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European Commission Consultation Paper on the state of the European carbon market in 2012

Thank you for the opportunity to comment on the structural options and views reflected in the report on *The State of the European Carbon Market in 2012* presented by the Commission.

General comments on the carbon market report

The Danish Energy Association supports a structural reform of the European Carbon Market (EU ETS) that aims at strengthening the system in order for it to become a key driver for low carbon investments in the modernization of the European energy system into a low carbon energy system. Furthermore, we consider the EU ETS to be the best instrument to increase investments in low carbon technologies because it is technology neutral, because carbon markets are the cost-effective way to promote investment choices in CO₂ reduction thereby creating a level playing field for industries and because the EU ETS is fully compatible with the internal energy market.

ETS as the key policy driver for low carbon investment and innovation

The Danish Energy Association further contends that there is a need to subsidise renewable energy technologies because there is a need to financially support innovation to make low carbon technologies competitive in the market. The increased revenues from auctioning EUA will support member states national budgets and ensure the needed finance to run the needed R&D programmes and eventually compensate industries that can document a real threat of carbon leakage.

Energy efficiency in industry increases industrial competitiveness

The Danish Energy Association favors the ETS to be the key driver policy for low carbon investments and innovation in a coherent 2030 policies package, while supplemented with additional policy instruments to promote renewable energy and energy efficiency. Especial-

ly energy efficiency in industry will have the additional positive side effect to increase the industrial competitiveness especially in a scenario of increasing prices of energy resources. Finally it is crucial to ensure greater policy coherence in the future EU energy and climate policy than in the 2020 policy package where renewable energy policies and energy efficiency policies tend to undermine the EU ETS.

**Need for a long term
RES framework**

Danish and European energy companies need a European RES framework up to and post 2020 in order to make these investments and industrialize the deployment of renewable energy and bringing down costs of RES deployment. RES support is essential for innovation and cost reduction in the short and medium term up to 2030.

Deficiencies in the current EU ETS

The EU ETS has been characterized by design faults from the very beginning. Most conspicuous is the fact that it is the only market where there is no supply reaction to changes in demand. This design fault is the reason for the back loading proposal and the following discussion of structural measures. Hence the ETS is at the moment not ideal as an investment instrument.

**Improved competi-
tiveness in the EU**

What is essential for The Danish Energy Association in the discussion of a structural change of the EU ETS is that the changes shall focus on creating a more enabling environment for investments in cost effective low carbon technologies, energy efficiency and also stimulate innovation. All of which, will improve the competitiveness of the EU.

Market uncertainty

The lack of CO2 reduction targets after 2020 until 2050 is causing uncertainty about the future of the ETS especially in the light of the current low EUA prices due to the economic recession and lack of policy coherence between renewable energy policies, energy efficiency policies and the ETS. Currently, the only thing that supports the price on the EUA from falling to 0€ are the markets expectations that 1) ETS will be strengthened, 2) the Commission will propose 2030 CO2 goals and 3) ETS will continue to play an important role in the EU's climate and energy policies.

**A clear path will
overcome uncertain-
ties**

However, we strongly regret that the structural options outlined in the report are not explicitly linked to a clear process of decisions on a post-2020 climate and energy framework. We need a clear path for investments in low carbon technology and a strong ETS before 2020 and post 2020 in order to avoid lock-in effects and that the investments we make today end as stranded assets tomorrow.

The EU as a global leader

What is needed to spur investment in low carbon power generation is a short term price increase, a long term price after 2020 and a more stable price.

Consequences of a failing market

The consequences of a failure of the EU ETS will be a distortion of the internal market with the emergence of a patchwork of 27 different energy and climate measures ranging from regulations to taxation. Globally (Australia, China and South Korea) carbon markets are emerging in order to foster investments in low carbon technologies. Many of them has learnt the lessons from the EU ETS and has incorporated some kind of price floor and price ceiling in order to make their carbon markets fit for investors needs and appetite for risk. The EU has an opportunity to stimulate our own economy through the development of new and low carbon industries, while at the same time continuing to show global leadership on climate change issues. However, policy makers must act now to support the ETS.

The Danish Energy Association welcomes the consultation that proposes both short term measures and long term stability options. We believe that a mix of these policy tools will be able to support a strong EU ETS and help meet the EU long-term target of an 80-95% reduction in a cost-effective manner.

Specific comments on the carbon market report

The Commission has put forth six proposals for structural reform in its first report on the state of the Carbon Market, including increasing the EU reduction target to 30% in 2020, retiring a number of allowances in phase 3, increase the annual linear reduction factor, extend the scope of the EU ETS to other sectors, use access to international credits and discretionary price management mechanisms. Yet none of these six proposals by themselves address the issue of industrial competitiveness.

