

## **European Commission consultation on revision of the EU ETS Directive for post-2020**

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### **EFET comments, 16 March 2015**

#### **1. Free allocation and addressing the risk of carbon leakage**

**1.1 The European Council called for a periodic revision of benchmarks in line with technological progress. How could this be best achieved in your view and, in particular, which data could be used to this end? How frequently should benchmarks be updated, keeping in mind administrative feasibility?**

The allocation of free emission allowances should be based on EU-wide harmonized product-benchmarks to ensure a consistent and constant incentive to reduce emissions through technological and efficiency improvements.

The present approach of granting free allowances for a level of production equivalent to the ‘10% most efficient installations’ in the sector could be maintained provided that its level is adjusted with sufficient frequency. The frequency of revisions must balance sufficient certainty for investors whilst also reflecting the latest technological developments. A revision of the benchmarks every 3 years is an acceptable solution, taking into account the need to have accurate indicators whilst avoiding excessive administrative complexity.

However, we would like to stress that, as the cap reduces over time, the level of total free allowances available will decrease post-2020 and mechanisms for pro-rating between and within sectors will have to be carefully monitored and agreed. In this regard, benchmarks should be revised in order to ensure an equal level of ambition across sectors and to minimise the impact of the Cross-Sectorial Correction Factor (CSCF).

**1.2 The European Council has defined guiding principles for the development of post-2020 free allocation rules which provide inter alia that “both direct and indirect costs will be taken into account, in line with the EU state aid rules” and that “the most efficient installations in these sectors should not face undue carbon costs leading to carbon leakage” while “incentives for industry to innovate will be fully preserved and administrative complexity will not be increased” and while “ensuring affordable energy prices”. Do you have views how these principles should be reflected in the future free allocation rules?**

EFET fully supports the European Council’s approach and the overall objective not to undermine European Industries’ competitiveness when taking into account direct and indirect costs. Therefore, the use of free allocation to compensate for direct costs to industrial sectors at risk of carbon leakage is necessary to provide sufficient protection to exposed sectors.

However we believe that direct and indirect costs should not be treated in the same way. Indeed, while direct costs directly derive from the industries' participation in the EU ETS, for which free allocation rules can be used to adjust the level of efforts required, the neutralisation of indirect costs is not strictly related to the EU ETS and should not interfere with the EU ETS supply/demand/reserve. *Indirect costs should not be compensated through free allocations as this would otherwise distort the market, but should be financially compensated from each Member State budget.* EFET believes that indirect carbon leakage should be compensated outside of the EU ETS and tackled at Member State level through specific industrial support measures protecting the most vulnerable industries. To guarantee a level-playing field across Europe and avoid market distortion, a harmonisation of indirect cost assessments and a strict application of the EU state aid rules (EEAG) will be needed.

When addressing the issue of 'indirect carbon leakage' in ETS sectors we suggest the European Commission provide some guidance per sector on the reasonable level of financial compensation, on the basis of the electricity and gas price differentials between the EU and its main industrial competitors (US, China, India, Japan and others) for industries most exposed to international competition. It is crucial that these adjustments are done:

- at a sector level taking into account the energy intensity of each product and the specific energy and carbon costs faced by the foreign competitors; (we expect each area under Carbon price mechanism to do the same in order to provide a level playing field and in order to avoid countries competing on carbon);
- with sufficient frequency to reflect the actual costs faced by industry (e.g. every three years as we suggest for the adjustment of the benchmark);
- at the EU level to avoid a distortion of the level-playing field in the internal market;

Also, we note that the current system of free allocation based on historical activity levels is flawed. As such, there is strong case for free allocation to be more 'fine-tuned' to reflect as accurately as possible the actual level of emissions of each industrial player. This can be achieved by a frequent review of sectorial benchmark (see our answer to 1.1). In addition, reform of the method of allocation of allowances could facilitate additional flexibility (downwards) to properly reflect production levels and to avoid penalising growth and rewarding reduced activity.

