MANAGING THE POLICY INTERACTION WITH THE EU ETS

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A Pöyry report in collaboration with Fortum Oyj, Statkraft AS and Vattenfall AB

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EXECUTIVE SUMMARY

Scope of this report

The EU Emissions Trading Scheme (ETS) is the cornerstone of the EU's policy to combat climate change and it is the key tool for reducing greenhouse gas (GHG) emissions cost-effectively. It works on the principle of 'cap and trade', setting a pre-determined declining limit on the total amount of greenhouse gases from around 11,000 installations covering about 50% of the EU's total GHG across EU Member States (MSs). Allowances for the emission of a tonne of greenhouse gas (known as a European Emission Allowances or EUAs) can be freely traded between installations and banked across trading periods.

Failure to effectively account for policies that overlap with the EU Emissions Trading Scheme has contributed significantly to the current weak carbon prices, limiting Europe's ability to follow a cost-effective decarbonisation trajectory. The formation of robust measures to address this overlap is required now to coincide with the development of new or extended EU and/or MS policies to be introduced as part of the 2030 framework for climate and energy policy. If left unaddressed additional policy overlap could further weaken efficient progress towards the European 2030 and 2050 decarbonisation targets.

In collaboration with our clients (Fortum Oyj, Statkraft AS and Vattenfall AB), we have developed an ETS Policy Coherence Mechanism to improve coherence amongst policies by adjusting the ETS to account for the future effects of both EU and Members State overlapping policies.

This report describes our proposed mechanism and addresses the following questions:

1. What is the approximate size and impact of overlapping policies on the EU ETS?
2. How can the impact of overlapping policies be accounted for and remedied? What criteria do we use to evaluate the effectiveness of each different approach and what are their respective pros and cons?
3. Based on the preferred approach which articles in the Governance Regulation and/or Emissions Trading Directive should be amended and how?

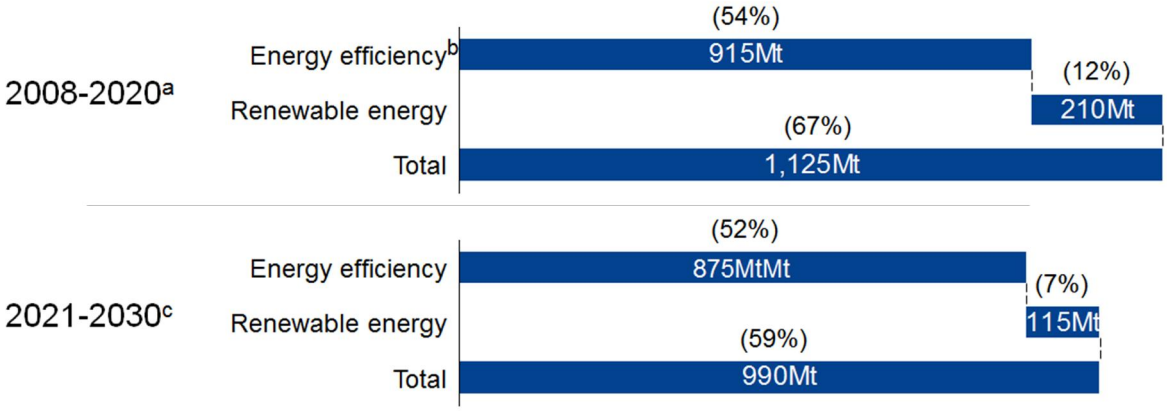
Key report findings

Policies that overlap with the EU Emissions Trading Scheme are a significant contributor to its current ineffectiveness and are a major on-going risk factor

A review of existing literature, including EC policy assessments, is provided in Section 1.2.3 and highlights the current extent and the potential significant risk of additional policy overlaps on the EU ETS. Figure 1 shows the projected additional emissions reduction in EU ETS sectors from energy efficiency and renewable energy development (compared against a baseline of the expected reduction at the time that the original cap was set):

- Overlapping EU-level policies are expected to lead to more than 1 billion tonnes of above-baseline emissions reduction between 2008 and 2020 or roughly 2/3 of the current surplus (the surplus stands at 1.7 billion tCO_2 by the end of 2016 – equivalent to a full year of the current allowance cap in the EU ETS).
- The proposed increases of the 2030 targets (relative to when the 2030 cap was set) for energy efficiency (4.9pp increase) and renewables (0.5pp increase) are expected to further increase the oversupply by nearly another 1 billion tonnes from 2021 to 2030.

Figure 1 – Projected impact of energy efficiency and renewable energy targets on EU ETS (Mt of abatement and % relative to 2016 surplus)



[a] Impact on the EU ETS compared to emissions reductions expected when the 2020 cap was set
[b] Energy Efficiency over 2008-2020 also includes 400Mt contribution from the Eco-design Directive
[c] Impact on EU ETS of increased RES (26.5 % to 27%) and EE (25% to 30%) targets relative to when the 2030 cap was set
Sources: IETA, CEZ Group and FTI Consulting - please see Section 1 for details.

In addition, analysis of the price impact of overlapping policies on the EU ETS shows significant price effects from both EU-led and domestic led policies:

- The EC's impact assessment for the Energy Efficiency Directive (EED) projects a 35% decrease in the carbon price, from €42/t to €27/t in 2030, in response to the policy overlap from the strengthened EED alone, compared to that assumed when setting the original 2030 EU ETS cap.
- Separate analysis, conducted in 2016 and 2017 by ICIS Tschach Solutions and Thomson Reuters, of the impact of an accelerated coal/lignite phase-out across the EU shows a similar scale of impact on the EU ETS price.

