Answers to consultation on ETS

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?

In the long run, free allocation should be abandoned, if we want to put a fair price on all carbon emissions. In the short run, it can be accepted for sectors with high risk for carbon leakage and global competition, as long as EU:s major competitors are not putting a price on carbon emissions.

Distributing free allowances according to benchmarks is a preferred method. The benchmark levels need to be revised at regular intervals according to technological advancement, and tightened to promote improvements in technology and energy efficiency. So far the experience has been that there has been an over-allocation in many sectors. The conclusion is that the benchmark process is not fully efficient, and that there should be a better connection to real emission numbers. One possibility would be to up-date benchmarks more often in sectors with measured high over-allocation. This could be done at a control point, e g after five years into the trading period.

The large over-allocation has compromised the whole system, and needs to be fixed, in order to reach higher prices on the allowances and give ETS credibility.

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?

Free allocation should only be given for direct costs. As said in the answer to question 1.1 the goal must be that no free allowances need to be given, and that all carbon emissions are priced for their environmental impact. For sectors outside ETS this can be done with carbon taxation, and inside ETS all emissions should be auctioned. This situation will be possible to implement once the major competitors on the global markets, including the U.S., China, Japan and other major industrial producers have introduced carbon emission trading schemes and/or carbon taxation. During 2016 we expect China to introduce a cap-and-trade system on national level with price levels near the levels in EU ETS.

Compensation for indirect costs should as much as possible be avoided. There is great risk for unfair treatment between industries in different Member states. Free allowances should not be

used for this purpose. It is important that compensation for indirect effects is harmonized, e g in the agricultural sector, to avoid unfair competition between Member states.

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?

I f a sector can pass through the carbon cost to costumers it should not be eligible for free allocations. The purpose of the system is to make products and services with a high carbon footprint more costly, so the carbon cost should be passed to the costumers.

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?

Free allocations must be considered a transitional measure, and 100 percent auctioning must be the goal in order to put a fair and equal price on all carbon emissions. The transition period should in this matter definitely have an end 2020 at the latest.

2. Innovation Fund

The European Council has concluded that 400 million allowances in 2021 to 2030 should be dedicated for setting up an innovation fund to support demonstration projects of innovative renewable energy technologies, carbon capture and storage (CCS) as well as low carbon innovation in industrial sectors. To make this fund operational, a legal basis has to be created in the EU ETS Directive while further implementation modalities can be set out in secondary legislation. The work can build on the experience with the existing "NER300" programme which made available 300 million allowances for CCS and innovative renewable energy technologies.

With regard to establishing a legal basis for the innovation fund as part of the revision of the EU ETS Directive, the Commission seeks feedback on the following questions:

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.

There is large room for improvement in the NER300 system. The major fault is the direct connection between the support system and the ETS Scheme. When the final value of the support relies on the value of the emission rights, too much unceratinty is built in to the support system. There is no reason to connect; it complicates the understanding of the schemes.

The experience from NER300 indicates that there is much room for improvement. To our knowledge few or none of the large bioenergy projects awarded NER300 support have been carried through. This clearly indicates that the measure has not been successful. There is no lack of prospective projects, and an urgent need to make these investments. Here are some crucial points:

There must be a better coordination with commitment and co-financing from the member states.

Payments to the projects must be made at least partly up-front, not only after start-up of the operation.

The reference plant methodology is complicated and the approach differs from case to case. If the technology is truly innovative it is very difficult to define a suitable reference plant.

For private investors, to be able to go through with the projects, there also needs to be certainty about the market development, to guarantee that the products will be demanded. This requires clear and long-term incentives.

There should not be any earmarking between the Member states, but the selection of projects should be solely based on their merits.

One should consider changing NER financing to an investment support scheme for innovative carbon technologies, and set up an investment fund administered by EIB.

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.

In principle the same criteria and technology neutrality should apply for all project support. No special preference should be given to CCS projects. All technologies should be evaluated to their potential to reduce carbon dioxide emissions, and to their medium and long term cost-effectiveness. The purpose is to speed up commercialization of proven innovative technologies.

Tailoring should as much as possible be avoided. It is always difficult for political or administrative bodies to define technological and innovative pathways. In the long run, economy will prevail, and the conditions will be constantly changing according to changing prices, learning curves, technological break-through, etc. The support scheme therefore needs to be adaptable.

CCS investments should be included fully in ETS. This would clarify the economic feasibility of CCS projects, and create a level playing field between CCS and other solutions for mitigation of greenhouse gas emissions.

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?

---

3. Modernisation Fund

The European Council has concluded that 2% of the total EU ETS allowances in 2021 to 2030 should be dedicated to address the particularly high investment needs for Member States with GDP per capita below 60% of the EU average. The aim is to improve energy efficiency and to modernise the energy systems of the benefitting Member States. The fund should be managed by the beneficiary Member States, with the involvement of the European Investment Bank (EIB) in

the selection of projects. To make this fund operational, a legal basis has to be created (in the EU ETS Directive), while further implementation modalities can be set out in secondary legislation.

