



EAI Response to Commission Consultation

Structural options to strengthen the EU Emissions Trading System

Electricity Association of Ireland

Energy and Environment Policy Committee

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The Electricity Association of Ireland (EAI) is the trade association for the electricity industry on the island of Ireland, including generation, supply and distribution system operators. It is the local member of Eurelectric, the sector association representing the electricity industry at European level.

EAI aims to contribute to the development of a sustainable and competitive electricity market on the island of Ireland. We believe this will be achieved through cost-reflective pricing and a stable investment environment within a framework of best-practice regulatory governance.



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EXECUTIVE SUMMARY

EAI welcomes the opportunity to respond to the EU Commission's consultation on the restructuring of the emissions trading scheme (ETS) based on its recent Carbon Market Report¹. Climate policy is now a core driver of energy policy and it is crucial that the instruments used to deliver this policy support the development of and investment in energy infrastructure and market operation.

EAI endorses the submission made by Eurelectric², the representative association for the sector at EU level, on this consultation. In addition, EAI wishes to highlight a number of issues in the particular context of the bi-jurisdictional Single Electricity Market (SEM) on the island of Ireland.

The Association wishes to state its view that it supports the ETS as a technology neutral, market-compatible instrument consistent with the effective operation of the internal energy market. Structural changes to the ETS following this review should respect a number of principles:

- Global action is required if the risk from climate change is to be addressed effectively.
- A least cost approach must take priority, in particular in the current economic and employment circumstances.
- A well-designed, common EU-wide instrument can best deliver least cost.
- Regulatory stability, in terms of instrument functioning, is highly desirable, and
- Ambition levels must consider the capabilities for technological solutions on both the supply and demand sides and the support provided for innovation.

The unilateral decision of the UK Government to introduce a carbon price floor mechanism will have an immediate and major distortive effect on the functioning of the SEM if not amended with respect to Northern Ireland. It will also act to distort trade between the SEM and Great Britain markets.

The unique greenhouse gas emissions profile of Ireland places it at the forefront in the EU of the structural, administrative and societal changes required to deliver its targeted emissions reduction. Consequently, major investment decisions in terms of both national infrastructure and at domestic level aimed at decarbonising the economy will be taken significantly in advance of most other member states. It is strategically critical that these private and public decisions are taken within a stable climate-energy policy framework. We need to know today whether the driver of emissions abatement policy post 2020 will be a reinvigorated ETS or new mandatory targets for low carbon generation (i.e. renewables in the case of Ireland).

While welcoming this consultation and those parallel consultations on the internal energy market and on renewable energy, we strongly urge that the process of finalising relevant proposals for adjustments be accelerated to the maximum extent possible. We ask that specific and coordinated Commission proposals to restructure the Directive, address the future contribution of renewable energy and advance the delivery of the internal energy market be presented before the end of 2013.

Responses to the queries raised by the Commission may be found in the attached Appendix.

¹ REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL on the state of the European carbon market in 2012 (COM(2012) 652 final)

²

http://www.eurelectric.org/media/73451/consul_carbon_market_report_structural_options_for_eu_ets_eur_response-2013-030-0096-01-e.pdf

Introduction

The Electricity Association of Ireland (EAI) welcomes the opportunity provided by the Commission to comment on climate policy matters which we believe are of critical importance to the future development of the electricity sector within the Single Electricity Market (SEM) and Europe in the context of a competitive, sustainable and integrated market.

The European Union has a number of targets and objectives in respect of climate mitigation and energy policy and competitive markets with both a near term (2020) and longer term (2050) focus. The European Commission has issued Communications on Roadmaps towards a low carbon economy and corresponding energy framework to 2050. Both suggest that the European Council's objectives for 2050 can best be achieved through decarbonisation of the electricity sector and progressive electrification of energy use within the economy. It has also been established that the Emissions Trading Scheme (ETS) supports the delivery of carbon emissions reductions under climate policy at lowest economic cost.

However, there exists a perception that the ETS instrument is failing to deliver the correct signals for investment in low carbon technologies due to its current low price trajectory. EAI is not concerned per se with the current low price of EUAs, which is an anticipated response to the current economic situation within the EU and the original level of ambition for emissions reduction adopted by the European Council. Rather it is the non-economic causes of the low price and the implications of the uncertainty this price has created for the future of the ETS that is of primary concern.