Option a – Increasing the EU reduction target to 30% in 2020

The Danish Energy Association sees this option as a means to support the EU ETS in the short term. Increasing the target from 20% to 30% will have an immediate effect on the carbon market prices but 2020 is not that far ahead and investments in low carbon technology will not increase as much as needed if there is no political support on the long term and after 2020. The Danish Energy association will support this solution while also underlining the need for at 2030 GHG target.

Option b – Retiring a number of allowances in phase 3

We see this option as clearly subsidiary to option c – increasing the annual linear reduction factor, but also closely linked. The case for

option b depends on when the revised linear factor can come into effect. Certainly a one-off retirement of allowances would be an insufficient measure on its own, because it does not provide the necessary long-term signal that the market needs. The European Parliament called in the negotiations of the Energy Efficiency directive for a permanent set aside of 1.4 billion EUA's in EU ETS phase III. We will support this volume of set aside.

Option c – Revising the annual linear reduction factor

The Danish Energy Association gives top priority to this option. An early revision of the annual linear reduction factor in line with a 2030 target would be sufficient to securing a long term effect of the EU ETS. The revision of the current 1.74% linear factor is necessary in order to meet the EU goal on emission reductions, and early revision furthermore has the clear merit of providing a stable long-term framework. The increase of the linear reduction factor depends on when it is implemented and it is essential that it is implemented in line with the overarching EU objective of an 80-95% GHG reduction in 2050. Depending on when the factor is changed, an increase to 2.5% is relevant to investigate further. To build on the past experiences this should ideally be implemented in line with some kind of stabilization mechanism which will ensure more policy coherence and a reduced risk for investments in low carbon technologies.

Option d – Extending the scope of the EU ETS to other sectors

Regarding this proposal it is crucial to investigate whether including more sectors will provide further incentives to decarbonize the power sector. We believe that it is necessary to carefully investigate the effects of ETS on the specific sectors, industrial competitiveness and carbon leakage. In relation to sectoral coverage we call on the Commission to carefully investigate how the sectoral coverage could be expanded or altered with the objective of making the ETS and the carbon price more “bankable” in the power sector to drive low carbon investment while at the same time protect the competitiveness of the European industry.

Just expanding the ETS to more sectors might be counterproductive to give more investor certainty. It might increase the risk and uncertainty the same way as the announced link between the EU ETS and the Australian ETS does. The lack of details and information on how the link will be established is making it almost impossible to hedge the impact on the future carbon prices by the AUS link.

Option e – Limit access to international credits

The Danish Energy Association has a clear priority to promote investment in decarbonizing the European energy system. Until a global climate change agreement is reached we suggest invest-

ments in Europe should be key priority on behalf of using international credits. However, we do not consider this measure to be sufficient in order to strengthen the EU carbon market. However any change in the use of international credits should not only be made for from 2020 and onwards and not in ETS phase III.

Option f – Discretionary price management mechanisms

With regard to this option the Danish Energy Association are very pleased to see that the Commission acknowledges the need of investors to have a reduced regulatory risk on the carbon price. A stabilization mechanism could do this. It is important that such a mechanism is transparent. Fluctuations in the carbon price between 0€ and 30€ as we have seen in the history of the ETS EUA's increases the investors risk, which could be overcome with a price floor. Foreseeable terms for investments are especially important in the energy sector when investments usually have long time frames and are often irreversible. It would however be desirable if the carbon market was capable of achieving stability on its own and without regulation.

Concluding remarks

The EU must act now

While welcoming the carbon market report as a step in the right direction, the Danish Energy Association nonetheless remains deeply concerned about design flaws in the current 20/20/20 package and the slow pace of current EU decision processes which will shape a future 2030 package. If decisions are not taken now, we foresee that a new Commission working with a new Parliament from 2015 is unlikely to agree the necessary measures before 2017 at the earliest – far too late to save the ETS and far too late to enable our sector to decide on investments for the years beyond 2020. A consequence of the current policy uncertainty is that investments in replacing old power generations and grids in Europe is no longer attractive for electric utilities that are now international and have the opportunities to invest elsewhere in the world. Our members mainly invest big and long term and for us, 2020 is tomorrow.

The Danish Energy Association does not only consider EU ETS as an effective means to reduce carbon emissions but also as a strong price signal to promote investments in the EU's energy system to become independent of imported and fossil fuels, including oil and coal.

Summing up, The Danish Energy Association strongly calls on the Commission to take an ambitious step forward to secure the future of the EU ETS as a fundamental tool to promote a transition of the European energy system.

Kind regards,

Danish Energy Association

Ulrich Bang