EURACOAL
European Association
for Coal and Lignite
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EURACOAL Position Paper

on the "back loading" of auctioning and "set aside" of allowances under the EU Emissions Trading Scheme (ETS) and why the Commission's proposal must be rejected or amended

Introduction

The Commission proposes to amend the ETS Directive[1] and the ETS Auctioning Regulation[2] to "back load" the Phase 3 auctioning of EU ETS allowances and thus ensure "an orderly functioning of the market"[3,4]. In EURACOAL's position paper dated 29 September 2012, submitted in response to DG Climate Action's public consultation, we explain why the Commission's proposal should be rejected. Here, we further explore the legality of back loading and propose an important amendment to the Commission's proposal.

Legal aspects of EU climate policy

In April 2002, the European Council agreed that the European Union would meet its Kyoto Protocol commitments by the joint and collective efforts of Member States.[5] This was the starting point for a number of policies with two key measures which were agreed as part of the EU climate and energy package of 2008:

- a strengthening of the EU Emissions Trading Scheme[1]; and
- the so-called effort-sharing decision[6].

Under the climate and energy package's 20-20-20 targets, the 20% greenhouse gas (GHG) emissions reduction target, compared with emissions in 1990, was split between ETS sectors (with a 21% reduction on 2005 emissions) and non-ETS sectors (a 10% reduction).

Any tightening of the emissions reduction target over and above 20% is subject to the conclusion of an international agreement on climate change and on an accompanying legislative procedure to amend the ETS Directive and to renegotiate the effort-sharing decision.[7]

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[1] 2003/87/EC as amended by 2009/29/EC

[2] Commission Regulation No. 1031/2010

[3] COM(2012) 416 final

[4] Draft Commission Regulation amending Regulation (EU) No. 1031/2010 in particular to determine the volumes of greenhouse gas emission allowances to be auctioned in 2013-2020 (DG CLIMA, 12 November 2012)