EAI recognises that, in order to progress, a level of certainty regarding the future of the ETS and its role in the climate-energy policy instrument framework is required. In particular, certainty is needed as to whether the ETS is to remain the key instrument to deliver least cost emissions abatement or alternative technical policy measures, specifically renewable energy goals, are to take the lead.

This matter has particular urgency in the context of the Single Electricity Market (SEM) and the Republic of Ireland (RoI). The SEM area has the highest level of penetration of variable renewable energy (Wind) for a network system in Europe. The RoI also has a unique emissions profile relative to its EU partners with a dominant role played by emissions from Agriculture. The nature of the policy instruments to be pursued and the level at which the issue is to be addressed (i.e. EU or national) will fundamentally affect investment decisions in the SEM in the near term.

Support for submission of Eurelectric

EAI endorses the submission of Eurelectric to this consultation. Specifically, in relation to that submission, the Association:

- welcomes the carbon market report as a first step toward improving the ETS and restoring its credibility as a key driver policy,
- further welcomes the Commission's intention to prepare a 2030 framework paper,
- looks to the European Commission to urgently bring forward a coherent top-down package of proposals,
- is concerned with flaws in the current 20/20/20 package and the slow pace of current EU decision processes which will shape a future 2030 package

- (in particular) notes that overlaps between the policy instruments in the 20/20/20 package have resulted in the energy efficiency target and support schemes for renewables creating a (high) *implicit* carbon price which competes with the (low) *explicit* EUA price in the ETS.
- urges that the decision processes should be substantially completed during the current Commission mandate,
- considers the ETS (as a technology neutral, cost-effective investment driver and internal energy market compatible tool) to be the best instrument to drive investments in carbon reduction,
- supports ETS as the main policy instrument for driving investment choice in CO₂ reduction, including for mature renewables and energy efficiency technologies,
- gives highest priority to option (c) for an early revision of the annual linear reduction factor in line with a 2030 target,
- urges that any retirement in phase 3 should be integrated into a subsequent revision of the linear factor
- supports, with reservation³, a phase 3 back-loading as a (one-off) signal to the carbon market that the EU is committed to a long-term strategy of driving carbon reduction through a strong ETS
- proposes the use of a common CO₂ metric to measure the delivery of all the emissions reductions (from the ETS, renewables and savings in primary energy)

EAI is concerned that the result of current policy interactions is undermining and distorting energy investments and that the climate target is not being delivered at least cost for taxpayers and energy customers with resultant consequences for EU competitiveness and economic well-being.

Position of the SEM and Republic of Ireland

EAI considers that a level of certainty regarding the future role of the ETS in the climate-energy policy instrument framework is required. In particular, certainty is needed as to whether the ETS is to remain the key instrument to deliver least cost emissions abatement or alternative technical policy measures, specifically renewable energy goals, are to take the lead. The direction taken in this regard will fundamentally influence investment decisions and the capacity of investors to recover their costs.

Whereas this situation is true for all operators within the EU, clarity as to the outcome is significantly more urgent in the context of the SEM and the RoI. The current 2020 architecture and the specific characteristics of the SEM and RoI places these at the leading edge of the challenge of addressing the climate and renewables targets in the EU. In this context;