Whilst we believe that such reform be considered, EFET stresses the importance of transparency and predictability in any allocation methodology for both free and auctioned allowances. Such clarity is also critical with respect to external policies which interfere with the global balance of the EU ETS. Market participants need regulatory stability to be able to take positions and provide liquidity into carbon markets. We warn against any ex-post adjustment of free allocation to protect against carbon leakage, as it is at risk of creating uncertainty in terms of the volume of allowances to be auctioned, and hence non market based volatility in the price of EUAs. The volume of allowances available to carbon leakage sectors must be explicitly defined ex-ante and not be subject to ex-post adjustment, as this would create uncertainty with regard to the available auctioning volumes with consequences for market liquidity and price volatility. The allocation methodology for free allowances needs to operate within certain constraints on total volume, while trying to recognise changes in levels of production.

Regulatory uncertainty also has a detrimental impact on market participants' perception, within and outside of the EU, on the EU commitment to the instruments and targets of its climate policy.

**1.3 Should free allocation be given from 2021 to 2030 to compensate those carbon costs which sectors pass through to customers? How could free allocation be best determined in order to avoid windfall profits?**

We cross-refer to our response at Q1.2.

Moreover, we believe that free allocation should be granted only to companies and sectors that are actually threatened by carbon leakage. However, it may be too complex to identify which sectors are able to pass costs through and at what rate. Instead, it may be easier to focus on the actual risk of carbon leakage that each sector faces which can be classified, for instance, as high, medium or low based on the share of costs arising from carbon emissions.

As noted in response to Q1.1. and 1.2, one solution to ensure against windfall profits would be the more frequent revision of benchmarks, and / or reform of the allocation methodology such that it better reflects actual emissions. However, as noted above we would also like to stress the importance of transparency and predictability for any allocation methodology so not to undermine the market.

**1.4 Are there any complementary aspects you would like to add to the replies given to the previous written consultation in the light of the European Council conclusions?**

EFET believes it is crucial to tackle the current oversupply of allowances as a matter of urgency. This is essential to safeguard the ability of the EU ETS to become a central instrument of the EU Climate and Energy Policy before 2030, as acclaimed in the Energy Union objectives and 24/10/2014 agreement.

In this context, we are urging all Members States and Stakeholders to remove the remaining obstacles preventing the implementation of the Market Stability Reserve (MSR) before 2018, with the direct integration of backloaded and unallocated EUAs into the reserve. This confirmation of the ability of Member States to take concrete measures to counter the current imbalance between supply and demand of allowances is essential to the ability of the EU ETS to play a central role in EU Climate Policies in the future. Also, in case the EUAs demand falls again in the next years due to macroeconomic contingency of low economic growth and reductions in heavy industrial output, we believe that it would be necessary to have in place a mechanism, to adjust for unanticipated changes in the trend of EU economic growth or heavy manufacturing output.

Without a rapid confirmation of the progressive removal of the existing surplus of allowances from the market, market expectancy will sharply decrease and price signals will collapse to reflect the current oversupply, thus directly threatening the future role of the EU ETS, both in terms of emissions reduction and in terms reliable common tool.

Also Member States also need to consider the importance of the EU ETS as part of the future Power market design and of the integrated Climate and Energy EU Policies. The Power sector needs a well-functioning EU ETS well ahead of 2030. This is why the EU ETS should be fully reformed before the

start of phase IV, so that the economic integration of mature Renewable Energy Sources (RES) and the market based and “*technology neutral*” energy transition can start before 2025.

A stronger CO<sub>2</sub> price signal will allow wholesale Power prices to better reflect the real cost of generation and consumption, thus allowing national RES support schemes to progressively decrease. This evolution is essential to allow for the progressive economic integration of renewables and the progressive phasing out of support schemes for mature technologies. This is also needed for the empowerment of final customers and for the development of Demand Side Response (which would otherwise require additional national support measures). These “transfer” effects will decrease the various climate levies on retail customers’ bills, which currently distort and depress wholesale prices, thus progressively decreasing the national component of energy costs and allowing for the common IEM wholesale prices to regain relevance, especially in the forward timeframe.

