

House of Lords  
European Union Committee  
Sub-Committee D (Environment and Agriculture)  
Att. Ms. Hazel Scott  
House of Lords  
London SW1A 0PW

19 June 2008

Subject: Call for Evidence revision EU ETS

Dear Ms. Scott,

EFET highly appreciates your invitation to submit to your call for evidence concerning the revision of the EU's emissions trading system and we are gladly willing to express our views of the European Commission's amendment proposal.

EFET, with more than 90 member companies operating in 21 countries, represents the most active traders under the ETS. EFET is a strong supporter of trading mechanisms as the most cost-efficient way to curb GHG emissions.

EFET is especially concerned with the proper functioning of the emissions trading system and market. A number of key criteria should be fulfilled to ensure this:

- Liquidity in terms of traded volume and active traders
- Level playing field for participants
- Clarity and predictability on regulatory aspects
- Clarity on factors that drive supply and demand
- Long-term certainty about the market framework
- Trustworthiness and transparency in reported emissions

Firstly, we shortly enumerate some key elements in the proposal that EFET supports (having advocated these to the European Commission in an earlier stage):

- A longer, 8 year trading period, parallel with the 2020 targets;
- Inclusion of more sectors and gases where appropriate;
- Exclusion of small installations;
- Harmonised allocation throughout the EU as to the cap, the allocation rules and the new entrant reserve.

However, we have concerns about several other important issues:



### **New Entrant Reserve**

As to the size of the New Entrants Reserve (NER), we recommend a careful reconsideration: in fact, the current limit seems fairly high, given the fact that the NER is not needed for electricity production. Reservation of too many allowances may cause unnecessary uncertainty in the market. We would like to stress that NER management should be transparent and information hereon timely. To strengthen transparency and predictability, the proposal should also include clear rules about what happens to un-allocated NER.

### **International agreement**

Depending on the question if a satisfactory international agreement is reached, the EU CO<sub>2</sub> target will be either 20 or 30%. EFET does not take a position on these targets as such, as this is a mainly political choice. However EFET has concerns on the timing. In case an international agreement should be achieved later than what is now assumed (2009 or 2010), there might be too little time to adapt to the 30% target. EFET therefore recommends applying an implementation time of at least three years for adaptation to the 30% target. In other words: the starting date of the EU cap decrease will start only three years after the decision to have a 30% reduction target.

### **Kyoto credits**

While, under the current proposal, Member State governments are allowed to use carbon credits for their national targets, the ability to use CERs/ERUs in the EU ETS is heavily restricted and subject to the conclusion of an international agreement on climate change. As a consequence, a situation of uncertainty for private entities involved in emission reduction projects is created. Moreover, as an international agreement on climate change is not likely to be concluded before late 2009, uncertainties are likely to persist for a long period of time.

During the last years, private investors from developed nations have provided large amounts of funding to greenhouse gas reduction projects, especially under the Clean Development Mechanism. If financial returns on those long-term investments are affected by sustained political uncertainties, the immediate result is the scaling back of new investment into low carbon technology in developing countries. Ultimately, the CER/ERU restrictions for the EU ETS would harm the development of an efficient market for emission reduction projects and would reduce the overall cost-effectiveness of the carbon markets, as low-cost abatement potential in developing countries would not be fully tapped.

EFET endorses the ability to use CERs/ERUs proportionate to required emission reductions. Sectors with restrictive caps should be given freer access to the use of CERs for compliance. The clear framework for CER usage, currently reserved to Governments, should be extended to operators of power plants and other industrial installations requiring emission allowances. It is also important to ensure that a CER created in one EU Member State is recognised in any other Member State; otherwise the market transparency and equal treatment of companies from different EU countries are put at stake.

### **Auctioning**

Now that the Commission has chosen auctioning as the basic allocation tool, it should be clear to the Member States - who will be the auctioneers - that auctions should serve as a means to have a fair, transparent and unambiguous way of distributing emission allowances. Although



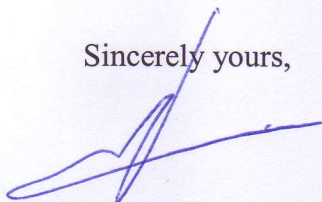
the Member States will have the auction revenues, *revenue maximisation* must not be the aim of these auctions.

As stated before, EFET strongly supports EU-wide harmonisation. This also counts for the execution of auctions: all auctions from the 27 Member States should have the same auctioning rules and should be fully coordinated regarding e.g. timing, frequency, size, pre-qualification and information disclosure. Preferably auctions will be carried out by one central EU body. But at least a European central interface should be established for coordination and communication of the member states auctions. Member states should be obliged to make available a minimum number of EUA's per year.

Power companies, who will face the lion's share of 3<sup>rd</sup> phase auctions, sell forward a large portion of their electricity production, or source forward a large portion of their electricity sales to consumers. If the auctions of EUA's will, as the proposal suggests, start as late as 2013, then there will be only the possibility for power companies to buy EUA's in the secondary forward market, to lock in the costs as they sell electricity forward. To build up more trust in the market prices, it will be necessary to establish early an underlying certificate market by selling certificates via auctioning. Therefore the first auctions should already start *before* the 3<sup>rd</sup> compliance period take off, as soon as the final cap for the 3<sup>rd</sup> phase is known, preferably in the course of 2011.

We hope and trust that our contribution will be valuable for your recommendations to the UK Government.

Sincerely yours,



EFET  
J.N.H. van Aken  
Secretary General