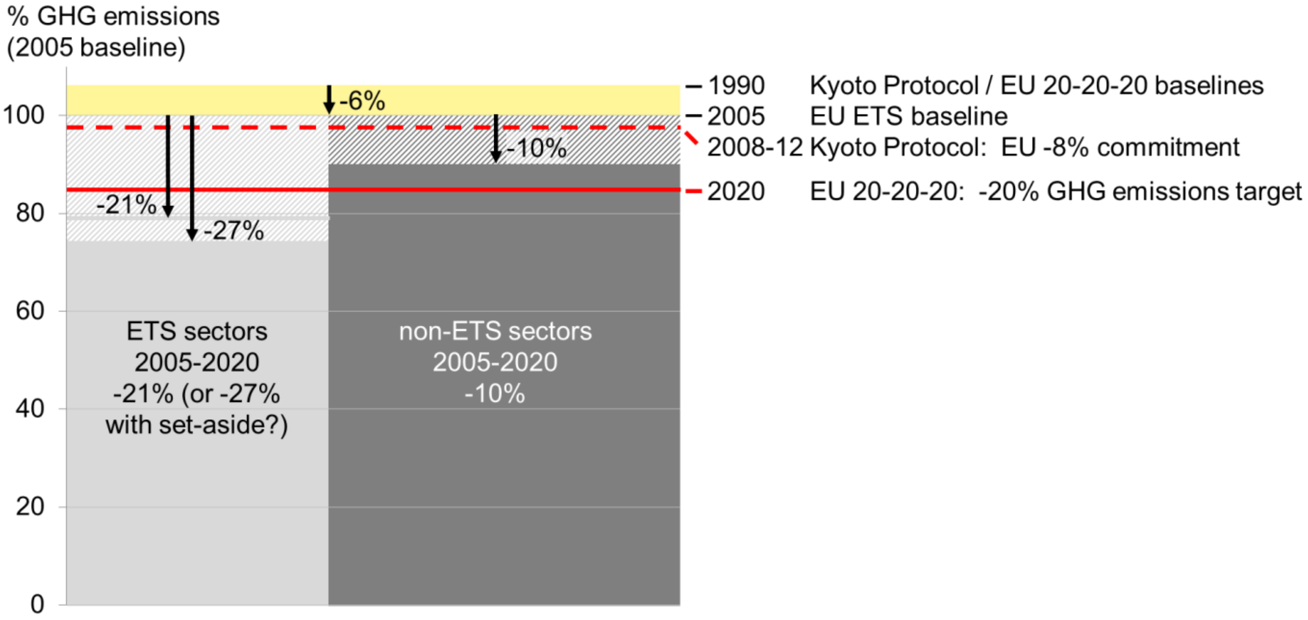
[5] 2002/358/EC

[6] Decision No. 406/2009/EC of the European Parliament and of the Council of 23 April 2009 on the effort of Member States to reduce their greenhouse gas emissions to meet the Community's greenhouse gas emission reduction commitments up to 2020

In assessing the Commission's proposals, it is important to understand that changing the emissions reduction target is not possible by a simple amendment to the Auctioning Regulation. The Commission recognises this since it is initially only planning to delay the auctioning of 900 million allowances, thus temporarily removing them from the market. However, behind this "back loading" proposal is the expectation that the Commission will permanently reduce the number of CO_2 emission allowance available in the EU ETS market through new structural measures. Already, possible "set-aside" measures have been announced in a report on the EU ETS published by the Commission ahead of schedule.[8]

The set aside of 900 million allowances in Phase 3 of the EU ETS would correspond to about 6% of the available ETS allowances. Already, the 21% reduction imposed on the ETS sectors makes a disproportionate contribution to the 2020 target. Setting aside 900 million allowances would see this increase to a reduction of approximately 27% from the 2005 baseline, as illustrated in the chart below. Compared with the Kyoto Protocol's 1990 baseline, this would be a reduction of approximately 33% – far exceeding the 8% that the EU has committed to achieve.

Figure 1 – GHG emissions reductions in the EU



Conclusions on the Commission's proposal

The Commission's proposals to amend the ETS Directive and the Auctioning Regulation to temporarily withhold allowances from the market raises important economic questions. The ETS has

[7] See Article 8 in Decision 406/2009/EC and Article 1 and Article 28 in the Directive 2009/29/EC.

[8] Report from the Commission to the European Parliament and the Council, "The state of the European carbon market in 2012", COM(2012) 652 final – *n.b.* in the ETS Directive, this report was scheduled for the first year of Phase 3 (*i.e.* 2013), but the Commission chose to issue the report ahead of schedule

proven to be cost-effective and economically efficient, as required by Article 1 of the ETS Directive. Indeed, it has to an extent compensated for the difficult economic situation in the EU by lowering the cost of carbon at a time when any additional cost burden would be unwelcome. Europe faces historically high energy prices and economic recovery could be jeopardised if the Commission were to intervene in the ETS market to raise allowance prices.

To provide legal certainty, it should be made clear in any amendment to current legislation that any allowances withheld in the years 2013 to 2015 would be permanently withdrawn from the market only if all necessary conditions under the ETS Directive and the effort-sharing decision were met – in particular, the conclusion of an international agreement on climate change – and only if a specific procedure for amending the ETS and the effort-sharing agreement were in place.

A proposed amendment to Commission's proposal

To ensure that allowances are not permanently withdrawn from the market without following due legal process, the scope of the Commission's proposed amendment to the ETS Directive needs to be explicitly stated. To this end, EURACOAL proposes that additional text is added to Article 1 of the Commission's current proposal as follows:

Text proposed by the Commission in COM(2012) 416 final to amend the ETS Directive	*Amendment*
Article 1	*Article 1*
In the first subparagraph of Article 10(4) of Directive 2003/87/EC the following sentence is added:	In the first subparagraph of Article 10(4) of Directive 2003/87/EC the following sentence is added:
"The Commission shall, where appropriate, adapt the timetable for each period so as to ensure an orderly functioning of the market."	"The Commission shall, where appropriate, adapt the timetable for each period so as to ensure an orderly functioning of the market. ***Any adjustment of the timetable by the Commission shall not reduce the total number of allowances auctioned in each trading period unless the conditions referred to in Article 1 and Article 28 of this Directive and under Article 8 of Decision 406/2009/EC of the European Parliament and the Council of 23 April 2009 are met.***"

10 December 2012