EURACOAL
European Association
for Coal and Lignite
AISBL

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EURACOAL Position Paper

on reform of the EU Emissions Trading System: *walking a fine line* (2015/0148(COD), rapporteur: MEP Ian Duncan)

Executive Summary

In light of the EU Emissions Trading System (EU ETS) reform, EURACOAL welcomes the Commission proposal of July 2015. It is for the most part a balanced, medium-term legislative proposal that takes into account the current economic realities in Member States. While the coal industry believes that the proposed reforms could have focused more on affordability and the security of energy supply, we consider that the Commission proposal is a good starting point for discussion.

EURACOAL firmly believes in a market-based approach to reduce greenhouse gas emissions, such as the EU ETS. The single European cap ensures that climate policy targets are achieved. The price follows from the target and reflects the cost of CO_2 reduction. If the price of allowances is low, then this means that the CO_2 reduction target has been achieved at a low cost – a good outcome.

Calls for a particular "carbon price" would result in the need to frequently change the cap. This would undermine the ETS as a market-driven trading scheme.

The coal industry is strongly against an EU or any national tax schemes super-imposed over and above the ETS. Such schemes weaken the EU's internal market and have led to major distortions in the power system.

EURACOAL presents below several points where we consider that improvements could be made, namely the Modernisation and Innovation Funds, the Market Stability Reserve, international credits, the free allocations for projects in eligible Member States and for district heating / CHP, the distribution between auctioning and free allowances, allowance fungibility and the New Entrants Reserve.

Introduction

In the very first article of the ETS Directive, it states that the scheme is established *in order to promote reductions of greenhouse gas emissions in a cost-effective and economically efficient manner* (2003/87/EC). According to the European Environment Agency, GHG emissions were already 19.8% below 1990 levels in 2013, almost reaching the 20% reduction target set for 2020 (EEA Report No. 4/2015). With the current measures in place, EEA projects a GHG reduction of 24% below 1990 levels by 2020. On the one hand, this shows that the EU ETS is a functioning mechanism, delivering its task. On the other hand, the GHG reduction also

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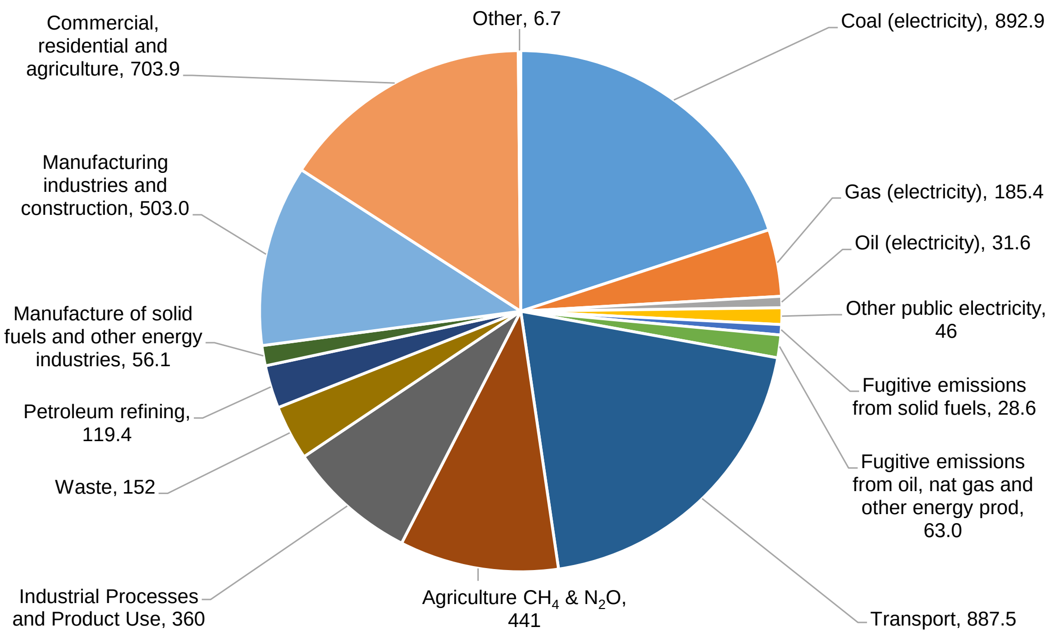
reflects the ongoing economic crisis since 2008 and shows that the policy focus should be on creating an investment-friendly framework to boost economic growth. Looking to future GHG reductions, it is important to note that the low-hanging fruits, from the power and manufacturing sectors, are already picked.

