STRATEGY & CORPORATE AFFAIRS

EU ETS Presentation 2015: Policy Perspectives on EU ETS

7 September 2015

 Customers Executive Policy and Regulation Update © February 2015 EDF Energy plc. All rights Reserved

European Union Emissions Trading Scheme (EU ETS) 2005- 2015

Introduction

- The EU emissions trading system (EU ETS) is a cornerstone of the European Union's policy to combat climate change and its key tool for reducing industrial greenhouse gas emissions cost-effectively. The first - and still by far the biggest - international system for trading greenhouse gas emission allowances, the EU ETS covers more than 11,000 power stations and industrial plants in 31 countries, as well as airlines.
- Covers around 45% of the EU's greenhouse gas emissions

History of EU ETS

- Launched in 2005, the EU ETS is now in its third phase, running from 2013 to 2020. A major revision approved in 2009 in order to strengthen the system means the phase 3 is significantly different from phases 1 and 2 and is based on rules which are far more harmonised than before.

The main changes are:

- A single, EU-wide cap on emissions applies in place of the previous system of national caps;
- Auctioning, not free allocation, is now the default method for allocating allowances.
- **300 million allowances set aside in the New Entrants Reserve** to fund the deployment of innovative renewable energy technologies as well as carbon capture and storage through the NER 300 programme.

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Greenhouse gases and sectors included

- While emissions trading has the potential to cover many economic sectors and greenhouse gases, the focus of the EU ETS is on emissions which can be measured, reported and verified with a high level of accuracy.

- **The system covers emissions of carbon dioxide (CO_2) from power plants, a wide range of energy-intensive industry sectors and commercial airlines.**

- **Participation in the EU ETS is mandatory for companies operating in these sectors**, but in some sectors only plants above a certain size are included. Governments can exclude certain small installations from the system if fiscal or other measures are in place that will cut their emissions by an equivalent amount.

- The EU ETS covers CO_2 emissions from flights within and between countries participating in the EU ETS. International flights to and from non-ETS countries are also covered.

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A 'cap and trade' system

- The EU ETS works on the 'cap and trade' principle. A 'cap', or limit, is set on the total amount of certain greenhouse gases that can be emitted by the factories, power plants and other installations in the system. The cap is reduced over time so that total emissions fall.

- Within the cap, companies receive or buy emission allowances which they can trade with one another as needed. They can also buy limited amounts of international credits from emission-saving projects around the world. The limit on the total number of allowances available ensures that they have a value.

- After each year a company must surrender enough allowances to cover all its emissions, otherwise fines are imposed.

- **By putting a price on carbon and thereby giving a financial value to each tonne of emissions saved, the EU ETS has placed climate change on the agenda of company boards and their financial departments across Europe.**

- **A sufficiently high carbon price also promotes investment in clean, low-carbon technologies.**

- In allowing companies to buy international credits, the EU ETS also acts as a major driver of investment in clean technologies and low-carbon solutions, particularly in developing countries.

