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Chairman and CEO

Commissioner Hedegaard
European Commission
DG Climate Action
B-1049 BRUSSELS

Paris, 15 October 2012

Object: Response to the public consultation on the review of the auction time profile for the EU Emissions Trading System

Madam,

I want to thank you for undertaking a public consultation process on the question of the auction time profile for allowances in the third phase of the EU ETS. I hereby wish to present to you our understanding of the issues as a complement to IETA's contribution which we also support.

1. CDC Climat shares the European Commission's diagnosis of the EU ETS situation

The analyses undertaken by our research team on the EU ETS to date have confirmed that the "EU ETS" properly functions as tool to achieve the EU's emission reduction objectives. A robust price for CO_2 emissions was introduced in Europe and adapts in response to clearly identified demand drivers in a liquid trading market. Consequently, European CO_2 emissions have been reduced since the beginning of the EU ETS Phase 1, while effects on competitiveness have so far been limited.

However, CDC Climat judges that today the effectiveness of the EU climate policy is threatened. As identified by our research team, the functioning of the EU ETS is unbalanced by exceptional circumstances which result in a cumulative surplus of 1200 million allowances in 2020. The lack of visibility in terms of post-2020 emissions reduction targets and the surplus of allowances announced until 2020 – due to the economic crisis and to the complementary policies of the climate-energy package (see Appendix) – will not allow the EU carbon price to play its role in promoting low-carbon investments in a cost-acceptable manner during this decade in Europe.

A low price for allowances raises two problems:

- It could limit the incentives to engage today in low-carbon investment, undermining the achievement at the lowest cost of the EU 2050 long-term emission targets, and
- It greatly reduces the potential revenues from Phase 3 allowance auctions for Member States, necessary for investments in the development of future technologies (including through the NER300 framework) and sustainable development of the European economy.

2. CDC Climat supports the European Commission in its move towards structural reforms of the EU ETS, giving priority to the negotiations on setting post-2020 emission reduction targets

CDC Climat supports the European Commission in its move towards structural reforms to ensure the better functioning of the EU ETS. CDC Climat took part in the debate in December 2011 publishing three reform proposals which included the break-down of the European 2050 target with interim targets to specify the emissions path after 2020. CDC Climat still gives priority to any action by the European Commission for the

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adoption of a long-term carbon constraint consistent with the 2050 Roadmap for the transition to a low-carbon economy.

Although the definition of reduction targets after 2020 is fraught with political obstacles within the EU, discussions must be initiated on their definition and on methods for adjusting targets if necessary. To this end, CDC Climat encourages continued dialogue between the European Commission, Member States and stakeholders of the EU ETS.

3. In the short term, as a second best solution, CDC Climat is in favour of modifying the auction time profile in Phase 3 under conditions

CDC Climat recognizes the potential for this proposal to increase the confidence of market participants through the mobilization of public authorities given the current state of the EU ETS. Of all possible measures, such as the outright withdrawal of allowances or the implementation of a reserve price, the option of modifying the auction time profile is the only option (besides taking no action) to be able to enter into force in 2013. It also has two other advantages:

- The temporary reduction in the allowances volume would operate only on the amount auctioned and therefore would only concern electricity producers and manufacturers who are not exposed to carbon leakage. Industrials who benefit from free allowances over the period will not see their allocations reduced; they will nevertheless be indirectly affected through the allowance price increase.
- In addition, by confirming the empowerment of the European Commission to improve the functioning of the EU ETS, such a measure would curb initiatives by Member States looking to strengthen the carbon price for their industries, and would thus affect more so coordination of climate and energy policies in Europe.

However, while this proposal may create scarcity in the short term, it will not however change the supply-demand balance in 2020. It is therefore essential to ensure in parallel the opening of negotiations on structural reforms in the EU ETS. CDC Climat considers that the expected rise in prices will be limited and temporary until further reforms confirm the needed long-term scarcity. The carbon price could then maintain an upward trend even given the return of the "backloaded" allowances.

To reassure economic actors on the stability of the regulatory framework, CDC Climat also calls for the issue of surplus Phase 3 allowances in the post-2020 negotiations to be addressed.

