas-fired power plants to displace old inefficient coal-fired power plants in the merit order and even much higher to replace new coal-fired plants. EUA prices required to support the switch from fossil fuel to renewable energy sources like solar and wind is even much higher.

The investment case

Depending on the assumptions, driving the technology choices from highly CO_2 emitting technologies towards more gas and renewable would require lower CO2 prices as technology matures and can be commercially deployed.

There is therefore a need to address the short term issue of power plant dispatch drivers. This might require additional measures in the short term.

For a carbon pricing mechanism like ETS to stimulate investments, stability and long-term predictability are key. Hence, the ETS must be resilient to significant fluctuations in demand and provide stability and security for investors.

The backloading proposals

The effectiveness of the EU ETS has been particularly undermined not only by a recession of unforeseen severity and by a surplus of allowances driven by regulation rather than market fundamentals.

The current carbon price (approximately 4-6 EURO/t) will not stimulate low-carbon investments or innovation and without agreement on the back loading proposal the price could fall further thus threatening the long term survival of the ETS.

A failure of the EU ETS would also distort the internal market with the emergence of a patchwork of 27 different energy and climate measures ranging from regulations to taxation. It could also undermine the efforts to build a single market and to meet the challenges of affordability and security of supply if much needed investment is not forthcoming in the power sector.

Action is required to restore the credibility and relevance of the EU ETS. We urge the Environment Committee to vote in favour of amendments supporting back-loading and the Climate Change Committee to endorse the proposal as soon as possible so that the EU ETS can help to reach EU climate and energy policy objectives.

Complementary measures to strengthen the EU ETS

The Energy Partnership sees the EU ETS as a flagship instrument to reduce emissions from power and industry and considers that its effectiveness within the climate and energy package needs to be improved.

Whilst there is an urgent need to take action, we also recognise the need for longer term structural reforms of the EU ETS but acknowledge that these will take time.

Furthermore we believe the ETS reform should be guided by the following key principles:

- The ETS must create the **incentives which will drive low carbon investment** decisions in the short and long run.
- It must be guided as much as possible by **policy certainty** which is key for power sector investment.
- The ETS must be **resilient to significant fluctuations in demand and provide stability and security** for investors.
- As maturing technologies are being integrated in the market, the ETS should emerge **as the overarching instrument driving the transformation of Europe's power sector** towards 2050.

However, it seems unlikely that the ETS alone can drive the transformation in the short and medium term.

In our view one way to address this could be to couple an ETS reform with additional or complementary measures, which could temper the effects on the globally competitive industry, while addressing the short to medium term issue. The status quo presents a significant risk of a coal + renewable scenario which is a more expensive way to decarbonise the energy system than a gas + renewable scenario as a gas plant is emitting about half of the emission of a coal plant.

While national measures might be required, there is a need for a thorough impact assessment of the impact of these national measures on the ETS. These national measures could include national targeted tax on coal-fired power production; standards along the lines of the British Emission Performance Standard; a strengthening of the ETS for the power sector along the lines of the carbon floor price in the UK or an auction reserve price, and specific and tailored support schemes, similar to the NER 300 at EU-level, for emerging technologies driving costs down towards grid parity and full market integration.

In the absence of a clear post 2020 framework, we do not have specific policy recommendations, but we nevertheless encourage the Commission to assess the impact of these measures together with the industry. Ideally, these temporary options should work together with the ETS to meet the EU GHG reductions ambitions, provide investors with clear guidance, and maintain electricity prices at acceptable levels.

Concluding remarks

The proposal put forward by the European Commission in its report reflects a critical time for the future of the EU ETS and the EU internal energy market. The Energy Partnership is committed to driving growth and sustainable development in the energy sector by leveraging synergies between renewables and gas.

As such we are concerned by the fate of the EU ETS and its future credibility and recognize the ETS as a mechanism for reducing carbon emissions at lowest cost while allowing for the needed flexibility in meeting the EU's carbon reductions targets.

We believe the ETS reform and additional measures should be guided by the following key principles. Aside from the broader reform discussion, there is an urgent need to address the growing surplus of emission allowances in the ETS, and The Energy Partnership fully supports the Commission's proposal to back-load the third trading phase of the ETS. We believe that this proposal will be an important political signal to the European energy sector, but it should be seen as the first step towards a more structural reform.

Though The Energy Partnership welcomes the carbon report as a very first step toward improving the ETS and providing guidance to companies and investors post-2020 we would like to emphasize the need for linking this process with other relevant processes with the aim of providing a clear and consolidated post 2020 framework.

Yours sincerely,

The Energy Partnership