The Paris Agreement is an opportunity for European coal and power sectors to use their experience and expertise in environmental protection and GHG emission reduction in those countries that have a growing demand for coal. In 2013, electricity generation from coal had a 41% share of the electricity market worldwide.[1] A 10% growth in total coal use is projected to 2040, largely due to a near tripling of coal demand in India and in Southeast Asia.[2] European industry has a strong record of reducing emissions from coal-fired power plants, having some of the world's most efficient lignite and hard coal power plants. The CO_2 emissions from these plants, per unit of electricity generated, can be as low as one half of those from the world's least efficient plants.

EU28 greenhouse gas emissions by source category in 2013: 4 477 $MtCO_2$-eq total



Source: Annual European Union greenhouse gas inventory 1990–2013 and inventory report 2015, EEA

Current status

The EU ETS covers about 42% of all EU GHG emissions (1 882 $MtCO_2$-eq out of 4 477 $MtCO_2$-eq), according to the latest (2013) data from the European Environmental Agency.[3] Burning coal, gas and oil for power generation represents 1 109 $MtCO_2$-eq,[4] so

[1] *Key World Energy Statistics 2015*, International Energy Agency, Paris, OECD/IEA, 2015.

[2] *World Energy Outlook 2015*, International Energy Agency, Paris, OECD/IEA, 2015.

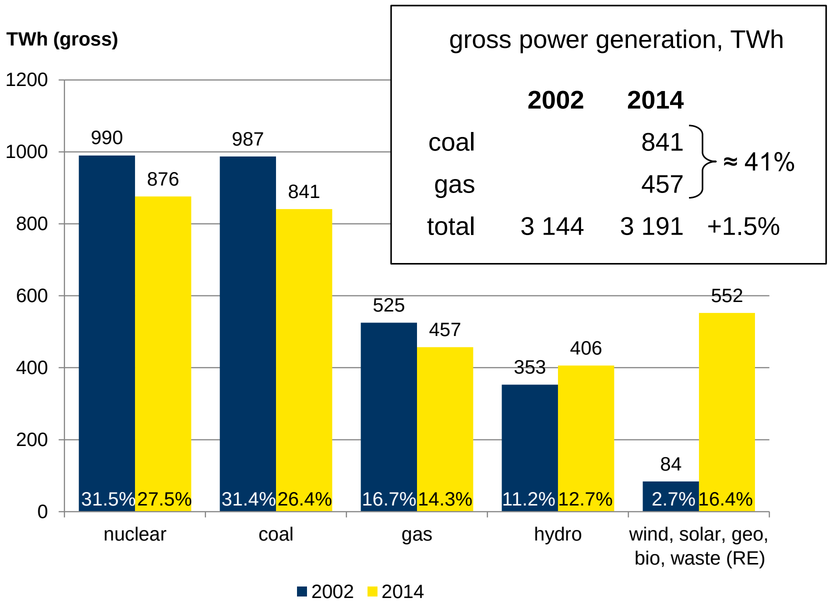
[3] EU Emissions Trading System (ETS) data viewer and the *Annual European Union greenhouse gas inventory 1990–2013 and inventory report 2015*, p.x, EEA.

[4] *European Union Greenhouse Gas Inventory 2015*, Annex 4: EU CRF tables, Table1.A(a)s1, EEA.

59% of EU ETS or around 25% of all EU emissions, providing about 42% of EU electricity. The EU emits around 10% of global GHG emissions, so EU fossil fuel-fired power generation contributes about 2.5% to global anthropogenic GHG emissions. EU policy should focus on power plant modernisation while avoiding carbon leakage and fuel switching. Neither fuel switching nor losing the EU's industrial base are viable, long-term solutions to achieve the climate objectives nor prosperity aims of the Union.

When it comes to the production of electricity, one could get the impression that the EU has a balanced mix of primary energy sources. The reality is that Member States have preferences for different generation technologies, based on their available natural resources and public acceptance. The clearest example is nuclear, with France fully embracing the technology while its neighbour, Germany, is phasing it out.

A comparison of the electricity generation mix for EU28 Member States in 2002 and 2014



Source: Supply, transformation and consumption of electricity – annual data, Database nrg_105a, Eurostat (last updated 28 January 2016)

There is a similar situation with coal; some Member States are embracing clean coal technologies, while others are phasing out of coal. The reasons for phasing out of coal and nuclear are similar: fear of catastrophic events that could jeopardise an entire country or even the world. However, the nuclear phase out in Germany is not creating pressure for a nuclear phase-out in France, although an accident in France would certainly affect Germany.

Therefore, the Commission and other Member States should not pressure those Member States who rely on coal, as is currently the case. The alarming results are an increasing polarisation of public opinion and a perceptible alienation between some Member States and the EU institutions, as noted by President Juncker when he met with the Prime Minister of Italy on 3 May 2016 in Rome.