**Properly addressing the needs of the various industries covered under the EU ETS, especially the Power sector which represents the majority of the market volumes is key for the reform of the EU ETS.**

It is also important to recognize the risk of EU-internal carbon leakage. For example, the current scope of the ETS typically does not cover installations on the heat market below 20 MW. In light of a stronger EUA price in the future, it means that efficient solutions such as district heating will bear the costs of CO<sub>2</sub> while less efficient and often more polluting competitors, such as individual and block heating, are in many Member states more or less exempted from corresponding costs in the non-ETS sector. These distortions of competition makes individual boilers more competitive and contradicts the EU’s long- term decarbonisation objectives. This problem can be fixed, for instance, by enlarging the scope of the ETS to fuel suppliers. Also, the larger the market, the more cost efficient the emission reductions can be achieved. A minimum of liquidity of the carbon market is crucial and must be ensured. In the end free allocation should be considered as a transitional measure with the ultimate goal to have 100% auctioning of allowances.

**Overall, we call for increased transparency on all fundamental data and a reasonable degree of regulatory stability to be able to take positions and provide liquidity in the carbon market. The timing of inflow or outflow of allowances into the market should be predictable to decrease the risk of unexpected variations and the threat of information asymmetry, thus allowing to improve trust and efficiency in the market.**

## 2. Innovation Fund

**2.1 Do you see reasons to modify the existing modalities applied in the first two calls of the NER300? Are there any modalities governing the NER 300 programme which could be simplified in the design of the innovation fund? If you see the need for changes, please be specific what aspects you would like to see changed and why.**

Revenue recycling is a good principle to drive the deployment of innovative low carbon technologies in the European Union, while preserving market liquidity. The NER300 programme should however limit its ambit to technologies that would otherwise not gather sufficient investment funds. The

priority of policymakers should be the creation of a functioning and liquid carbon trading system that would in the long-term provide a price signal for low-carbon energy investment in the EU.

To the extent that there is support for projects, we believe that the choice of projects should be non-discriminatory. All kind of technologies, asset sizes etc. should get a fair chance to secure funding. Higher certainty on total revenues at disposal for financing should be encouraged through the promotion of forward sales aimed at reducing the “price-risk” effect. At the same time, allowing the European Investment Bank more freedom in determining when to monetize allowances (setting temporal windows) will enable to maximise revenues and exploit the Fund as a market stabilizer.

The monetisation mechanisms under the funding should be designed to avoid price distortions for allowances, including timing and predictability of inflow of allowances to the market.

**2.2 Do you consider that for the extended scope of supporting low-carbon innovation in industrial sectors the modalities should be the same as for CCS and innovative renewable energy technologies or is certain tailoring needed, e.g. pre-defined amounts, specific selection criteria? If possible, please provide specific examples of tailored modalities.**

Funding should be as targeted as possible and address the gaps and market failures identified by policymakers, in order to meet EU decarbonisation goals. Nonetheless, competition between technologies and projects should be ensured in order to guarantee cost-effectiveness and value for money

**2.3 Are there any complementary aspects regarding innovation funding you would like to add to the replies given to the previous written consultation in the light of the European Council conclusions?**

It is generally important to avoid that more funds with the same/similar purpose are established in order to keep the ETS as simple and transparent and predictable instrument.

It is important to clarify the exact role of the Innovation Fund (NER400) and the proposed new 300Mt innovation fund as part of the MSR decision. We support that there is only one innovation fund with all allowances bundled. In order not to undermine the MSR (and functioning of the ETS), it is important that the Innovation Fund (NER400) is fed by phase IV allowances, and that unallocated allowances from phase III go directly to the MSR.