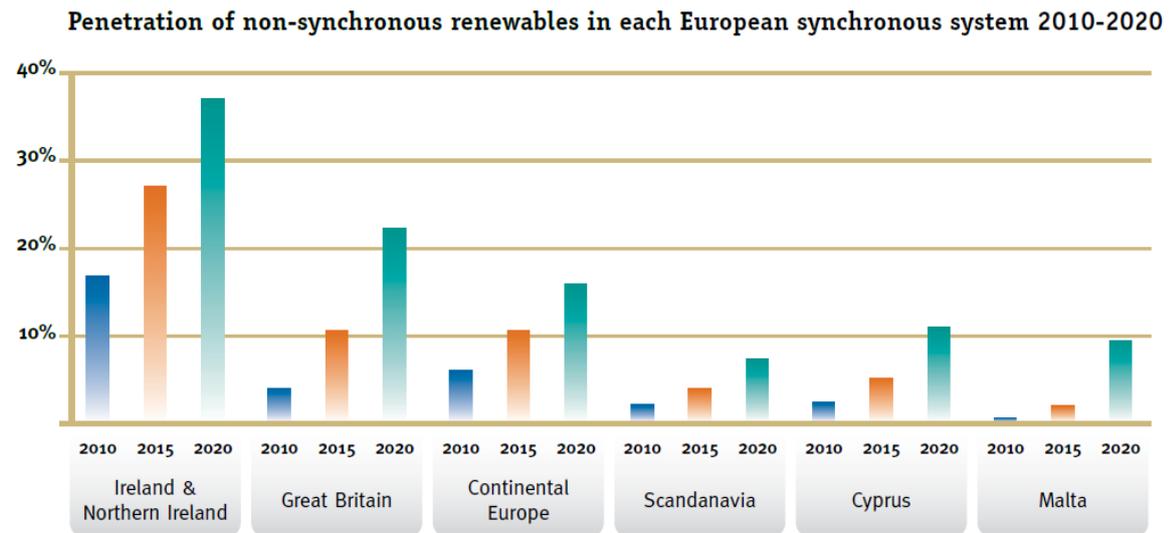
- The SEM area has the highest level of penetration of variable renewable energy (Wind) for a synchronous network system in Europe (see Figure 1 below) and
- The RoI also has a unique emissions profile relative to its EU partners with a dominant role played by emissions from Agriculture (see Figure 2 below).

A target of 40% generation from renewable sources in 2020 applies to the SEM area. Managing this target on the relatively small and isolated system that is the SEM presents major technological and

³ EAI is opposed in principle to regulatory interference in the markets, which the backloading proposal represents. However, given the negative perception of the ETS by many stakeholders and the resultant challenge to its credibility, EAI would support a one-off, short-term adjustment as part of a more fundamental structural review.

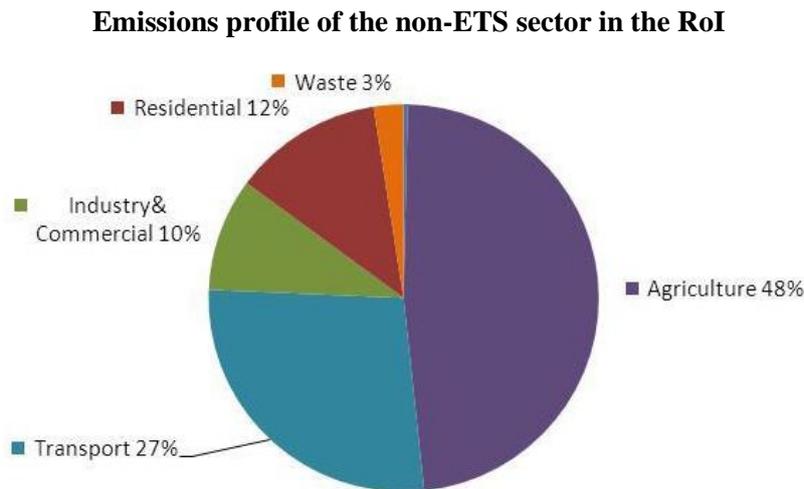
infrastructural challenges beyond those encountered elsewhere in the EU. Investors and regulators need to know now the extent of a post 2020 commitment to emissions reductions and, more specifically, the form and scale of the role that renewables will play. This is to ensure appropriate planning and support systems are put in place. It is self-evident that a significantly different investment profile (and quantum) would apply depending on whether future emission reductions are to be driven by reliance on renewable energy penetration targeted at national level or a strengthened ETS targeted at EU level.

Figure 1



Data collated from information submitted to the National Renewable Energy Action Plan by EU Member States to the EU Commission in June 2010.
Source: Eirgrid / SONI

A similar level of urgency is driven by the unique greenhouse gas emissions profile of the RoI. Agriculture will comprise almost 50% of emissions from the non-ETS sector in 2020. Significant efforts have and are being made to effect reductions in these emissions. However, there is no logic in cutting highly efficient systems of food production in the RoI to have them replaced by less efficient systems elsewhere. As a consequence, the burden of non-ETS emission reductions, already the highest in the EU, falls on the remaining 50% of the non-ETS sector - in particular heating and transport. This challenges the RoI to lead in the electrification of heating and transport, as envisaged in the Commission's 2050 energy and low carbon Roadmaps. Significant efforts in this regard are underway. If however, as noted above, the policy emphasis for emissions reductions moves from EU to national level (via a diminished role for the ETS) or priority is assigned to other mechanisms (e.g. more stringent binding national renewables targets) then a major reconsideration of the type and scale of investments would be required.

