VERBAND KOMMUNALER UNTERNEHMEN e.V.

POSITION PAPER

on the European Commission's legislative proposal to reform the Emission Trading Directive for the period beyond 2020

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The Verband kommunaler Unternehmen (VKU) represents over 1,400 local utilities in Germany in the sectors of energy, water/waste water and waste management. With over 245,000 associated employees, the members of VKU achieved a turnover of over 110 billion euros in 2012, in which year they also invested over 8.6 billion euros. In the end-customer segment, the VKU's member companies have a market share of 46 percent in electricity, 59 percent in natural gas, 80 percent in drinking water, 65 percent in heating supply and 26 percent in waste-water disposal. They also dispose of 31,500 tonnes of waste each day and make a vital contribution towards ensuring the highest recycling rates in Germany compared to any other EU member state with some 65 percent.

Verband kommunaler Unternehmen e.V. · Invalidenstraße 91 · 10115 Berlin
Fon +49 30 58580-0 · Fax +49 30 58580-100 · info@vku.de · www.vku.de

DSB Partner der Olympiamannschaft DEUTSCHLAND

DIE KOMMUNALEN UNTERNEHMEN

Introduction

The European Emission Trading System (ETS) is the EU's main climate policy tool and is designed to ensure that the installations it covers reduce their emissions every year in line with the abatement path. However, some uneven developments have meant that emission trading does not provide an incentive to invest in low-emission technologies at present. There are currently 2.3 billion surplus certificates. Certificates cost around EUR 8 per tonne of CO_2.[1] With the Market Stability Reserve (MSR), the European Union intends to set up a mechanism for reducing this surplus. The European Commission has also put forward a legislative proposal for reforming the ETS for the period beyond 2020.

If emission trading is to act as any kind of incentive, certificates have to be in short supply and this scarcity has to be expected to last for some time. Neither has been the case so far. The reform of the emission trading system must therefore find a way to ensure the long-term scarcity of supply and make emission trading more adaptable to changes in the underlying conditions. Any factors or exemptions that could hinder efforts to deliver reform also need to be scrutinised.

Ensuring long-term scarcity of supply – Making emission trading more adaptable

This Emission trading reform should make the system more resistant to external shocks, like the financial crisis and sluggish economic growth among factors that have contributed significantly to the surplus certificate stocks we are seeing today.

The VKU sees the MSR as another important step forward towards making the ETS more adaptable in the long term. The MSR will skim off surplus certificates once a certain threshold is exceeded and return certificates to the market once the level falls below another specific threshold.

The decision on the MSR planned to transfer unallocated allowances to the reserve is particularly promising as far as the VKU is concerned. Preventing unallocated allowances from remaining on the market would allow surplus stocks to be reduced more quickly.
When deciding on the MSR, the Commission was asked to suggest how these unallocated allowances might be utilised.
Under the legislative proposal, 250 million certificates would be transferred from the MSR into an industry reserve for new and growing facilities, while 50 million from the unallocated allowances would go to an innovation fund for industry (developed out of the current NER300 programme). In addition, all certificates that have not been freely allocated by 2020 are also to be added to the reserve for new and growing facilities.

[1] EEX (13.08.2015)

Unlike the procedure originally envisaged, the VKU does not believe that this plan will help to reduce surplus stocks or make emission trading an incentive promoting energy efficiency or environmentally sustainable investment. This is because unallocated allowances that should really be taken off the market will actually be returned to it, and certificates that are clearly not required will be carried forward into the next trading period.
The VKU is therefore in favour of the unallocated allowances remaining in the MSR and the certificates that have not been allocated by 2020 being either cancelled or transferred to the MSR as well.

Furthermore, it will also be necessary to clarify what should happen if the reserve keeps on growing. The VKU is requesting that, in this case, the certificates be cancelled from the reserve after a certain period of time. This period of time must be long enough to make sure that the certificates really are surplus to requirements.

Modifying the conditions underlying emission trading

One reason for the build-up of surplus certificates has been the weak economic trend in Europe, while another has been the various too extensive exemptions and alternatives to participating in emission trading. These exemptions could continue to prevent emission trading from acting as an incentive in the future. The VKU is therefore advocating a change in these underlying conditions.

a) Utilising credit from climate protection projects

One reason for the surplus stocks in emission trading is the use of credit gained from climate projects. The Clean Development Mechanism (CDM) allows Annex I countries[2] to carry out or finance climate protection projects in developing countries. The Annex I country can use the units saved via the project (known as Certified Emission Reductions or CERs) as credit towards its Kyoto target. The intention is for developing countries to be supported in creating a climate-friendly economy while reducing emissions where this can be done most cost-effectively. In August 2015, a CER cost no more than 44 euro cents,[3] making the CDM a low-cost way for a country to meet its energy-saving obligations.

Projects undertaken under the Clean Development Mechanism generate new certificates, thus effectively inflating what was already a rather unambitious cap. The

[2] Annex I countries: the Framework Convention on Climate Change distinguishes between two groups of countries, industrialised and developing ones. The former are listed in Annex I to the Convention.
[3] EEX (13.08.2015)

VKU therefore welcomes the fact that this option is no longer available in the fourth trading period.

b) Industry: carbon leakage regulations and free allocations

To prevent the European industry from being handicapped compared with its international competition, the policy of free allocations for industry should be continued as a basic principle. This will be necessary for as long as no comparable systems to the ETS exist at international level. Nevertheless, free allocations must remain the exception rather than the rule.

Under the European Commission's legislative proposal, the carbon leakage list would be cut from 177 to 50 sectors and the benchmarks for free allocations updated. Although the VKU welcomes these changes in principle, exactly what form they will take in practice remains to be seen.

The VKU is critical of the Commission's decision to give Member States the option of using auction proceeds to help offset indirect CO_2 costs via electricity prices. The ETS is a tool to facilitate climate protection. Auction proceeds should therefore go towards climate protection projects and investments in renewable energies and energy efficiency as well as serving the common good.

In Germany, funding for offsetting indirect CO_2 costs via electricity prices is drawn from the Energy and Climate Fund (EKF), which itself is designed to be financed mainly from the ETS. However, due to the low cost of certificates, it is currently being propped up with subsidies from Germany's federal budget. The EKF is intended primarily to finance initiatives connected with energy efficiency, renewable energies, energy storage, etc. This gives rise to a situation that runs counter to the principle of emission trading, namely that climate protection measures are not actually being paid for out of the proceeds of emission trading but are in fact being financed predominantly from the public budget.

As a basic principle, exemptions and special circumstances for industry but also, for example, for economically weaker Member States cannot be allowed to impose ever greater burdens on other participants covered by the ETS.

c) Involving more sectors in emission trading

The VKU welcomes the intention to increase the linear reduction factor for the maximum permitted emissions from 1.74 to 2.2 per cent. However, the association is concerned that the increased reduction factor and an ambitious application of the ETS will lead us much more quickly to situations in which neither the energy sector nor industry in general will have any more scope left for cutting their emissions. Producing

and generating energy gives rise to emissions that, above a certain level, it will only be possible to reduce by shutting down power stations or production facilities.

For this reason and to promote a fair and economically viable distribution of the burden, more sectors should be included in emission trading.