### 3. Modernisation Fund

**3.1 Implementation of the modernization fund requires a governance structure: What is the right balance between the responsibilities of eligible Member States, the EIB and other institutions to ensure an effective and transparent management?**

We do not have comments on this question.

**3.2 Regarding the investments, what types of projects should be financed by the modernisation fund to ensure the attainment of its goals? Should certain types of projects be ineligible for support?**

We believe that the Modernisation Fund should be targeted on modernising the bottom line of a sector, while in contrast the Innovation Fund should be on driving technological development forward.

We encourage the EC to elaborate methodologies to verify a baseline efficiency level as a target for the coming years: this would create a goal for all facilities/installations within a sector to reach this level. Those units that would fall below the base level should be reviewed as to whether they are eligible for support (i.e. whether they are included in the future scope of a sector's technology resource base). In principle, this could enable quick wins due to the ability to set the level such that units eligible for funding would catch up more quickly with modernised units, especially through technological transfer and knowledge from the experiences of the relatively developed projects.

**3.3 Should there be concrete criteria [e.g. cost-per-unit performance, clean energy produced, energy saved, etc.] guiding the selection of projects?**

We do not have comments on this question.

**3.4 How do you see the interaction of the modernisation fund with other sources of funding available for the same type of projects, in particular under the optional free allocation for modernisation of electricity generation (see section 4 below)? Would accumulation rules be appropriate?**

We do not have comments on this question.

**3.5 Do you have views how the assessment of the projects should be reflected in the forthcoming 2030 governance process (e.g. national climate programmes, and plans for renewable energy and energy efficiency)?**

We do not have comments on this question.

**3.6 Should the level of funding be contingent on concrete performance criteria?**

We do not have comments on this question.

## **4. Free allocation to promote investments for modernising the energy sector**

**4.1 How can it be ensured that investments have an added value in terms of modernising the energy sector? Should there be common criteria for the selection of projects?**

It is crucial for the functioning of the EU ETS that only investments that deliver concrete results in terms of modernisation of the energy system are allocated free allowances. The ability to unlock the current sectorial and regional blockage is indeed key to any serious reform of the EU ETS and ultimately to allow for a well-functioning energy and ETS markets.

Strengthening the provisions concerning project selection requirements is essential, as well as ensuring that transitional periods are only granted in return of a clear support for the overall decarbonisation objective and of the associated commitment not to block other areas/sectors.

**4.2 How do you see the interaction of the free allocation to energy sector with other sources of funding available for the same type of projects, e.g. EU co-financing that should be made available for the projects of common interest under the 2030 climate and energy framework? Would accumulation rules be appropriate?**

This issue should be addressed by state aid rules (EEAG) and appropriate guidelines by the Commission.

**4.3 Do you have any views how the assessment of the projects should be reflected in the forthcoming 2030 governance process (e.g. as regards improving transparency)?**

From a general perspective we fully support some increased transparency and reliability of all fundamental data that affect the overall supply and demand balance of the common ETS market.

A detailed account of derogations from auctioning, as well as the use of the modernisation fund, should be included in the national plans to be elaborated in the context of the 2030 governance process.

**4.4 The maximum amount of allowances handed out for free under this option is limited. Do you think eligible Member States should use the allowances for a period of time specified in advance (e.g. per year), or freely distribute them over the 2021-2030 period? (Please explain your motivation.)**

Market participants need a reasonable degree of regulatory stability to be able to take positions and provide liquidity into carbon markets. The timing of inflow of allowances into the market should therefore be predictable for uncertainty exposes market parties to risks that are difficult to manage and increases the threat of information asymmetries. Regulatory uncertainty has a detrimental impact on market participants' perception, within and outside of the EU, of the EU's commitment to the instruments and targets of its climate policy. Any uncertainty in the free allocation process would drive up costs unnecessarily.

