Free allowances for power sector through Article 10c: lessons learned for the post-2020 revision of the EU ETS

Urska Trunk, Carbon Market Watch

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urska.trunk@carbonmarketwatch.org

www.carbonmarketwatch.org

@CarbonMrktWatch

carbonmarketwatch

Supporting the transition to a climate friendly economy

In Paris last year a legally binding agreement was adopted by 195 countries, which sets the long-term objective of keeping global warming well below 2°C and to pursue efforts to limit it to 1.5°C.

The EU ETS can be one of the EU's main instruments to achieve this objective, by:

- Setting an adequate carbon price to make the polluter pay and incentivize cleaner ways of production
- Gradually reducing the total amount of pollution permits, and hence the emissions of the power and industry sectors in line with 95% reductions by 2050.
- Generating revenues from the auctioning of emission allowances and investing these public funds in industrial breakthrough technologies, renewable energy and energy efficiency.
- **Spending public funds wisely in line with the EU's 2050 decarbonisation objective**

The low-carbon funding mechanisms

The EU ETS funding mechanisms represent substantial financial resources:

- **The modernization fund** (310 mio allowances) **> €7.5 billion**
- **The innovation fund** (450 mio allowances) **> €11 billion**
- **Art 10c** - optional free allocation to power (max 680 mio allowances) **≈ €12 billion**
- **Just transition fund**

EU has committed to phase out fossil fuel subsidies by 2020 and to achieve 80-95% emission cuts by 2050

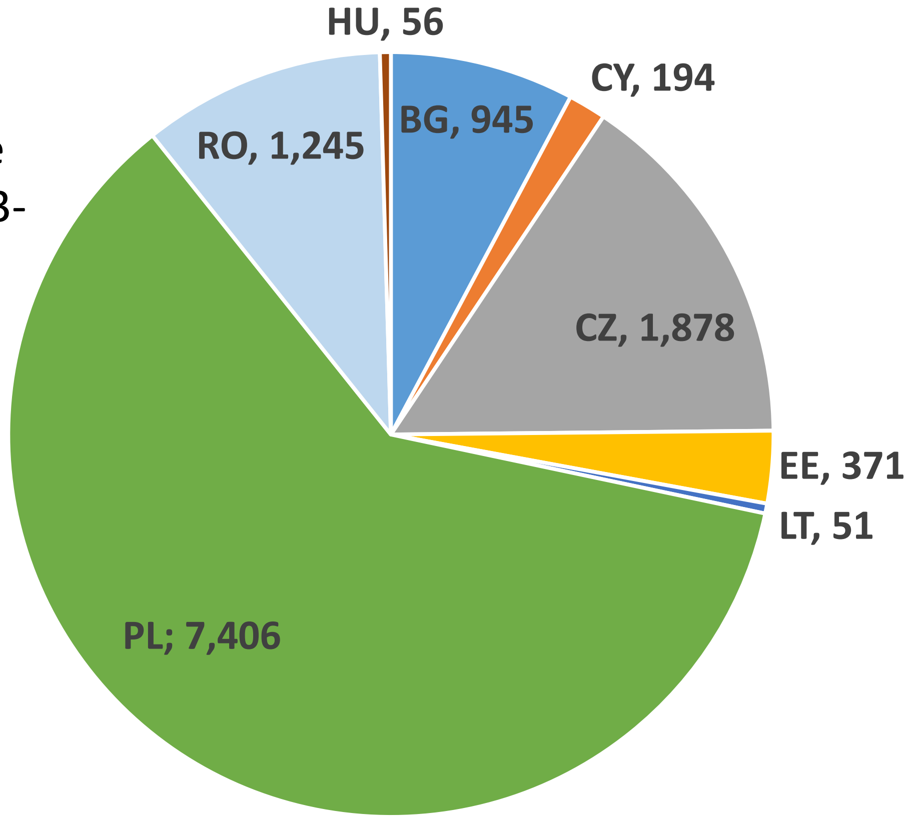
Smart and effective use of public funds can create a virtuous cycle that funds further emission reductions and delivery of renewable and energy saving technologies

Free allocation to promote investments for modernising the energy sector

What is the current Art. 10c?

