

To the European Commission

Fortum's response to the EU Consultation on review of the auction time profile for the EU Emissions Trading System

Fortum is a Nordic power and heat company whose operations focus on the Nordic countries, Russia, Poland and the Baltic Rim area. Fortum has more than 100 installations in six EU member states in the EU Emissions Trading Scheme. About 95% of Fortum's CO₂ emissions in the EU are included in the ETS. Fortum has registered to the EC with the EC Register ID Number 03501997362-71.

Since the very beginning of the EU Emissions Trading Scheme (ETS), Fortum has supported ETS as a preferable market-based climate instrument and emphasised that energy market prices shall reflect the cost of carbon dioxide emissions. In our opinion, ETS has been working as intended, delivering the emission reductions (environmental goal) in a cost-effective manner (economic goal). The system has flexibly adjusted to external changes, like economic cycles. However, the operation of the ETS has recently been characterised by a significant surplus of allowances as well as lower and more volatile allowance prices than expected. This is largely a result of the economic downturn, but also due to the intervention by overlapping policy measures that have watered down the ETS mechanism. As a consequence, the ETS has been weakened as a climate instrument and is not driving the low carbon investments.

Fortum believes that the ETS should continue as the main climate instrument, but both long-term and short-term corrective changes are required to allow for proper functioning of the carbon market.

Long-term, transparent and predictable climate policy the key driver for low-carbon future

Fortum is committed to climate change mitigation and has established its vision of the future energy system - Solar Economy. Among the key prerequisites for Solar Economy is a market-based energy and climate policy ensuring long-term predictability and stability for climate actions.

In order to strengthen the ETS, the cap of the system should be aligned with the long-term targets of the EU's low-carbon Roadmap 2050. An ambitious CO₂ target for 2030 should be established as soon as possible to reduce the policy risk and to stimulate investments in the low-carbon future.

The ETS is a key driver to clean technologies and technology transfer for developing countries. However, with the current prices of EUA and CER, this incentive has largely vanished, thereby endangering the boom of the cleantech market.

Overlapping policies undermining CO₂ price signal

A low EUA price per se is not a problem, nor is it a result of a flaw in the scheme's design or functioning. It is mainly the overlapping, and to a large extent, national fragmented policies for renewable energy and energy efficiency that distort the functioning of the ETS and undermine the ETS price signal. After 2020, a target of CO₂ emissions reduction alone – without any parallel

Corporate Relations and Strategy
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October 12, 2012

targets for renewable energy or energy efficiency – should be steering the EU climate policy. A common metric for measuring the contribution of different policies to the emission reductions is needed so that all climate policies could be measured in terms of CO₂.

In the case of the ETS goals, the effects of energy efficiency policies are complementary in that reducing energy consumption will also reduce CO₂ emissions. The Energy Efficiency Directive could reduce emissions within the scope of the EU ETS by 450-650 MtCO₂ between 2014-2020.⁽¹⁾

Over the period 2008-2020 member states' RES-programmes are expected to reduce CO₂ emissions from energy by 5.8% ⁽²⁾ or even up to 2 GtCO₂⁽¹⁾. If roughly half of this is assumed for the ETS sector, the CO₂ reduction would be in the order of 1 GtCO₂.

Structural reform of the ETS needed

The Commission proposal from July 25 refers to the structural changes of the ETS to be proposed in connection to the Carbon Market Report. The proposed backloading should be seen only as the first, but necessary, step in the reform of the ETS before 2020.

In the structural reform, the long-term targetsetting for 2030 is a key priority. This combined with the tightening of the ETS cap (=increasing the linear emissions reduction factor) starting from 2021 and the extension of the ETS to new sectors, like transport and heating and cooling should be considered.

Permanent set-aside of allowances preferred

A temporary backloading or a postponed allocation of allowances will increase the regulatory risk and most likely will not change the market behaviour nor decrease market volatility. A temporary backloading is however necessary in order to restore trust in the market and to increase the carbon price signal for low-carbon investments. A short-term action also gives time to work out longer-term structural changes and reduces the risk to apply a more and more national/regional approach.

Fortum would prefer a permanent set-aside. The volume of set-aside should be well defined and linked to the estimated impact of the overlapping policy measures on the ETS. According to the figures presented in the paragraphs above, the estimated impact of the overlapping policies on the ETS might be clearly over 1 GtCO₂. Taking into account these estimates and regarding the alternative volumes (400-1200 million EUA) for backloading of allowances presented in the Commission proposal, Fortum considers the figures in the upper end of the range (400-1200 million EUA) most appropriate.

⁽¹⁾ Energy efficiency, renewable energy and CO₂ allowances in Europe: a need for coordination, Climate Brief No 18, September 2012, cdc climat research.

⁽²⁾ COMMISSION STAFF WORKING DOCUMENT SEC(2008) 85, ANNEX TO THE IMPACT ASSESSMENT, Document accompanying the Package of Implementation measures for the EU's objectives on climate change and renewable energy for 2020.

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