**4.5 Should there be priorities guiding the Member States in the selection of areas to be supported? If so, which of the following areas, if any, currently supported through investments for modernisation of electricity generation up to 2020 should be prioritised for support up to 2030 and why?**

We do not have comments to this question.

**4.6 How can improved transparency be ensured with regard to the selection and implementation of investments related to free allocation for modernisation of energy? In particular regarding the implementation of investments, should allowances be added to auctioning volumes after a certain time period has lapsed in case the investment is not carried out within the agreed timeframe?**

The framework for this type of investment should be flexible enough to accommodate changes to project plans and investors' needs, particularly in light of the highly complex and volatile European power system. However, if an eligible investment project is not realised within a reasonable timeframe, allowances related to it should be auctioned and its proponents should not gain any free allowances.

## **5. SMEs / regulatory fees / other**

**5.1 Are there any EU ETS administrative requirements which you consider can be simplified? Do you see scope to reduce transaction costs, in particular for SMEs? If yes, please explain in detail.**

EFET does not have comments on these issues.

**5.2 Member States had the possibility to exclude small emitting installations from the EU ETS until 2020. Should this possibility be continued? If so, what should be the modalities for opt-out installations to contribute to emission reductions in a cost-effective and economically efficient manner? Should these be harmonised at EU level?**

As stated in response to question 1.4, EFET does not see any reason why small emitting installations should be granted an exemption from the EU ETS after 2020.

**5.3 How do you rate the importance of a high level of security and user-friendliness of the Union Registry? Do you think the costs for providing these services should be covered via Registry fees?**

A high level of security is obviously required to preserve trust in the system. Ensuring this should be the responsibility of the European Commission as the sole operator of the Registry.

We believe there should be no fees for operators levied at the EU level. A solution to cover costs for providing these services may be to use auctioning revenues from Member States to finance the Registry.

#### **5.4 Do you consider discrepancies in Registry fees in different Member States justified? Should Registry fees be aligned at EU level?**

In principle, we believe the same fees should be applied to the provision of the same services. However, we are not favourable to fees levied at the EU level.

#### **5.5 Under the current EU ETS Directive, at least 50% of the revenues generated from the auctioning of allowances should be used by Member States for climate-related purposes. For the calendar year 2013 Member States have reported to have used or to plan to use 87 % on average to support domestic investments in climate and energy. Do you consider the current provisions regarding the use of the revenues adequate for financing climate action? If not, please explain why?**

The current provisions in the ETS Directive refer to auctioning revenue being used, among others, to achieve the Renewable Energy and Energy Efficiency targets. As any emission reductions achieved through RE and EE improvements in ETS sectors would reduce the demand for EUAs, this ultimately would also reduce the carbon price signal and the revenues raised by auctions. Therefore, special care and neutralisation of the effect of these overlapping policies would certainly apply to these usages.

EFET would like to emphasize the need for more transparency on how Member States use auction revenues. However, we believe that there is no relation between a well-functioning EU ETS and the use of revenues generated from the auctioning. Action from the European Commission should focus on the former as a matter of priority.

## **6. General evaluation**

#### **6.1 How well do the objectives of the EU ETS Directive correspond to the EU climate policy objectives? How well is the EU ETS Directive adapted to subsequent technological or scientific changes?**

EFET is firmly convinced that carbon reduction targets combined with a reformed and well-functioning GHG emissions trading market could deliver the objectives of the EU energy and climate policy and reduce carbon emissions in a cost-effective manner across the whole economy. We also believe it should be the central pillar of EU climate policies going forward and should be extended to other sectors (e.g. transport) in the longer run. However, this requires that the overall market design is robust and that unnecessary interferences are neutralised.

Policy makers have to a large extent relied on external instruments such as dedicated support schemes up till now and will necessarily continue to use national measures in order to reach their 2030 Climate and Energy objectives. We should fully take stock of this reality when considering the expected role of the EU ETS and the size of the MSR stabilisation factor (12%).

