FuelsEurope statement on the proposed Market Stability Mechanisms under EU ETS Directive

Brussels, July 2014

Introduction:

FuelsEurope supports the EU ETS as the EU's 'flagship instrument' within its energy and climate policy framework, as a cost-effective market mechanism for emissions reduction in the power and industry sector.

FuelsEurope notes that:
- because of its fixed cap, the 2020 EU ETS reduction target will be achieved;
- the EUA market is robust, liquid and has been growing in volume since its birth in 2005;
- any Commission legislative proposal on the ETS needs to address the interlinked issues of carbon leakage post 2020 and the level of ambition for emissions reduction for EU ETS sectors by 2030 Phase 4 EU ETS Cap.

Comments on the scope and timing of the Commission's proposal

The Commission proposal is designed to address market imbalance during a future economic crisis. In setting the reference date back to 2008, the proposed Market Stability Reserve (MSR) also is designed to address historic market surplus. FuelsEurope believes that ETS reforms should not aim solely at influencing the ETS price and that consideration of stability mechanisms should be debated as part of a wider legislative proposal - including carbon leakage protection and the GHG reduction objective for ETS based on progress at international level.

FuelsEurope believes that an appropriate scheme to protect EU industry against the risk of loss of competitiveness and carbon leakage must remain in place after 2020. This is missing from the Commission's legislative proposal on the EU ETS. We welcome the European Council request to rapidly develop measures to prevent potential carbon leakage, thus guaranteeing long-term planning security for industrial investment.

Depending on the level of target ambition devolved to EU ETS for 2030, and the use of EU ETS overlapping regulatory measures (in particular on energy efficiency and renewables), future demand/supply balance could change markedly. If the cap reduction is great, the allowance surplus will diminish anyway, rendering the MSR proposal unnecessary. It is such an analysis of future surpluses-made transparently using most recent Phase 3 data - that is missing from the Commission proposal and impact assessment.

FuelsEurope's preliminary assessment of the proposed market stability mechanisms

FuelsEurope believes that the proposed mechanisms:

- will add **additional complexity** to the EU ETS; in particular the interactions between the Market Stability Reserve, the smoothing mechanism at the end of each phase and application of EU ETS Article 29a are not well-defined and are unclear in effect;

- will **restrict market liquidity**; the Commission proposal sets an EU ETS market surplus band between 833m and 400m EU ETS Allowances (EUA). Outside this band, the MSR would intervene initially by filling the reserve. By this removal of allowances from the market, the efficiency of the market is compromised, and market liquidity is reduced increasing the risk of market price volatility. In addition if allowances are removed from the market reducing overall supply then EUA prices would be expected to increase reducing competitiveness. Conversely if the reserved was triggered, then EUA prices would be expected to be lower than otherwise. However the reserve must first be filled thus an upward pressure on prices is to be expected in the first instance.

- has an **artificially low reserve release trigger level** of 400m EUA. Surplus needs to be held for different and separate purposes: for future industrial compliance, for hedging in support of futures electricity supply contracts and to ensure liquidity for market trading. Expert assessment points to levels needed at 1.2 to 1.6 bn EUA. These are considerably higher than the 400m EUA proposed by the Commission. Even allowing for future reduced rates of power sector hedging (due to decarbonisation of the sector), with only a 400m EUA trigger for reserve release, the higher rate of surplus held in the system for future compliance and hedging means that the reserve trigger of 400m EUA may not be achieved. This would be equal to a de-facto cancellation of allowances in the reserve unobtainable;

- will create another precedent (after back-loading) for in-**phase intervention**; The Commission has asked for a review in particular of these intervention levels by 2026 before EU ETS phase end. These precedents further undermine regulatory stability and deter investment;

- will encourage **pre-determined rather than market-based outcomes**;

- is designed to work with a **two-year delay**, thus risking a programmed intervention when the market is indicating no such need, or indeed when market dynamics are the reverse of the situation two years earlier;

The MSR does have advantages - there have been calls for permanent cancellation of some of or even the entire current surplus but the Commission proposal does allow for allowances to be returned to the markets - albeit it at a low rate of 100m EUA per annum. In addition, its rules-based approach gives a degree of predictability when compared to ad-hoc regulatory interventions.

Bd du Souverain 165 | 1160 Brussels | Belgium
T +32 (0)2 566 91 00
contact@fuelseurope.eu
www.fuelseurope.eu
fuelseurope
Transparency Register
26207914726-42

– END –

FuelsEurope, the voice of the European petroleum refining industry

FuelsEurope represents with the EU institutions the interest of 43 companies operating refineries in the EU. Members account for almost 100% of EU petroleum refining capacity and more than 75% of EU motor fuel retail sales.
FuelsEurope aims to promote economically and environmentally sustainable refining, supply and use of petroleum products in the EU, by providing input and expert advice to the EU institutions, Member State Governments and the wider community and thus contributing in a constructive and pro-active way to the development and implementation of EU policies and regulations.

Contact : **Florie Gonsolin**
T +32 2 566 91 09
F +32 2 566 91 11
florie.gonsolin@fuelseurope.eu
www.fuelseurope.eu