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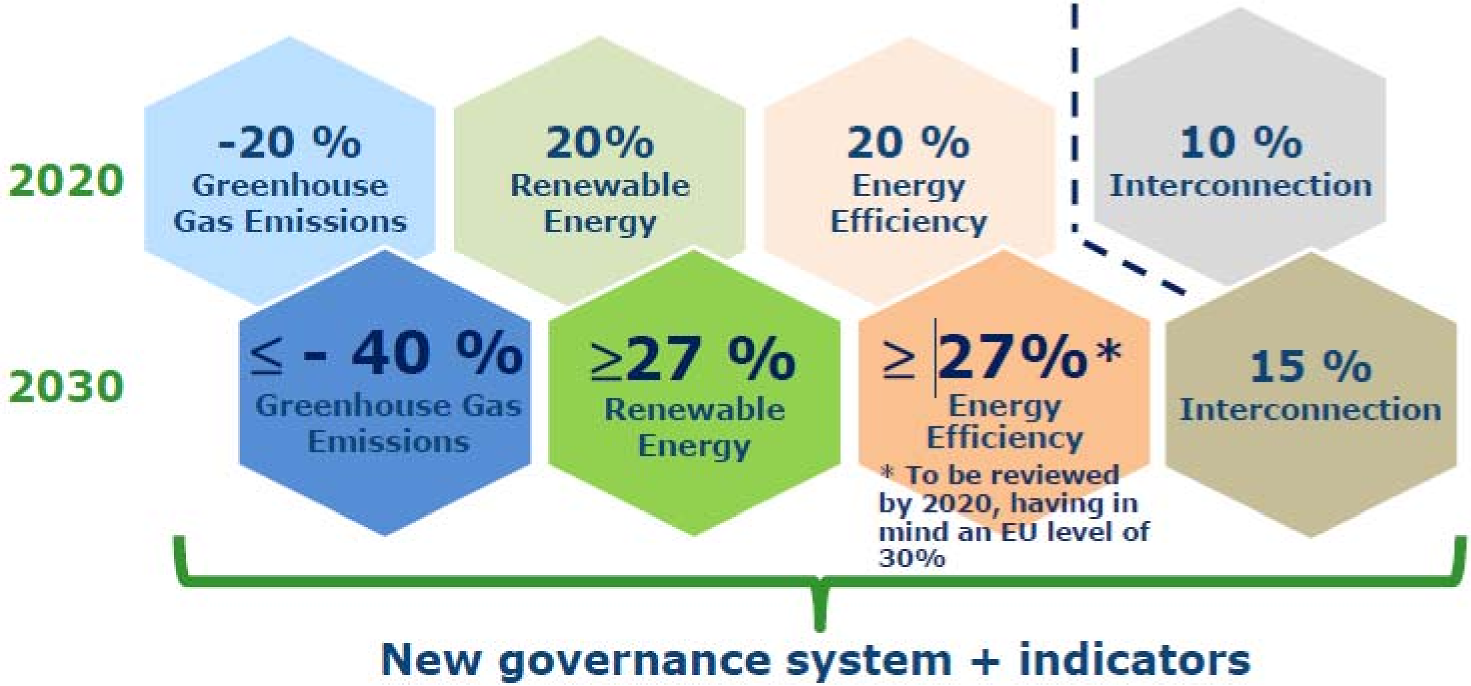
Structural reform and 2030 framework (Phase 4)

- Strong EU ETS needed to allow subsidies to be phased out after 2020 for mature technologies
- **A sufficiently high carbon price also promotes investment in clean, low-carbon technologies.**



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Phase 3: Structural reform of the European carbon market

- A surplus of emission allowances has built up in the ETS since 2009. The European Commission is addressing this through short- and long-term measures.

- The debate on structural measures was launched by the first report on the state of the European carbon market(133 kB) , published in November 2012, in which the Commission identified six options for correcting the surplus.

- The surplus of allowances is largely due to the economic crisis (which has reduced emissions more than anticipated) and high imports of international credits. This has led to lower carbon prices and thus a weaker incentive to reduce emissions.

- The surplus build-up is expected to slow from 2014, but not to decline significantly during **phase 3 (2013-2020)** from a level of around 2 billion allowances.

- In the short term, the surplus risks undermining the orderly functioning of the carbon market. In the longer term it could affect the ability of the ETS to meet more demanding emission reduction targets cost-effectively.

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‘Phase 3: Back-loading’ of auctions

- As a short-term measure the Commission postponed the auctioning of 900 million allowances until 2019-2020.

- This ‘back-loading’ of auction volumes does not reduce the overall number of allowances to be auctioned during phase 3, only the distribution of auctions over the period.

- The auction volume is reduced by
  - 400 million allowances in 2014
  - 300 million in 2015
  - 200 million in 2016.

- The impact assessment(815 kB) shows that back-loading can rebalance supply and demand in the short term and reduce price volatility without any significant impacts on competitiveness.

- Back-loading was implemented through an amendment to the EU ETS Auctioning Regulation, which entered into force on 27 February 2014.

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Market stability reserve (MSR) – to be implemented in early 2019

- As a long-term solution, the Commission has proposed to make a structural change in the ETS by establishing a market stability reserve.

- The reserve would
  - address the current surplus of allowances
  - improve the system's resilience to major shocks by adjusting the supply of allowances to be auctioned.
  - It would operate entirely according to pre-defined rules which would leave no discretion to the Commission or Member States in its implementation.

  - The legislative proposal(64 kB) , put forward in January 2014 at the same time as the framework for climate and energy policies up to 2030, was **approved by the European Parliament on 7 July 2015.**
  - **It still requires approval by the Council to become law and will be implemented as of 2019.**

  - Efforts to address the market imbalance would also be helped by a faster reduction of the annual emissions cap.

  - **As part of the ETS revision for phase 4 (2021-2030), the Commission proposes to reduce the overall number of allowances by 2.2% each year from 2021 onwards, compared to 1.74% currently.**

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