For this reason, it is essential to check and publish the natural decrease of carbon emissions (for example through the already implemented Policies and through natural technological progress) and also to understand that any “out of the market” Climate Policy will have a direct effect on the EU ETS (such as Energy Efficiency or RES support schemes).

These effects should be minimised, published and neutralised or taken into effect ex-ante when reforming the EU ETS, and individual Member States should inform each other of the additional local measures they intend to undertake (as part of the Energy Union) so that the common EU ETS market is not undermined by individual Member States decisions and so that the common Climate objectives are preserved.

Looking back at the 2020 Climate and Energy Package we believe it ever more important to ensure that the ETS is a flexible system, which can react promptly to supply-demand changes caused by unforeseen developments such as the economic recession in recent years. The main flaw of the EU ETS in its current design has been related to the rigidity of the cap and allocation volumes (the 'supply-side' of allowances). Such a system was not designed to adjust to unexpected changes in the EU's emission path (the 'demand-side' of allowances) triggered by the macro-economic situation and the build-up of renewable technologies due to policy and technological developments. As a result, a massive oversupply of allowances has been accumulated and the price signal provided by the EU ETS has become irrelevant, limiting its contribution to EU climate policy objectives.

The increase of the Linear reduction factor (LRF) to 2.2% as mentioned in the European Commission Communication of 25 February 2015 and the European Council Conclusions of 5 March 2015 will play a role in the ETS structural revision, although it does not align yet the ETS cap trajectory with the 2050 target of 80-95% reduction.

When looking at EUAs market prices, it seems that the EU ETS has progressively regained credibility but that the willingness (and ability) of Europe to reform the EU ETS and to make it central to its Climate Policies is still being tested. However ambitious the current discussions may seem, it is clear that the current market signals still remain quite moderate. The implementation of a Market Stability Reserve (MSR) as soon as possible and before 2018 will allow to put the EU ETS back on track and this issue must therefore be addressed as a matter of urgency. However the MSR in its current design cannot solve all past and future external Policy interventions, which is why a "reality check" is needed, as well as more transparency on fundamental data and on the natural decrease of emissions.

The EU ETS was created to guarantee that emissions are reduced cost-efficiently through a market-based mechanism, and to provide a market price signal for investment in low-carbon technology. Investors need long term commitments and sufficient predictability on EU's common objective to use the EU ETS as a central mechanism to allow for these objectives to become a reality. Should these signals remain unapparent, investors will continue to call for the prolongation of financial support for renewable energy production, back-up generation and Demand Side Response and distortions to the European energy market will proliferate accordingly.

## **6.2 What are the strengths and weaknesses of the EU ETS Directive? To what extent has the EU ETS Directive been successful in achieving its objectives to promote emission reductions in a cost-effective manner compared to alternatives, e.g. regulatory standards, taxation?**

EFET sees many advantages in the EU ETS over alternative climate policies, particularly related to its cost-effectiveness and technology neutrality. We believe it should be the central pillar of EU climate policies going forward and should be expanded to other sectors (e.g. transport).

The ETS, compared to taxes or command and control measures, ensures:

- The ability to define common objectives across countries in terms of emissions reduction targets, together with harmonisation: ensuring a level playing field at EU level,
- The flexibility for market participants to choose when to abate/procure EUAs and how to best manage their exposure to GHG prices (hedging and Inter-Temporal Flexibility),
- The flexibility for market participants to define their own decarbonisation pathways through hedging or investment decisions,
- Dynamic GHG emissions pricing according to market based drivers, factoring the complexity of countries/sectorial evolutions and variations of market needs. Ultimately the carbon price will reveal the marginal cost of abatement when investment decisions will start being taken based on EUAs' prices and when external interferences will be adequately neutralised.
- Competition and cost efficiency thanks to the continuous adaptation of market prices to the adequate level of tension in the market,

As argued above, this requires the EU ETS not to be subject to substantial changes due to macro-economic evolutions and overlapping policies.