ETS reform and EURACOAL recommendations

Modernisation Fund investment decisions

The Modernisation Fund (Art. 10d) is a vital source of funds for the modernisation of the electricity system in eligible Central and Eastern Member States. However, the investment decision-making process should be reconsidered, because it limits significantly the power of the ten beneficiary Member States. A project is approved with at least 8 out of 15 votes, 2 being held by the Commission and the European Investment Bank (EIB), and 3 by non-beneficiary Member States. However and very importantly, if the EIB opposes a project, then 10 out of 13 votes are needed. So even with unanimity among beneficiary Member States, a project may fail as the beneficiary Member State and EIB cannot vote.

This Commission proposal goes against Article 2.7, paragraph 4 of the October 2014 Council conclusions, which explicitly states that, "the reserve will serve to establish a fund which **will be managed by the beneficiary Member States** [our highlight]".

EURACOAL is in line with EURELECTRIC's position (November 2015) and the common position of Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania and Slovakia (March 2016) on this topic and proposes to respect the Council conclusions where there is no mention of the Commission and other non-beneficiary Member States. Furthermore, EURACOAL supports the provision added by the Member States' common position that, "the investments suggested by applicants for financing from the Fund shall be put forward by the beneficiary Member States".

EURACOAL does not agree with Italy's position paper on this topic. The EIB energy sector lending criteria, published in July 2013, would mean that, in practice, no Modernisation Fund investments could be made in modernising coal-fired plants. This would seriously hinder the liberty of Member States to choose their own energy mixes. Furthermore, we disagree that the composition of the Investment Board is unbalanced towards beneficiary Member States, given what was agreed in October 2014. Finally, Italy's opinion that the Modernisation Fund should be primarily in the form of guarantees on loans, not grants, is in contradiction with the purpose of the fund, which is, as described in the Council conclusions, "to address particularly high additional investment needs in low income Member States".

EURACOAL Recommendation

Respect the October 2014 Council conclusions and eliminate the presence of the Commission and other Member States in Modernisation Fund investment decisions.

Innovation Fund project eligibility

The eligible criteria for the Innovation Fund include only capture and geological storage (CCS) of CO_2 and innovative renewable energy technologies. These objectives narrow significantly the range of eligible projects, leaving out other technologies that reduce GHG emissions, such as energy efficiency, flexibility and carbon capture and use (CCU). High efficiency is a bridge to CCS and higher flexibility can help to increase the penetration of renewable generation technologies.

EURACOAL is in line with the positions of BUSINESSEUROPE (February 2016), the UK (November 2015), Italy and partly EURELECTRIC (November 2015), who all express a widening of the eligibility criteria to include energy efficiency. While availability of financing for CCS is welcomed, there is little public acceptance for the technology, which significantly hinders investment decisions and therefore deployment of CCS. EURACOAL strongly suggests that CCU should be included as well, alongside energy efficiency savings and flexibility, which would incentivise coal-fired power plants to reduce and monetise CO_2 and give the EU credibility as a global leader in the fight against climate change with smaller, but viable projects.

Furthermore, EURACOAL fully supports the positions of the UK and EURELECTRIC in asking for the allowances to come from the “free” allocation share, and not from the “auction” share.

Finally, EURACOAL disagrees that dedicated lines are needed for each Annex I sectors in the ETS Directive, as called for by some. This provision would significantly reduce competition between bidders.

EURACOAL Recommendation

Widen the eligibility criteria for projects to include CCU, energy efficiency and flexibility. Allowances for the Fund should come from the “free” allocation share.

Market Stability Reserve

The Emission Trading System has seen already two major overhauls, in the form of the backloading of 900 million allowances in 2014 and the creation of the Market Stability Reserve (MSR) in 2015. The current Commission proposal will change again, for a third time, the number of allowances available on the market, by taking allowances out of the MSR. Even though it is not yet in place, allowances from the MSR are being earmarked for the New Entrants Reserve (250 million) and for the Innovation Fund (50 million).

The predictability of the ETS is being jeopardised by the continuous tinkering with the system. Investment planning is impossible because of rule changes made every year or so, leading to a significant increase in risk and consequently, to a lack of much-needed investment in the EU power sector.

EURACOAL agrees with the UK position (November 2015) which finds it essential that the integrity of the MSR is maintained and EURELECTRIC (November 2015) which argues that allowances from the MSR should not be auctioned for any other reason than as explicitly stated in the Directive.

EURACOAL Recommendation

The integrity of MSR should be maintained, no allowances should be put on the market except as agreed when setting up the reserve.

International credits

EURACOAL notes the specific provision in the current ETS Directive which states that no international credits can be used beyond 2020 and understands that the proposal of the Commission would delete the respective articles (Art. 11a(8) and Art. 11a(9)).

However, EURACOAL believes that the spirit of EU climate policy and of the ETS Directive is *to allow* a link with other international carbon markets, "once an international agreement on climate change has been reached, only credits from projects from third countries which have ratified that agreement shall be accepted in the Community scheme from 1 January 2013." (Art. 11a(7)).