Figure 2

Ireland's Non-ETS GHG emission projections, EPA (2012)

Conclusion

- EAI recognises that climate change is a pressing challenge requiring a substantive response from policy-makers at a global level. The Association considers that the ETS provides a market based measure, compatible with the good functioning of the electricity market, that can ensure least cost delivery of carbon reduction targets and promote appropriate investments. In this context, the ETS should be promoted as the key driver of CO₂ abatement within the EU.
- Early structural reform of the ETS, coupled with energy policy measures, is required so as to address the lack of confidence regarding its future currently evident in the market. This reform should focus on aligning the instrument, via the linear reduction factor, with the EUs' 2050 objective. A clear target for 2030 would be a positive interim development providing greater certainty to investors.
- The unique characteristics of the SEM and emissions profile of the RoI require that a high level of urgency is applied in addressing the issues above with the policy process significantly advanced in the current year.
- EAI takes the view that In general, short term regulatory interventions in any market, including the carbon market (such as the proposed backdating proposal), undermine confidence and should be avoided. Such measures should only be considered in situations where it is deemed necessary for the continuation of the market as a viable mechanism to achieve the policy goals. It is important to balance any intervention with market confidence and stability, and as such any intervention, if deemed necessary, should be limited to a one-off corrective adjustment.

Appendix 1 - Responses to queries raised on the Consultation webpage⁴

Expected impact of structural option on ...

| Option | <i>Emissions reductions?</i> | <i>The ability of the EU ETS to meet the EU long-term target of an 80-95% reduction in a cost-effective manner?</i> | <i>EAI member activities, including estimated changes in compliance and administrative cost</i> | <i>Employment and households?</i> |
|------------|--|--|--|---|
| (a) | No structural reduction post 2020 other than carryover effect | Positive where early adoption delivers cost efficiencies. Negative where rapid improvement in cost curve or new technological developments arise | Depends from which year the adjustment (equivalent to approx. 250m EUAs reduction annually) is made. It could encourage gas to substitute for and/or close coal plant and would increase costs to 2020 (primarily related to higher EUA prices and system Ancillary Services provision). Limited investment consequences to 2020 given the satisfactory level generation adequacy to then. There would be no significant extra administrative costs. | Depends from which year the adjustment is made. Generally cost increasing for final customers (as a result of higher EUA and system costs) with negative impacts. |
| (b) | No impact post 2020 | No significant impact | EUA price impact will increase costs. No significant extra administrative costs. | Higher prices for final customers. |
| (c) | Structural impact | Positive to the extent it accelerates investment and innovation | EUA price impact will increase costs. Will accelerate post 2020 investments in low carbon generation and energy efficiency. No significant extra administrative costs. | Higher prices for final customers. |
| (d) | Dependent on overall EU level of ambition. No impact unless | Positive in that it improves the prospect of target delivery by | Dependent on overall EU level of ambition. No impact unless | Dependent on overall EU level of ambition and change in |

⁴ http://ec.europa.eu/clima/consultations/0017/index_en.htm

| Option | <i>Emissions reductions?</i> | <i>The ability of the EU ETS to meet the EU long-term target of an 80-95% reduction in a cost-effective manner?</i> | <i>EAI member activities, including estimated changes in compliance and administrative cost</i> | <i>Employment and households?</i> |
|---------------|--|---|--|---|
| | associated with (c) assuming a pro-rata increase in allowances (cap) associated with the additional sectors. | transferring responsibilities from Governments to obligated private entities (generally) operating within competitive markets | associated with (c) assuming a pro-rata increase in allowances (cap) associated with the additional sectors. | emissions (abatement) costs between ETS and non-ETS entities. (Currently the non-ETS carbon tax is higher than the EUA price. This would result in a potential saving for consumers.) |
| (e) | Increase in domestic effort | No significant impact | EUA price impact will increase costs. | Higher prices for final customers. |
| (f) | Dependent on design (ability to permanently retire un-auctioned EUAs) | Dependent on design and support for innovation. Effective “safety net” allows policy-makers set more ambitious targets, driving innovation. | Mitigates the risk of a severe price spike post 2020 in the event technological solutions are limited, delayed or unacceptable to society. Thus supports decision making on investments. | Modulates price variations to favour consumers. |



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