One of the clear difficulties in this context, which is also one of the strength of the EU ETS, is the coexistence of various sectors with different dynamics. This requires for the overall market design to be reviewed before phase IV so that the market can work effectively during this important phase and so that no change of parameters are needed any more within a defined phase (phase III should remain an exception in this respect and only to take stock of past experience).

Also in terms of market design and oversight we believe that with the classification of EUAs as financial instruments and with the various associated reporting obligations and with additional transparent publications on fundamental data, the market will benefit from the adequate regulatory instruments to work effectively.

Finally the adequate "sectorial" coverage is also a matter of interest. For example the EU ETS could be expanded to cover more sectors, e.g. transport or more completely some sectors, such as heat. This would limit distortions of competition, in particular on the heat market (see response to Q1.4), at least in some Member states, and a risk of intra-EU carbon leakage. A potential solution to this problem is adding fuel suppliers in the scheme so that all competitors on the heat market internalize the CO<sub>2</sub> costs and are encouraged to cost-effectively contribute to achieving the EU's overall climate objectives. These evolutions should however only occur well in advance of the following phase and always taking into account the potential impact on the EU ETS balance, so as not to undermine its price signals.

**6.3 To what extent are the costs resulting from the implementation of the EU ETS Directive proportionate to the results/benefits that have been achieved, including secondary impacts on financing/support mechanisms for low carbon technologies, administrative cost, employment impacts etc.? If there are significant differences in costs (or benefits) between Member States, what is causing them?**

As a quantity-based instrument, the EU ETS is by design able to deliver emissions reduction in the most cost-effective sectors and locations, and is therefore preferable to alternative instruments which do not compete with each other, such as taxes or command and control measures which have already proven to be very costly.

Price signals in the carbon market are of particular importance in the power sector as explained in 1.4. As the carbon price signal has the essential beneficial effect of being technology neutral, it has the capacity to act as the key instrument to achieve many of the sector's structural evolutions, i.e. not only the decarbonisation objective, but also energy efficiency, demand-side response and consumer empowerment, the development of carbon capture and storage (CCS) technologies or alternative technologies, potentially not even yet known, to decrease GHG emissions.

#### **6.4 How well does the EU ETS Directive fit with other relevant EU legislation?**

The binding carbon target of 40% should remain the centrepiece of the EU climate action framework, while minimising the negative effects of complementary policies' overlap. In this regard, the coherence and the co-existence of different energy related policies should be checked and tackled, also with a careful monitoring of impacts from other policies in order to maximise transparency and predictability.

In this context, the Market Stability Reserve represents a positive step since it will contribute to progressively absorb some of the excessive volumes of allowances on the market.

**However the 12% stabilisation factor is already expected to be used at its full capacity over the next 10 to 12 years just to absorb the current accumulated surplus and some additional surplus may still be created during phase III. This means that the MSR, in its current design, will not be able to tackle any additional surplus nor external Policy interventions while in the meantime compensating for the natural decrease of emissions due to already implemented Policies and natural technological changes.**

EFET, therefore believes that the interactions between the EU ETS Directive and other relevant EU energy and climate legislation (Renewables Directive; Fuel Quality Directive; CCS Directive; Eco-design Directive; Industrial Emissions Directive; Energy Efficiency Directive; etc.) is still not properly taken into account and priority should be given to correcting this as a matter of urgency. Please refer to our answer to question 6.6 for concrete proposals.

**6.5 What is the EU value-added of the EU ETS Directive? To what extent could the changes brought by the EU ETS Directive have been achieved by national measures only?**

The EU ETS is the only truly European climate policy instrument and we see no alternative to it at national levels. A “nationalisation” of carbon trading would lead to a distortion of the level-playing field within the single market that would be highly damaging for both the energy system and the industry in general.

