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Committee on Industry, Research and Energy (ITRE) draft opinion on the proposal for a directive of the European Parliament and of the Council amending Directive 2003/87/EC to enhance cost-effective emission reductions and low-carbon investments

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EFET comments – 18 May 2016

General comments

The European Federation of Energy Traders (EFET[1]) would like to provide its views on the Committee on Industry, Research and Energy (ITRE) draft opinion on the EU ETS reform proposal set by the EU Commission. EFET is firmly convinced that a reformed EU Emission Trading System will deliver the objectives of the EU energy and climate policy and reduce carbon emissions in a cost-effective manner across the whole economy. However, today's reality is that the EU ETS is drastically oversupplied, prompting a prolonged period of low EUA prices. Arguably, the EU ETS now plays a residual role in decarbonisation.

In order to regain the role of the central pillar of EU climate policies going forward, we believe it is crucial to tackle, as a matter of urgency, the current oversupply of allowances, arising from the lack of consistency between the EU ETS as a cap and trade system on one hand, and other climate policies (such as renewable energy, energy efficiency) on the other. Without an ambitious reform and without the progressive removal of the existing surplus of allowances from the market, there is a risk that market confidence will sharply decrease and price signals will collapse to reflect the current oversupply, thus directly threatening the future role of the EU ETS.

We believe that some of the proposals presented in the ITRE text go in the right direction. As set out in our discussion paper published on 18 January 2016[2], EFET remains convinced that **the best means of tackling the current oversupply and return to scarcity is the strengthening of the Market Stability Reserve (MSR)** at the earliest opportunity. We believe that in order to rapidly absorb the surplus, the maximum withdrawal rate should be increased to 33%. This would help to accelerate the extraction rate when it is most needed, but also to slow it down as we get closer to the target.

Below, we have provided our comments to specific points or amendments presented in the ITRE draft opinion.

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[1] EFET, The European Federation of Energy Traders (EFET) promotes and facilitates European energy trading in open, transparent and liquid wholesale markets, unhindered by national borders or other undue obstacles. EFET currently represents more than 100 energy trading companies, active in over 27 European countries. For more information: www.efet.org

[2] 'Tackling overlapping policies with the EU ETS', EFET discussion paper, 18 January 2016

Consistency between EU ETS and other climate policies

EFET is pleased to see that the need of ensuring **consistency between the EU ETS and the objectives set by the Energy Union** is acknowledged in the ITRE draft opinion. In particular, we support the idea under which '*a general review of the interaction between the EU ETS and other climate, air quality and energy policies at European and national level should be conducted regularly, in order to avoid overlapping policies and negative interaction between different instruments*.' Above all, EFET believes that there should be no 'out of market' policies that have the effect of reducing carbon emissions in ETS sectors. We believe that **the governance of the EU ETS should be strengthened** and that Commission should take a more active role in preventing and addressing the distortions caused by overlapping policies. At the very minimum, the EU Commission should make sure that no national policies are approved without being supported by a full impact assessment of their impacts on the EU ETS.

We believe the amendment n.11 proposed by the ITRE Committee goes in the right direction to make Member States more responsible for their actions. In fact, Member States also need to consider the importance of the EU ETS as part of the integrated power market design and of the integrated EU climate and energy policies. There we agree that, at the very least, **Member States should publish an impact assessment of the effects of their policies on the ETS** in order to provide greater transparency of non-ETS national policies.

The provision asking Member States to retire a share of the auctioning volume equal to the related emissions should seek to preserve **market stability and predictability** and needs careful consideration as there are pros and cons. The triggers of such mechanism and the methodology to calculate the equivalent emission reductions should be clearly and fully set ex-ante, in order to avoid unpredictable outward flows of allowances. Moreover, an additional withdrawal mechanism working alongside the MSR should not increase the complexity of the EU ETS. In this context, we believe the transfer of allowances to the MSR could be a less extreme alternative to a complete removal.

Nonetheless, EU policymakers would also need to reflect over the rationale behind the retirement/transfer of these allowances. We recommend that, whether the mechanism does take place to counteract an 'out of market' policy, **the retirement/transfer should be applied to both auctioned and free allowances in proportion to the impact of this policy,** so as to reflect any subsequent reduction in demand for either auctioned or freely allocated allowances. This should prevent over-allocating allowances to receivers of freely allocated allowances and under-allocating allowances to stakeholders who participate in auctions (or vice-versa), as well as any potential cross-subsidization between users of both kinds of allowances.

Full auctioning should be ultimate goal

EFET is pleased to see that the ITRE text recalls **the ultimate goal should be the full auctioning of allowances**. We share the view that free allocation should be considered as a transitional and temporary measure. EFET also strongly supports the position of EU Member States, outlined in the October 2014 Council Conclusions, that **the share of allowances to be auctioned will not be reduced.**

Free allocation should be better targeted

We support a more targeted approach to free allocation, which should be granted only to companies and sectors that are actually threatened by carbon leakage. We fully agree with the solution proposed in the amendment n.25, under which **sectors and sub-sectors with insignificant exposure to the risk of carbon leakage shall not be allocated allowances free of charge** for the period up to 2030.

Unallocated phase 3 allowances should be kept off the market

EFET understands that 150m unallocated allowances will be re-directed to the Innovation Fund. While this is preferable to the option of releasing them to the market via auction or free allocation, our position is that **these allowances should be kept off the market** and are hence cancelled or transferred to the MSR.

An institutionalised review of the cap in line with the Paris Agreement would be beneficial

EFET welcomes the amendments n. 28 and 29 under which the cap and the carbon leakage list should both be reviewed under the Paris stock take and ambition ratchet. EFET believes that the cap review process should be institutionalised in order to reduce the risk of political ‘intervention’ as a ‘quick fix’ in response to unexpected events. This could be done by **moving to shorter trading periods of 5 years,** which would have the clear benefit of improving the ‘accuracy’ of cap setting process. A 5-year period would also be fully aligned with the 5 yearly reviews and submissions of climate pledges requested by the Paris Agreement under the UNFCCC framework.