EURACOAL agrees with the Commission proposal to "include provisions to put into effect rules on the mutual recognition of allowances in agreements to link emission trading systems." (Art. 19(3)) and urges the Commission to link the ETS with other carbon markets. International credits could have a dramatic influence on the ability of the EU to meet its tough climate targets in a cost-effective manner.

The coal industry joins therefore the positions of EURELECTRIC (November 2015) and IETA (January 2016) in urging the Commission to include international credits as part of the efforts to develop carbon markets globally.

EURACOAL Recommendation

The European Commission should enable the ETS to be linked with other carbon markets around the world to help develop a global market.

Free allocations for projects in eligible Member States

EURACOAL welcomes the Commission proposal to support eligible Member States with free allocations for particular projects (Art. 10c). This measure will significantly assist eligible Member States to finance improvements to environmental protection and to reduce emissions. There are parts of the article, however, that can be improved.

Firstly, the current approach to investments through national investment plans was a success and should be continued. The bidding process proposed by the Commission could be complementary to the national investment plans, but the beneficiary Member States should have control of the investments with a transparent allocation of funds. Although we understand the political agreement on the 40% auctioning share, the coal industry raises the issue that the number of allowances available might be insufficient for large projects.

Secondly, EURACOAL suggests increasing the threshold for projects to €50 million so that projects having a material impact might be financed. Moreover, larger investment projects have more difficulties to find finance than smaller ones, so a higher threshold would address a real challenge in environmental protection.

Finally, the coal industry suggests scrapping the 30 June 2019 deadline for project proposals in order to allow more flexibility and more time for analysis by prospective investors. On this topic, EURACOAL is largely in line with the EURELECTRIC position (November 2015).

EURACOAL Recommendation

The beneficiary Member States should have control over project investments. The threshold for projects should be increased to €50 million, to allow larger projects with greater impact to be financed. The 30 June 2019 deadline for project proposals should be removed to allow investors more flexibility.

Free allocation for district heating / CHP

EURACOAL joins EURELECTRIC's call to the Commission to clarify if the allowances will come from the "auctioning" share (57%) or the "free" share (43%). The coal industry strongly suggests that the allocation of allowances for district heating (Art. 10a.4) should be from the "free" share.

EURACOAL Recommendation

The allocation of allowances for district heating / CHP should be clarified and come from the "free" allocation share (43%).

Distribution between auctioning and free allowances

The Council conclusions of October 2014 make a clear reference to the distribution of allowances into an "auctioning" share (57%) and a "free" share (43%). The coal industry has first-hand experience of the difficulties arising from the extra costs related to carbon emission allowances and the resulting loss of industrial competitiveness. There is also the problem of indirect costs of higher electricity bills that should be addressed.

It is very tempting to hope for a free allocation of allowances. However, a change towards a larger free allocation share would only create an opportunity for rent-seeking in the EU and an ever-present argument from our industrial competitors that the EU is not really serious about climate change, preferring to put ever-more burdens on the power sector alone.

EURACOAL joins the call from the common position of the UK, France, the Czech Republic and Slovakia (October 2015), the UK position paper (November 2015) and EURELECTRIC position paper (November 2015) not to decrease the share of allowances auctioned on the open market.

EURACOAL Recommendation

Do not decrease the share of allowances auctioned on the open market.

Allowance fungibility

EURACOAL welcomes the Commission proposal for allowances issued from 1 January 2013 onwards to be valid indefinitely (Art. 13). From this perspective, it is disturbing that the Commission proposes to date stamp allowances from 2021. This might be a sign that the Commission is reserving the option to cancel old allowances at some point in the future, which would seriously affect the trading scheme as a market in a fungible right. Previous date stamping of allowances made sense, in the first trading period, due to the immaturity of the ETS. However, there is no need for such tagging in 2021, thirteen years after trading began.

EURACOAL Recommendation

Eliminate the date stamping of allowances.

New Entrants Reserve

The latest ENTSO-E *Yearly Statistics & Adequacy Retrospect 2014* report shows a remaining capacity margin of below the 20% threshold considered safe, hitting a low of 14% in November 2014.

Reliable backup capacity is needed in the system. However, new conventional capacity is hindered by the need to surrender allowances. In order to boost new projects and encourage investment, the New Entrants Reserve should be available for the power sector.

While we understand the political context behind the current ETS Directive, capacity margins have lowered in recent years, with insufficient new investment anticipated because of low wholesale electricity prices. This is why EURACOAL recommends deletion of the paragraph, “No free allocation shall be made in respect of any electricity production by new entrants” (Art. 10a.7).

EURACOAL Recommendation

Remove the paragraph “No free allocation shall be made in respect of any electricity production by new entrants” (Art. 10a.7).

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