Since 2010, the weak carbon price did not provide any significant low-carbon investment signals. 2020 decarbonisation targets implementation has in reality largely relied on uncoordinated national schemes supporting renewable power generation development. The operation of those schemes has had a number of negative effects on other policy objectives, especially the completion of the single electricity market in a cost-efficient way. A solid package of additional structural measures, coming into effect in 2020, should be designed to remove conflicting signals arising from a weak carbon price on the one hand and from uncoordinated national RES-E support schemes on the other hand.

A unique, reliable carbon reduction price signal will produce the most cost-efficient and least distortive means of achieving decarbonisation, promoting renewable energy deployment and increasing energy efficiency.

**6.6 Do you have any other comment on the revision of the EU ETS Directive that you would like to share?**

EFET makes the following suggestions for the improvement of the EU ETS:

**1. Changes in the 'demand' for allowances, including those due to overlapping policies, should be taken into account, together with an overall review of the global market design.**

We believe that excessive rigidity in the allocation of allowances has been one of the major design flaws of the EU ETS so far. In our view, an urgent design reform of the EU ETS is needed to make it resilient to distorting effects of RES-E and energy efficiency out-of-the-market support schemes, as well as to major economic shifts. As a first step we support the establishment of the MSR currently being negotiated by EU institutions and we would like to see it operational as soon as possible and before 2018. However, in case the demand for EUAs falls again in the next years due to macroeconomic contingency of low economic growth and reductions in heavy industrial output, then it would be necessary to have in place a mechanism, to adjust for unanticipated changes in the trend of EU economic growth or heavy manufacturing output. An automatic mechanism for potential further withdrawal of allowances post 2020, which sets aside a portion of the annual supply according to dynamic criteria, based on the level of economic growth, will prevent over-supply and carbon price from sinking again to insignificant levels.

However, the European Commission should also consider additional measures in terms of fundamental data transparency and preservation of the EU ETS from external Policy interventions in the context of its EU 2030 package.

**2. Free allocation should be better targeted.**

We acknowledge that the risk of carbon leakage should be carefully assessed by policymakers. We believe that there is strong case for free allocation to be more 'fine-tuned' to reflect as accurately as possible the actual level of emissions of each industrial player. This can be achieved by a frequent review of sectoral benchmark (see our answer to 1.1). In addition, reform of the method of allocation of allowances could facilitate additional flexibility (downwards) to properly reflect production levels and to avoid penalising growth and rewarding reduced activity. This issue could be tackled also with a more frequent review of benchmarks, every 3 years. In any case, EFET stresses the importance of market transparency and predictability on the auctioned volumes within each phase of the trading scheme. Market participants need regulatory stability to be able to take positions and hence to provide liquidity in the markets.

**3. The EU ETS should be extended to more sectors.**

In order to expand its role as a central pillar of EU climate policies and increase liquidity in the market, we support the extension of the EU ETS to new sectors, provided that the impacts to the EU EST balance are well understood, managed and published. We see road transport as a natural candidate for inclusion in the EU ETS, and urge for its inclusion as soon as practicable. We also suggest extending the ETS scope to small emitting installations. Also as mentioned above the revision of the EU ETS Directive should look into ways to establish a level playing field on the heat market so that all emissions associated with heat production are exposed to a CO2 price signal.

**4. The role of international credits should be reinforced.**

International credits provide vast opportunities for cost-effective emissions reductions at the global level. Whilst we acknowledge the importance not to undermine the EU ETS and the care that needs to be taken when designing such measures, we see a role for international credits in the longer-

term, especially in the context of international agreements and carbon linkage discussions, such as those established under the Kyoto Protocol (Joint Implementation and Clean Development Mechanism credits). Such mechanisms may play an important role in facilitating discussions on global emissions trading markets: to achieve the goal of a worldwide trading scheme, the EU should also prepare to link the ETS to other cap-and-trade schemes.