PKEE
Polish Electricity Association

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Assessment of the result of negotiations concerning revision of the EU ETS Directive

On 8th-9th November 2017, the European Parliament and the Council have reached an agreement on the final text of the amended Directive 2003/87/EC establishing a scheme for greenhouse gas emission allowance trading[1] ("**EU ETS**").

The Polish Electricity Association ("**PKEE**") during the entire decision process that lasted over two years, presented several regulatory postulates and analyses supporting solutions most beneficial from the perspective of the Member States-beneficiaries of the solidarity mechanisms after 2020, i.e. transitional free allocation for the modernisation of the energy sector (Article 10c) and the Modernisation Fund (Article 10d). In this position, PKEE wishes to present its assessment of the finally adopted solutions.

Strengthening the reduction ambitions

According to the finally adopted agreement, the Linear Reduction Factor (LRF) is increased from 1.74% to 2.2% annually as of 2021. Moreover, **doubling the volume of allowances**, agreed to be placed in the Market Stability Reserve[2] ("**MSR**") in years 2019-2023, **from 12% to 24%** of the number of allowances in circulation along with introduction of their cancellation **as from 2023** in a number exceeding the total volume of allowances auctioned during the previous year, will lead to a **significant increase of the EU's 2030 emissions reduction ambitions.**

In spite of the conclusions adopted by the European Council in October 2014 (reduction by 43% compared to 2005), **the actual reduction ambitions will as a result of the agreement reach even 54%** as compared to 2005, which we assess negatively.

Increase of carbon prices

Reduction of supply of allowances in the subsequent 4th trading period **will lead to an increase of EUA prices**.

According to the available data provided by EURELECTRIC, the cost of purchasing the entire volume of carbon permits required for the Polish energy sector may reach even **up to EUR 35.84 billion** (ETS compliance costs in 2021-2030). Within this amount, amendments to the legislative proposal agreed in trilogue negotiations (doubled MSR uptake) will result in ca. **EUR 6.2 billion additional cost** for the Polish energy sector as compared to the solutions proposed by the European Commission in 2015.

[1] Directive 2003/87/EC of the European Parliament and of the Council of 13 October 2003 establishing a scheme for greenhouse gas emission allowance trading within the Community and amending Council Directive 96/61/EC, OJ L 275, 25.10.2003, p. 32—46.
[2] Decision (EU) 2015/1814 of the European Parliament and of the Council of 6 October 2015 concerning the establishment and operation of a market stability reserve for the Union greenhouse gas emission trading scheme and amending Directive 2003/87/EC, OJ L 264, 9.10.2015, p. 1—5.

Transitional free allocation – derogation (Article 10c of the EU ETS Directive)

According to the decisions made during the last trilogue, the EU ETS Directive shall establish **complex criteria for participation in the competitive bidding process** through which the free of charge allowances are to be allocated to electricity producers for investments with a value exceeding **EUR 12.5 million**.

The categories adopted by EU legislators apart from investments in RES, grids or grid heat are introducing the possibility of partial financing of environmental modernisation investments in the conventional energy sector, which should be considered as a positive solution.

However, the formula for balancing the free of charge allowances is not optimal in terms of predictability from the investor's perspective, as the National Investment Plan was replaced with competitive bidding. Thus, in the subsequent period **the derogation will not be automatically addressed to the EU ETS installations setting electricity prices and will lose its compensatory nature**. The competitive bidding additionally increases the uncertainty for investors as to obtaining support, allocation will take place after the project is selected through bidding and completed. Moreover, the free allocation will allow to **cover up to 70% of investment costs –** the remaining funds will have to come from investors.

Modernisation Fund (Article 10d of the EU ETS Directive)

Contrary to the derogation, the rules defining the operation of the Modernisation Fund were decided with **solutions directly excluding support from this mechanism to coal-fired power generation (generation based on the solid fossil fuels)**. The new Article 10d (1) of the EU ETS Directive provides that no support from this fund shall be provided to energy generation facilities using solid fossil fuels.

It also needs to be stressed that the potential increase of the volume of allowances dedicated for the Modernisation Fund by the volume of allowances not exceeding 0.5% (that is from 2% to 2.5%) of the total volume of allowances may materialise only in a situation where energy intensive industry will utilise less than 3% of the total volume of emission allowances required to increase the free of charge allocation. Therefore, a risk should be considered that **the increasing of the Modernisation Fund may not materialise due to lack of allowances.**

Nevertheless, at the last stage of the negotiations an amendment was adopted that **will improve the use of Modernisation Fund resources for transformation of the Polish energy sector**. The agreed text of the EU ETS Directive provides for a **simplified decision-making process** that provides to the Member States a significant freedom in selecting individual investments. The simplified decision-making process is, however, limited to a **closed list of a six types of investments**, which includes:

- renewable energy sources;
- improvements of energy efficiency;
- energy storage;
- modernisation of energy networks, including district heating pipelines, grids for electricity transmission and increase of interconnections between Member States;
- support for social transformation of carbon-dependent regions;
- initiatives for energy efficiency in transport, buildings, agriculture and waste management.

At least 70% of the value of the Modernisation Fund shall be used to support the above listed priority areas. The investor, contrary to the derogation, will however be able to **cover up to 100% of eligible costs** delivered from the above catalogue. For comparison, in case of projects from outside this catalogue, at least 30% of own contribution will be required.

Combining of solidarity mechanisms

Positive amendments adopted as a result of negotiations include **allowing possible integration of the solidarity mechanisms.** Member States will be entitled to place in the Modernisation Fund all or part of their allowances dedicated to them under the so called solidarity share of allowances dedicated to less wealthy EU Member States for the purposes of solidarity, growth and interconnections as well as the free of charge allocations for the power sector (derogation).

Free allocation dedicated to district heating and high efficiency cogeneration (Article 10a of the EU ETS Directive)

It should be additionally stressed that the EU ETS Directive revision takes into account **the continuation of free of charge allocation of allowances to district heating** and **high efficiency cogeneration** in respect of the production of heating or cooling, which should be viewed positively as at an earlier stage there were proposals to remove the free allocation.

Summary

- We welcome the **option of increasing the derogation from 40% to 60%** of the national auctioning volumes and the possibility for financing inter alia environmental modernisation investments in conventional power generation. More so, as at the last round of the negotiations, limitations were introduced making it impossible to support modernisation investments in conventional plants with the use of the Modernisation Fund.
- In the opinion of PKEE, as a result of decisions of the European Parliament and the Council **no significant increase of compensation mechanisms from external funds took place.** The potential increase of volume of allowances dedicated to the Modernisation Fund from 2% to 2.5% is of conditional nature.
- A positive solution is the possibility of potentially combining the derogation, the solidarity share of the allowances and the Modernisation Fund. However, it should be noticed that there will not be any possibility to finance coal-based investments from the Modernisation Fund.
- At the same time, it should be stressed for comparison that we assess the total cost of purchase of emission allowances for the Polish energy sector at ca. EUR 35.84 billion, thus **spending on allowances will significantly exceed the combined support mechanisms for the Polish power sector even in the maximum option**.

The investments for which the new solidarity mechanisms are dedicated could be **implemented by the Polish energy sector**, which already now in its business strategies considers the perspective of growth of, among others, low emission sources, gas sources, electric transport, energy storage and district heating systems. Realisation of investments in these areas would contribute towards not only **diversification of sources of energy supply**, but will also tangibly improve **the quality of environment and the comfort of life of residents** exposed to degraded air quality.