For CDC Climat, the proposed revision of the auction calendar remains a second-best measure. If the European Commission decides to implement it, the Commission should clearly set out an action framework to reduce the risk of unnecessary intervention by: (i) Limiting its ability to change rules to "exceptional circumstances" instead of "appropriate" circumstances; and (ii) Defining the criteria for the evaluation of such "exceptional circumstances". The Commission must not neglect the governance framework of its action.

The impact of this measure on the carbon price would be even stronger the higher the quantity of backloaded allowances is and the later their return on the market. The issue of the quantity of allowances to be backloaded must be assessed based on the estimated surplus of allowances in 2020, of the gross demand from incumbents[1] and of behavioural asymmetries between buyers and sellers of allowances.

CDC Climat is committed to continuing discussions with the European Commission.

PIERRE DUCRET

Chairman and CEO
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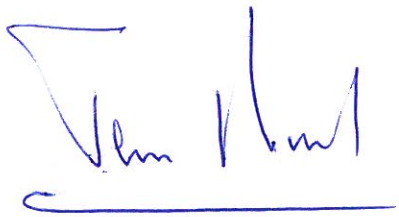


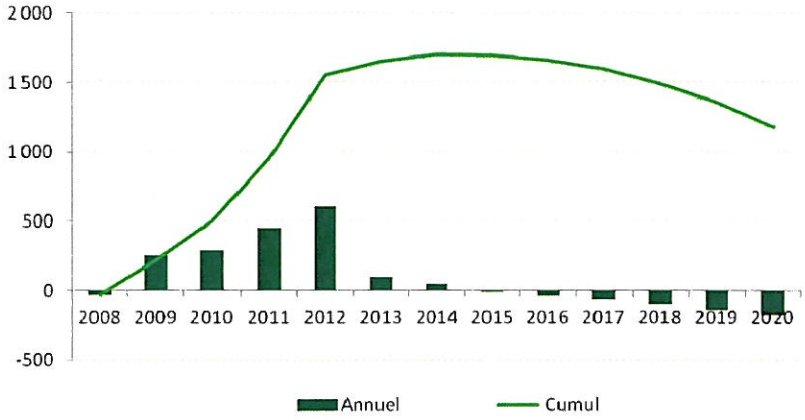
[1] The research team of CDC Climat estimates the gross allowance demand from 2008 to 2011 at 1,1 $GtCO_2$; it will be greatly increased by the implementation of auctions.

Appendix: CDC Climat Research analysis

1. A supply-demand balance in excess: surplus estimated at 1,200 $MtCO_2$ by 2020

CDC Climat Research revised its estimates of the supply-demand balance in the EU ETS by 2020 with new economic growth assumptions and identified a cumulative 2008-2012 surplus transferable to Phase 3 of 1.5 billion allowances, or 80% of annual emissions in the EU ETS. Taking into account the use of international credits, CDC Climat Research estimates that the EU ETS will be in excess of a total of 1,180 $MtCO_2$ until 2020.

Figure 1 - Supply-demand balance on the European CO_2 market - baseline scenario with Kyoto credits (in $MtCO_2$)



Source: CDC Climat Research.

2. EU ETS coordination with others climate-energy package policies is necessary

CDC Climat Research evaluated the weight of each policy of the climate-energy package in the reduction of CO_2 emissions to gauge the actual contribution of the EU ETS.

- Using the figures provided by the Member States in their interim reports on the development of renewable energies, CDC Climat Research estimates that the growth in renewable energy production reduced emissions by 116 $MtCO_2$ in 2010 within the scope of the EU ETS, and that it will reduce them by 2.0 $GtCO_2$ over the 2008-2020 period, i.e. 40% of the effort needed.
- In view of the impact analysis published by the Commission in June 2011, the implementation of the Directive on energy efficiency could additionally reduce CO_2 emissions by 450 to 650 $MtCO_2$ in the EU ETS.

The combination of these two policies would thus incur a reduction of approximately 2.5 Gt CO_2 by 2020, leaving 2.5 Gt CO_2 emission reductions to be achieved in the EU ETS, or 50% of the 5 $GtCO_2$ effort estimated by the European Commission in 2008 compared to a "business-as-usual" scenario.

Including the possible use by EU ETS installations of 1.6 $GtCO_2$ of Kyoto credits and in case the two objectives of energy policies are met, the net domestic effort required from the EU ETS would amount to 0.9 Gt CO_2.