- **Derogation to 10 new MS to hand-out free allowances to power companies*** - in the rest of the EU the power sector has to buy all of their allowances at auction.
- The temporary derogation was conditional on **investing the value of free allowances in modernization and diversification of the energy sector**.
- The MS need to submit **National Investment Plans**, **listing the investments to be realized in return for free allocation**.
- Between 2013 and 2019, the European Commission has approved up to **680 million allowances** with an estimated market value of **€12 billion**

Estimated market value of the free emission allowances per MS* 2013-2019 (million EUR)



*Bulgaria, Cyprus, Czech Republic, Estonia, Hungary, Lithuania, Poland, Romania

Free allocation to promote investments for modernising the energy sector

Investments in National investment plans should be based on **6 core principles**

- ❑ contribute to **decreasing GHG** emissions
- ❑ contribute to **diversification** and reduction in carbon intensity of the electricity mix and the sources of energy supply
- ❑ **not distort competition and trade** in the internal market, and rather strengthen competition
- ❑ be **economically viable** to continue after the stop of free allowances
- ❑ be **additional** to investments MSs must undertake in order to comply with other objectives or legal requirements accruing from Union law
- ❑ **eliminate the need for such derogation in the future**

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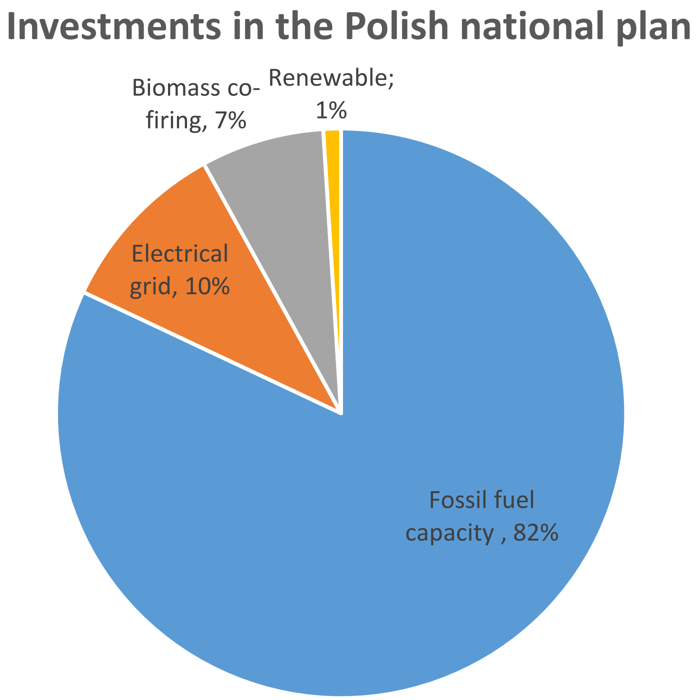
Country experiences: Investments mainly benefiting fossil fuels

- **In Polish NIP, 82% of projects relate to the modernization of existing fossil fuel capacity**.
  - Investment in Bełchatów, the biggest coal-fired power plant in Europe
  - including investments in a new lignite coal fuelled unit with the capacity of 858MW – the largest power unit in Poland
  - Only about 8.5% RE investments (mostly biomass co-firing with coal)



Source: Stronger Together (2014)

Country experiences: Investments mainly benefiting fossil fuels

- **In the Czech Republic, about 46% of investments relates to the upgrading of coal power plants**.
  - Investment in the installation of a condensing turbine TG6 is expected to increase coal consumption by over 24.000 tons of brown coal annually.