With regard to establishing a legal basis for the modernisation fund as part of the revision of the EU ETS Directive, the Commission seeks feedback on the following questions:

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?

General criteria should be defined at EU level. Evaluation and approval of projects should be done by Members states, and funding made available by EIB.

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?

The projects should be in accordance with EU energy and climate policies, to improve energy efficiency and reduce climate gas emissions as well as increasing security of supply and economical development in the region. Highest priority should be to project that in the most cost-efficient way reduce carbon emissions in the medium term.

Typical projects that should have priority are: investments in district heating infrastructure and CHP plants, waste-to-energy projects, conversion of boilers, heat plants and CHP:s from fossil fuels to renewable biomass fuels and energy efficiency projects. Technology neutrality should be maintained when choosing project solutions.

Financing must also be guaranteed for new, cutting-edge technologies.

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

Yes, the best cost per units or per energy saved is what the market would favour, and such criteria therefore also makes sense for projects getting EU support. A better alternative than giving direct subsidies would be to impose a carbon dioxide tax in the Member states and let the market make decisions about investments. It is also important to secure reasonable lending and financing conditions with the support money.

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?

Overlapping funding should be avoided.

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)?

The Member states should put forward plans for energy efficiency and modernization, as well as for renewable energy investments, as part of the governance process.

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

Yes

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

The conclusions of the European Council provide for the continuation after 2020 of the mechanism foreseen in Article 10c of the EU ETS Directive, which allows some Member States to opt to hand out free allowances to power plants in order to promote investments for modernising the energy sector. The current Article 10c modalities, including transparency, should be improved to promote investments modernising the energy sector, while avoiding distortions of the internal energy market.

With a view to reviewing and improving the current modalities as part of the revisions to the EU ETS Directive, the Commission seeks feedback on the following questions:

To help modernise their electricity sector 10 new Member States were given the option of exempting themselves from the 'full auctioning' rule and continuing to allocate a limited number of emission allowances to power plants for free until 2019.

They are Bulgaria, Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland and Romania.

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?

The conditions may vary between countries, and it is therefore natural to let the selection be a part of the iterative governance process where the Member states can define their own priorities. As stated in our answer to question 3.2 projects that should have priority in this decision process are: investments in district heating infrastructure and CHP plants, waste-to-energy projects, conversion of boilers, heat plants and CHP:s from fossil fuels to renewable biomass fuels and energy efficiency projects. All of these priorities lead to radically reduced greenhouse gas emissions and improve the efficiency of the energy system.

In many cases building new plants gives much bigger improvements than refurbishing existing plants. CHP plants instead of condensing plants more than double the efficiency, but require investments in district heating grids.

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?

Overlapping of funding from several sources should be avoided. Many of these modernization projects may be commercially viable, and definitely would be so with higher prices on carbon emissions.

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)?

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.)

The allowances should be distributed during the first years of the period, and the modernization measures should also be introduced early on.

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?

See answers to 3.2 and 4.1

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?

---

5. SMEs / regulatory fees / other

In order to allow taking stock of the EU ETS aspects beyond those examined by the European Council, respondents are also invited to provide feedback on certain other questions.

The Commission ensures that better regulation principles govern all of the policy work, including that the specificities of small and medium sized enterprise (SMEs) are taken into due consideration. Member States can exclude certain small installations from the EU ETS in the current trading period (2013-2020) if taxation or other equivalent measures are in place that will cut their emissions. If such a possibility was to be reviewed, a legal basis would have to be created in the EU ETS Directive.

The accurate accounting of all emission allowances issued is assured by a single Union Registry with strong security measures. The operations were centralised in a single Registry operated by the Commission, following a revision of the ETS Directive in 2009. This has replaced Member States' national Registries. Despite the considerable resources from the EU budget required for maintaining the EU Registry, as does supporting work on auctioning, the Commission does not have the possibility to charge any fees. However, Member States administrators may still charge Registry fees to account holders administered by them. There are discrepancies in fees across different Member States.

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.

In general the procedures for monitoring, reporting and verification work well, and the transaction costs are reasonable for larger actors. For SME one could simplify the work and reduce cost by using a system of self-control. Many of the companies have verified environmental management systems (e.g. ISO14001), and a mandatory external audit is not necessary in these cases. Random external checks by authorities would be enough to guarantee compliance.

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?

All emissions of carbon dioxide within EU should pay according to polluter pays principle, either under ETS, or by paying a carbon tax or carbon fee. The installations inside ETS should be treated equally throughout EU. Small installations, less than 20 MW, should be excluded for administrative reasons. Small boilers connected to a district heating grid with more than 20 MW capacity should however be included. For all other middle and small-scale installations paying carbon tax would be a sufficient incentive to reduce emissions. The treatment of small installations is closely connected to the issue of carbon taxation. If heat plants are required to have emission allowances, and these increase in price, as we wish, but smaller boilers have no cost for their emissions, there will be an unfair competition on the heating market, at disadvantage to the heat plants and district heating alternative compared to individual heating solutions. This will also be negative for the air quality, as the small boilers in general have less cleaning than larger boilers. It is important that every plant or company should pay for emissions either within the ETS or with a carbon dioxide tax.

