May 2nd, 2016

KEY PROPOSALS TO STRENGTHEN THE EU ETS IN THE REVISION OF THE DIRECTIVE FOR PHASE 4

Operating in the whole value-chain of the deregulated Nordic and integrated European power market, we three major Nordic energy companies[1] highlight the importance of a predictable, market-based and harmonised EU climate policy.

We are strongly committed to making EU power generation CO_2-neutral by 2050 at the latest. The EU Emissions Trading System (ETS) is a technology-neutral and cost-efficient market instrument to mitigate GHG emissions. However, due to a structurally oversupplied market, resulting in sustained low market prices of ETS allowances, the EU ETS is not incentivising the long-term investments needed for the transition to a low-carbon economy.

On this background, and in the context of the ongoing revision of the EU ETS directive for the post-2020 period we propose ***that a minimum of three immediate actions are incorporated in the revision of the ETS Directive***: strengthen the linear reduction factor (LRF), improve the coherence between the EU ETS and parallel policies, and minimize market distortions from the Innovation Fund and the New Entrants' Reserve (NER).

1. Increase the linear reduction factor

We propose to increase the linear reduction factor (LRF) to at least 2.6% from 2021. While the currently proposed LRF of 2.2% post-2021 is significantly less than what is needed to reach the EU's 2050 climate target, a 2.6 % LRF would establish a predictable trajectory towards the EU's current 2050 climate target, resulting in a 95% reduction in the EU ETS sectors by 2050[2]. A higher LRF also better anticipates a revised EU climate target, which reflects the aspirational goal (1.5 °C) in the Paris Agreement. The earlier the EU ETS is adjusted to reflect long term European climate goals the lower the overall societal costs for reaching the long-term climate target will be, and the more predictability the EU ETS operators and investors will have.

2. Adjust for the impacts of parallel policies in the ETS sectors

We propose that the impacts on the ETS from parallel policies are quantified and that the supply of ETS allowances is adjusted accordingly by placing an equivalent volume of ETS allowances directly into the MSR or by adjusting the EU ETS cap ex-ante. This adjustment should take place before the MSR starts in 2019 and before each subsequent trading period. Further, quantification of the impact of such policies on the ETS has to be made a compulsory element of the Impact Assessment processes.

Such an adjustment would mitigate the impact which parallel EU-level and national policies have on the EU ETS price signal. Those policies result in reduced demand for ETS allowances and increase the oversupply in the EU ETS, thereby weakening the CO_2 price and long-term investment signals. In addition, by increasing the oversupply in the EU ETS, less CO_2 abatement is incentivised in other Member States or other ETS sectors under the legally pre-defined allowance cap.

[1] Our companies represent around 305 TWh of power and around 57 TWh of heat production with an aggregated turnover totalling 25 billion euros per year (2015).
[2] EC 22/01/2014 - SWD(2014) 15 - Impact Assessment (2030 climate & energy framework)

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3. Minimise the distortion of the ETS market balance from the Innovation Fund and the New Entrants' Reserve

We propose that the allowances from the Innovation Fund do not enter the market before 2023 and thereafter evenly throughout Phase 4. A later monetisation of ETS allowances from the Innovation Fund is likely to result in more financial resources to be used for supporting low-carbon innovation projects across the EU. We are concerned that the monetisation of allowances from the Innovation Fund (in total 450 Mt) carries the risk of counteracting the intended effect of the Market Stability Reserve (MSR), thus resulting in further market disruptions. This will be the case if the allowances dedicated for this purpose are to be released at a too early stage, as allowances will be taken away with one hand and returned with the other. Further, we propose that ***the NER for Phase 4 should originate from the Phase 4 cap,*** just as NER allowances for Phase 3 originated from the Phase 3 cap**.** Using 250 million ETS allowances from the previous trading period, which are currently presumed to enter the MSR, and the 150 million unallocated allowances from Phase 3 for the creation of the Phase 4 NER effectively lowers the EU's climate ambition for the fourth trading period.

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