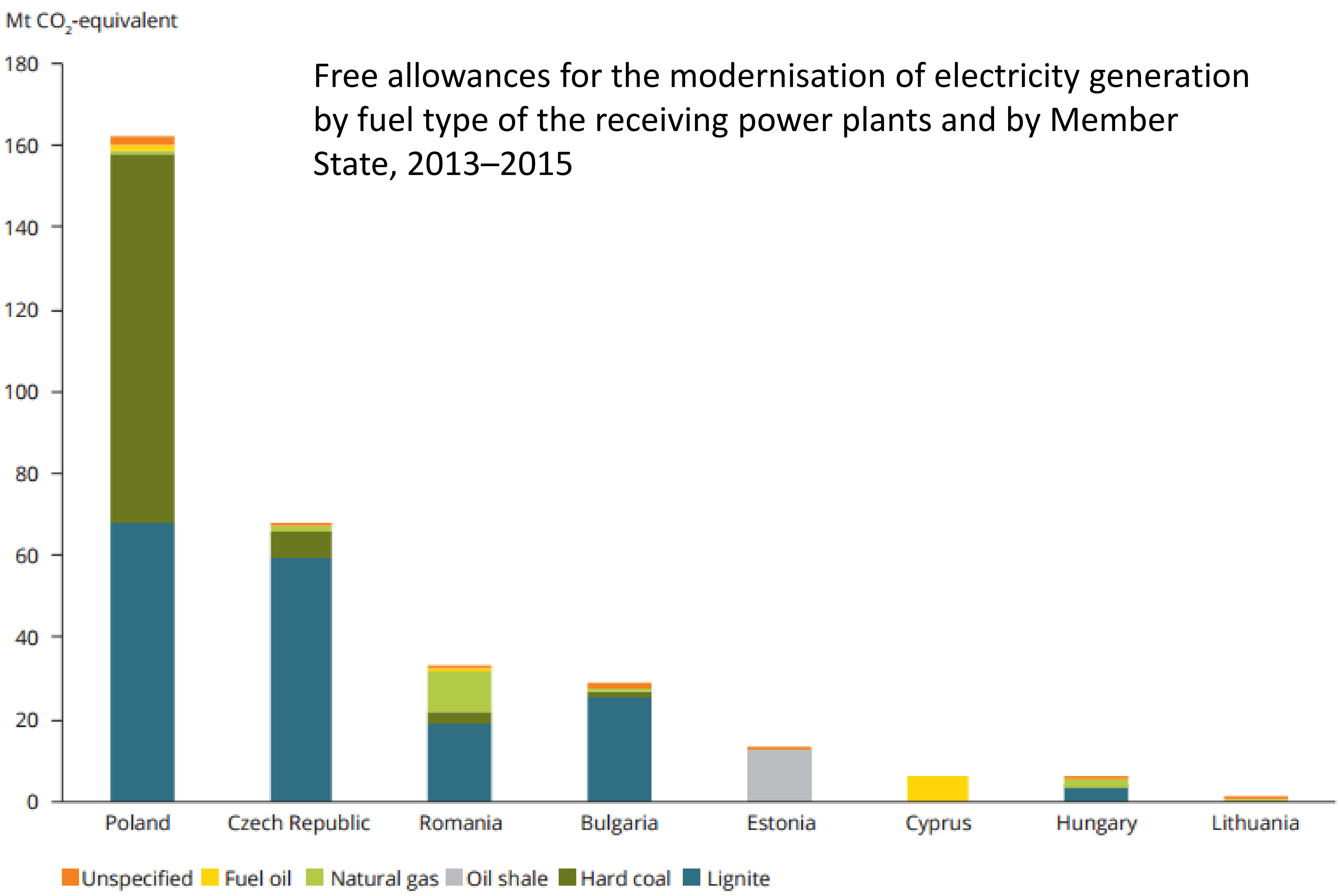
- **In Romania, the majority of planned investments (20/29) provide support for new fossil fuel energy production**, predominantly natural gas, local and imported hard coal, and lignite.

Significant share of investments does not contribute to reduction of GHG emissions or reduction of the share of coal in national electricity production

Experience with Art 10c to date: Investments mainly benefiting fossil fuels

- PL, CZ, RO– which account for **85% of the free allowances**, plan to use derogation to:
  - modernise fossil fuel capacity,
  - invest in new fossil fuel energy production, such as hard coal and lignite,
  - or increase future coal consumption.
- In 2013, only about 10% of the investments through Article 10c were related to clean technologies or the diversification of the energy mix. An overwhelming 90% of investments benefitted the upgrading and retrofitting of existing (fossil fuel) infrastructure.
- To date, the majority of Article 10c allowances have been distributed to **lignite-fired** and **hard coal-powered** plants, mainly in Bulgaria, the Czech Republic, Poland and Romania

Free allowances for the modernisation of electricity generation by fuel type of the receiving power plants and by Member State, 2013–2015



Source: EEA, 2016

Current experience: non-transparency and poor stakeholder consultation

- Non-transparency of national investment plans and annual reports

Investment no.	Description
PL-$-0001	Modernizacja B1
EE-$-0008	Modernisation of the electricity system
EE-$-0005	Investments to modernize the electricity production

- Inadequate public consultation
  - **CZ**: 1 week window to provide comments, without access to CZ national plan
  - **Bulgaria**: no public access to information on investments of coal industry companies included in Bulgarian NIP
  - **Romania**: the documents available to the public differed from those submitted to the Commission and leave out some of the most contentious investments (e.g. new Braila Power coal power plant)
- Poor monitoring and enforcement provisions not effectively integrated in national regulations

Reform process

- ITRE committee voted on their position and endorsed a compromise
  - \+ projects relating to electricity production: total GHG emissions per kWh shall not exceed 450 grams of CO_2 equivalents
  - \+ do not contribute to new coal-fired energy generation and heat capacity nor increase coal-dependency
  - \- No criteria for small projects
  - \- Extends eligibility for free allowances to Greece
  - \- Excludes that investments must be supplementary to those required to comply with the Best Available Techniques)
  - \- Does not put a stop date to this derogation

- ENVI will vote on its position on December 8
- The proposal will be subject to a final vote in parliament's plenary in February 2017.

Recommendations for Article 10c

Preferred approach: **no continuation of Art 10c**

- Set **strict eligibility criteria:**
  - **Exclude coal** and focus on renewables, smart grid development and efficiency
  - Investments in **diversification** of energy mix a
  - Investments that foresee significant levels of **CO_2 reductions**
  - Prioritize projects with **co-benefits**
- **Open consultation and transparency** throughout the process
- Projects must be **additional** to currently planned investments and additional to investments MSs must undertake in order to comply with other objectives or legal requirements accruing from Union law