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?

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

Our opinion is that the revenues should not be used for climate investments but should be a general income for the member states' governments to spend as the government decides within

the country. A specified percentage of the revenues used for climate-related purposes can have odd effects if the market is volatile. If the price goes down to zero, the revenue dries up, and if the price goes up to a high level the member states will have to spend more money on climate-related projects, despite the fact that the market itself has created strong incentives.

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?

The objective of the ETS Directive is to establish a system for greenhouse gas reductions in the sectors covered by the directive, and that these reductions should take place in the most cost-effective way wherever the lowest cost for reductions occurs. Beside reducing emissions according to the preconceived rate, the system also should promote innovation and technical development by making low-carbon solutions more competitive compared to fossil fuel based alternatives. For this to take place, the prices of the emission allowances need to be sufficiently high, and the expectations of future prices need to be high as well.

So far, the prices on the emissions market have been low and unstable. This is proof that the system has not been fully efficient. The system has not been flexible enough to adapt to lower economic growth and to unexpected improvements in energy efficiency. The system has delivered reductions in total emissions, but even more could have been achieved if the system had been more flexible, and the prices of the emissions allowances had been higher. A price level of at least 25 – 30 euro is needed to promote innovation and technical development. The Market Stability Reserve may improve the system and lead to higher prices, but the emissions rights that are withdrawn from the market should be permanently withheld and not be back-loaded at a later stage.

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?

The strength of ETS is that it functions in a similar manner in all EU countries, and creates a level playing field for the actors in the sectors included. It is cost-effective and creates incentives to reduce carbon emissions where it is cheapest. A strength is also that it guarantees that a certain reduction target is achieved.

The weakness of ETS is that it gives a varied price on carbon emissions, and therefore also an uncertainty of the benefits of different investments. The price of the emission allowances has been too low to motivate innovation and change, e.g. conversion of boilers from fossil fuels to biomass. The system has an oversupply that puts a pressure on the price level. The total volume of the system must be better related to the demand – the actual emissions.

It is urgent that ETS is supplemented with carbon taxation in all sectors outside ETS. The carbon tax level should be at least at a level comparable to the intended level of ETS, or 25 – 30 euro/tonne CO2. Coordinated price levels on emissions inside and outside ETS will give the most cost-effective reductions of emissions in all sectors.

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?

The most cost-effective climate policy in EU would rely primarily on carbon pricing through a combination of ETS and carbon taxation in sectors outside ETS. That way subsidies for investments could be avoided. Direct subsidies would only be needed for introduction of new technologies with investment support to pilot and demonstration plants. A stronger carbon price signal would also give member states higher revenues that could be redistributed as support for low-income households, and to research, development and full-scale demonstration of low-carbon technologies. ETS has not impacted investments or support for low-carbon technologies, as implied in the question. It is the other way around; overly generous renewable subsidies, like feed-in-tariffs, have impacted ETS in a negative way, and pushed down the price of emission allowances. Multiple targets and overlapping policies in general reduce the overall efficiency and results in higher cost for emission reduction.

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

ETS is one of two major components in EU:s greenhouse gas emission's target. The other being the burden sharing and national goals in the other sectors. While ETS is functioning as a system, although delivering a too low price on emissions, the compliance with national goals for other sectors is reached with different policies and measures in the different EU countries. Some of these measures are based on direct subsidies that may distort the markets. In our view it would be better to harmonize the policies and incentives in these other sectors, preferably through the introduction of a common minimum carbon dioxide tax on all fossil fuels.

For the coming period, 2020 – 2030 EU has set a target of 40 percent GHG emissions' reduction compared to 1990. This may seem like an ambitious target, but it is really only in line with the current trend. The target is more ambitious for ETS (43 percent), than it is for the economy at large (40 percent). This means that the sectors outside ETS, mainly transport, heating/cooling, service sector, industry outside ETS, agriculture, etc, have a much less challenging target. This is not logical, as heavy industry with strong competition on the global market, and risk for carbon leakage, makes up a major part of ETS. The sectors outside ETS, on the other hand are in general not subject to international competition. In our view, the target for the non ETS sectors, and especially for the heating sector, should therefore be more ambitious than the target for the ETS sector. With heating, there is no risk for carbon leakage.

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 value added is that the least costly measures inside ETS will be taken – at least this is the theory – regardless of where in the ETS area this measures will be taken. The system therefore should be the most cost-efficient way to reduce the emissions. As the system is market based it is flexible both when it comes to geography and to technology. This cannot be achieved with national measures only.

A common carbon tax would have a similar effect, putting the same price on equivalent emissions all over Europe. It would therefore also use the forces of the market economy, by internalizing the external environmental cost, primarily the climate cost.

ETS also opens up the future possibility of linkage with other cap-and-trade system, like in North America and China.

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

It is of utmost importance that the system is tightened in a way that the price level of emission allowances will increase. This is important both in order to reach maximum climate effect, to promote change in energy supply (conversion from fossil fuels to renewable energy), promote efficiency, and to guarantee the credibility of the system and public support for EU climate policy.