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## **E.ON Position**

### **on structural options to strengthen the EU Emissions Trading System**

#### Position

- **A coherent EU climate policy consisting of a transparent cap-setting process for the ETS and non ETS-sector is a necessary prerequisite for the structural reform of the ETS.**
- **The annual EUA supply should be more flexible to allow a supply reaction to changes in demand due to other EU climate policies such as renewable and energy efficiency policy or external economic shocks. This necessitates the possibility to adjust the cap automatically within a trading period without deviating from the general trajectory to a binding 2030 target.**
- **Within the current ETS framework and after a necessary one-off remedy of retiring a significant number of EUA the annual linear reduction factor has to be adjusted as soon as possible with respect to the 2050 target of the EU Carbon Road Map thus taking a 2030 target as binding milestone.**
- **Additional instruments like price floors/ceilings or even supporting tax scheme might be second best approach to maintain the integrity of the ETS as the efficient European system to achieve long-term climate targets.**



## **General Remarks**

E.ON supports the EU Emissions Trading System (ETS) as the leading instrument for the transformation of the EU energy system for a future low-carbon economy: the ETS should provide long term investment signals for innovative low carbon technologies and it should trigger the use of existing, already competitive, carbon abating technologies, such as fuel switching.

The Carbon Market Report provides a good basis to start the discussion needed to revise the EU ETS. We support the EU ETS as the leading system for the transformation of the EU energy system by a two-step approach consisting of:

- First, backloading a significant number of allowances to restore the price signal as a temporary one-off remedy and
- second, initiating a debate to analyse the ETS and its objective(s) followed by appropriate changes in the ETS and the associated packages for renewable energy and energy efficiency so that the ETS is the primary policy and driver for investment in these areas.

The Carbon Market Report presents six options for structural changes, but the report misses the need for a clear objective and framework for the structural changes within the climate policy– which must be the fundamental basis from which the options are derived. Furthermore the Carbon Market Report misses also the link to the current overall energy policy framework, especially the interdependencies to other political energy objectives as promotion of renewables and energy efficiency.

The ETS reform has to be incorporated in the overall EU climate strategy and should be deduced from a top-down approach starting with a binding economy-wide target for 2030 for the EU as a whole in line with the EU 2050 Climate Targets. This should be followed by a transparent process on how to split the economy-wide target between the ETS and the non-ETS sectors.

## **Coherence of EU climate policies**

The EU's 20-20-20 goals lack coherence: the abatement targets of the EU ETS directive do not currently reflect the achievements of EU renewable energy sources and energy efficiency policies.

Growth in renewable power production has to be reflected in setting the ETS cap. Over- or under-achievement in renewable growth has an impact on the ETS, as can now be seen, so the cap has to be adjusted for unanticipated developments.

The financial crisis showed that the overall economic growth has a big impact on the carbon price. The carbon market is the only known market where there is no supply reaction to changes in demand. In order to establish a robust incentive for investment in carbon friendly technology some flexibility within the trading period should be given to adjust the annual cap for business cycle purposes. There needs to be a discussion as to how we can incorporate more flexibility in the supply without jeopardizing a binding fixed long-term target in 2030.



## Specific Remarks

### ***As starting point: implement a transparent cap-setting process***

A transparent top-down process, with flexibility in carbon supply and linkages with other climate instruments (renewables and energy efficiency), could serve as a model for a restructured ETS to achieve the politically set climate target in a cost-efficient manner.

Following this approach provides a guideline how to deal with the proposed six options for structural reform in the Carbon Market Report.

### ***Option A: Increasing the EU reduction target to 30% in 2020 -***

#### ***E.ON: Prolong the period to 2030 and implement a transparent burden sharing***

This option A has to be seen in the context of any progress that can be made at international level. It is imperative that CO<sub>2</sub> is reduced more broadly than just in the EU and other remaining Kyoto signatories. This option has been proposed in the recent past in the absence of an international agreement, but failed to get political backing. If this option were to be adopted, there are questions as to what actual changes can be achieved by 2020. Longer term investment signals are more important. Moreover this option does not propose significant reductions after 2020 to join a reduction path suitable for reaching the 2050 target. This option may be potentially used if:

- The target date is changed to 2030.
- Burden sharing between ETS and non ETS sectors is agreed.
- The percentage reduction is increased better to track the 2050 objective.

### ***Option B: Retiring a number of allowances permanently in phase 3 -***

#### ***E.ON: Best quick response but only for short term revitalisation and has to be followed by structural changes***

E.ON supports this option as it tackles the problem by a direct approach. But following option B alone does not place the EU on track on the political agreed 2050 climate target. So option B does make only sense in combination with option C.

### ***Option C: Early revision of the annual linear reduction factor -***

#### ***E.ON: Best approach within the ETS framework***

This option will tighten the whole ETS. However it also means that the ETS sector will have to make a much bigger effort than the other sectors. It is therefore important that the EU also decides on the reduction efforts the non-ETS sectors. For practical reasons a two-step approach should be used: first option B – definite retirement of EUA as soon as possible, followed by option C with the next European Parliament in 2014. Following option B without pursuing option C will not generate any long term effect.



***Option D: Extension of the scope of the EU ETS to other sectors -***

***E.ON: Choose other sectors carefully with respect to their ability to be integrated in the ETS***

The EU has to consider carefully where a cap and trade system makes sense. Where it is appropriate, the ETS might be applied. In reality option D could be a tightening mechanism, similar to option C. To extend the scope to heating might be difficult as compliance function problems might occur and Member States might have issues addressing this. Extending the scope to transport might be challenging as well as there are already quite some measures affecting the transport sectors, for example taxes or energy efficiency measures that are all probably better suited to deal with those sectors. Already in passing the Energy Efficiency Directive we saw a lot of resistance from Member States and the residential sector is struggling to realize all of the requirements in the Energy Efficiency Directive. Expanding the scheme to airlines and shipping is proving an enormous challenge already.

***Option E: limit access to international credits -***

***E.ON: Make EUA and other emission trading certificates convertible***

This measure mainly applies to Phase IV. Since there is only a limited number of countries participating in a new Kyoto commitment period, there will not be many new CDM certificates in the market. However certificates from already registered projects are in the market and are part of the current oversupply of allowances.

But in order to promote the instrument "emission trading" internationally there should be closer links to the developing ETS-systems in other parts of the world by allowing to convert EUA back and forth to other emission trading "currencies". Therefore we need a reliable exchange mechanism consisting of well-defined exchange rate between different emission trading systems.

***Option F: Discretionary price management mechanisms -***

***E.ON: Active price management contradicts the market approach but may be last weapon to defend ETS***

In general, option F may not be a suitable approach since it is not market based. The ETS is not a tool for price management; it manages volumes. But coming from politics price management mechanism might come up if more Member States like the UK or the Netherlands decide to intervene in the national market to secure revenues or to foster investment. In a not very unlikely situation consisting of many national price interventions in the CO<sub>2</sub> market it might be appropriate thinking about an intervention only on European level as last resort to save an European-wide ETS approach.

These interventions such as price floors / ceilings or tax related scheme should be installed preferably on the EU level, thus to be consistent with the European internal market approach. In a hierarchy effective price corridors are closer to a market approach than tax related systems that finally might terminate the ETS-approach. These interventions should be seen as last attempt to defend an European approach for achieving the climate target for 2050 before the European climate and energy policy is again totally fragmented.