

Warsaw, 10 October 2012

PKEE response to the European Commission's consultation on the review of the auction time profile for the EU Emissions Trading System

http://ec.europa.eu/clima/consultations/0016/index_en.htm

The Commission has invited comments on the draft for a future amendment of the Commission's Regulation No 1031/2010 *on the timing, administration and other aspects of auctioning of greenhouse gas emission allowances pursuant to Directive 2003/87/EC* (hereinafter: **ETS Directive**) of the European Parliament and of the Council establishing a scheme for greenhouse gas emission allowances trading within the Community (hereinafter: **Auctioning Regulation**). This provides for an auction time profile change (hereinafter: **backloading**) in the EU Emissions Trading Scheme phase III (2013-2020). The following is the Polish Electricity Association's (hereinafter: **PKEE**) response to the Commission's consultation.

1. Backloading proposal - fundamental concerns on keeping the integrity of the EU ETS

In the opinion of PKEE, the backloading proposal is not justified given the current state of the EU ETS. The system is working well and delivering the necessary reductions in the most cost-efficient manner. The primary principle of the Emissions Trading Scheme is to find the cheapest way to reduce emissions. Maintaining the required reduction trend will be further assured by establishing an EU-wide cap as of January 2013 which will be met allowing Europe to achieve the targets set out for 2020 cost-efficiently.

The lower the CO₂ price while staying within the cap, the more cost-efficiently the system works – this is an ideal situation from an economic perspective. Therefore, artificial measures aimed at increasing CO₂ prices to introduce uncompetitive technologies are not justified when assessed through the prism of economics, particularly in the times of economic crisis.

In sum, the primary objective of the ETS is to deliver reductions of greenhouse gas emissions in a cost-effective and economically efficient manner¹. Furthermore, the backloading proposal depreciates the concept of ETS being a market-based mechanism. We perceive the backloading proposal as a first step to centralized steering of the ETS through institutional intervention when prices are perceived to be too low. This measure will increase volatility of this market and will add even more uncertainty for stakeholders, while its impact on actual prices is difficult to foresee. In the European Commission's proposals we find no specific definition on what basis such intervention would be deemed justified, as the terms

¹ Article 1, Directive 2003/87/EC.

“exceptional circumstances” and “when appropriate” are quite vague and can be interpreted in many ways.

Finally, we find no justification for the argument that low CO₂ prices discourage investments in low-carbon power generation technologies. In last year alone when the carbon price hovered around EUR 10/t ca. 20 GW of new RES capacity came on board in the European Union. Therefore other mechanisms such as support schemes for renewables and energy efficiency measures can work complementarily with the EU ETS to reduce the impact of industry on environment while keeping the costs bearable for industrial producers.

2. Legal concerns associated with backloading

In the opinion of PKEE which is supported by a legal analysis, the ETS Directive 2003/87/EC does not allow to use the Auctioning Regulation, negotiated through the comitology procedure, as a tool for carbon market intervention and for boosting the EUA price. Despite the fact that the European Commission claims backloading will not influence the carbon price, it will do so. Moreover, it is a measure intended to precede a permanent withdrawal of EUAs from the market, so it is a stepping stone towards serious distortions on the balance between the supply and demand on the market and possible cancelations of backloaded allowances between trading periods.

The ETS Directive is a legislative act adopted by the *ordinary legislative procedure*, therefore it contains an explicit provision under which the European Commission is empowered to adopt a delegated act, supplementing or amending certain **non-essential** elements of the legislative act². Article 10, paragraph 4 of the ETS Directive refers to the adoption of the Auctioning Regulation to ensure that it is conducted in an open, transparent, harmonized and non-discriminatory manner.

An in-depth legal analysis of the backloading proposal leads to the conclusion that **it is an essential amendment of the ETS Directive because it distorts the linear cap reduction rate of 1,74% set out in the Directive. The draft amendment of the Auctioning Regulation should therefore, be regarded as contrary to Article 290 of The Treaty on the Functioning of the European Union.**

It is also not in line with the *transparency* and *predictability* principles laid down in Article 10 (4) of the Directive with regard to the auctioning procedure. This is due to obvious disruptions in liquidity of the market due to irregular auctioning schedule.

Thus, a Union-wide number of EUAs that is going to be auctioned is already fixed by binding EU law and Member States are obliged to auction all allowances that are not allocated free of charge and must not hold back or cancel any of them. We see no basis for proposed modifications without changing essential elements of the Directive.

In consequence, the intervention proposed by the EC requires essential changes in the ETS Directive itself. PKEE believes that the EC proposal for a Decision amending the ETS Directive needs further clarification from a legal perspective and additional impact assessment is required in terms of the result of backloading on CO₂ prices.

In particular we seek more guidance clarifying the circumstances under which the EC will use the possibility to change the auction time profile:

- Definition of i) “exceptional circumstances [of] artificial and largely temporary imbalances between supply and demand”; ii) “as appropriate”, iii) “orderly functioning of the market”, iv) the objectives of “a smooth transition” between trading periods and v) “a steadier price signal”

² Article 290, The Treaty on the Functioning of the European Union

as well as answer for the following questions:

- Which essential element of the carbon market will be fixed by the backloading proposal other than EUA price?
- How, and based on which criteria, will the EC assess the volume of EUAs to be backloaded?

Despite the fact that the EC claims backloading might not influence the carbon price, in the opinion of PKEE it will due to fluctuations in the supply/demand ratio.

In documents accompanying the backloading proposal the EC did not analyse the impact on EUA prices. It is not clear what volume of allowances the EC would like to see backloaded which also makes it difficult to comment on the proposal.

Therefore PKEE opposes the concept of backloading as presented and asks the EC to clarify its methodology and provide stakeholders with an in-depth impact assessment of EUAs price volatility caused by the proposed intervention as well as present planned structural measures to the ETS in a broader scope.