In response to the current allowance oversupply in the EU carbon market, there have been a series of legislative improvements to enhance the functioning of the market. Most recently this has led to the introduction of the Market Stability Reserve (MSR), a non-discretionary rule-based supply adjustment mechanism scheduled to start in 2019. While the evidence of both a volume impact and price impact from overlapping policies is clear from the literature, there is no such evidence that either the legislative improvements proposed in the EU ETS revisions, or the MSR at the proposed temporarily increased 24% intake rate, are sufficient to address the risks of continued policy overlap on EU ETS sectors.

We have therefore developed a solution to deal with this overlap directly, outside of the existing MSR process. Our mechanism seeks to address future policy overlaps rather than seeking to retroactively correct for policy overlap to date.

A robust Policy Coherence Mechanism should be broad in scope and directly and promptly neutralise the impact from responsible policies

Our proposed Policy Coherence Mechanism has been developed after consideration of the effect of several design options, reflecting different combinations of 'building blocks' as outlined in Section 2.1. The core elements of the Policy Coherence Mechanism are:

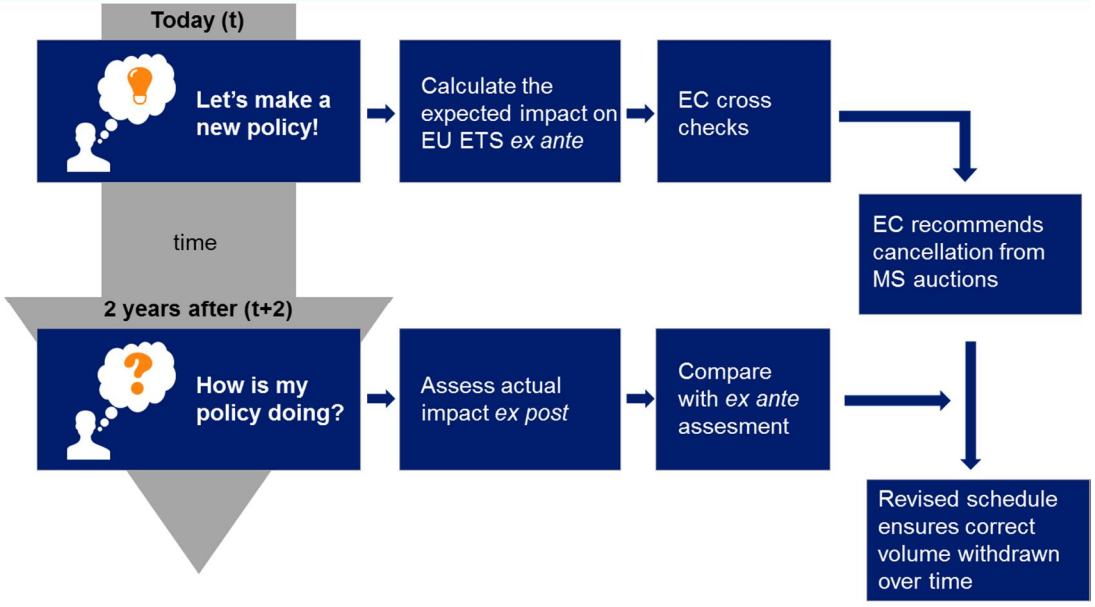
1. **Action should cover a wide range of EU and national level policies that impact EU ETS sectors –** without a wide scope the Mechanism would be less effective as it would fail to address potential large sources of future overlapping policies;

2. **Quantification of the overlap should combine an *ex ante* assessment and *ex post* re-basing –** The extent of the overlap to be addressed will be quantified in two stages (outlined in Figure 2) to ensure the actual impact of the policy overlap is accounted for in final adjustments:
   - a forward looking (*ex ante*) assessment of the expected impact; and
   - a backwards looking (*ex post*) re-assessment and rebasing to ensure the correct volume is captured over time.

   Member States will have primary responsibility for the quantification with cross-checking and recommendations for a cancellation schedule performed by the EC. The quantification process is designed to tie into existing envisaged reporting requirements under the proposed Regulation on the Governance of the Energy Union (Governance Regulation), limiting the additional administrative burden on Member States (MSs) and the European Commission (EC).

3. **Identified overlap volumes should be removed through direct cancellation of allowances from upcoming Member State auctions –** where the volume is cancelled from the Member state that introduces the policy (a 'policy pays' approach). We note that a 'backstop' option of placing allowances into the MSR could also be used, though this may be less effective in mitigating the carbon price effect. In the case that the Commission intervenes directly to ensure the Union's binding targets are met (through the powers in the Governance Regulation), we would propose that allowances are cancelled from upcoming auctions on a pro-rata basis in accordance with the MSs' current auctioning shares. It is important to note that in both cases the proposed mechanism does not have an impact on the free allocation, which the energy intensive industry receives in order to prevent the risk of CO_2 leakage.

Figure 2 – High-level overview of the ETS Policy Coherence Mechanism



Process applies to all national and EU-level instruments on an on-going basis

The first quantification of any overlaps would take place in 2019 based on the first Integrated National Energy and Climate Plans (INECPs), and every two years thereafter through the Biennial assessment reports. The first cancellation of allowances is proposed to take place in 2021, with an annual schedule defined thereafter.

We propose this mechanism design because it performs well against our evaluation criteria – comprehensiveness, timeliness, accuracy, predictability and feasibility. Design choices that make the mechanism comprehensive, timely and accurate, also contribute to its complexity so there will be inherent trade-offs between these features. To counteract some of these less desirable trade-offs we have taken a number of mitigating design choices to create a streamlined approach, based on feedback from a range of stakeholders.

Our evaluation of the mechanism against our criteria is contained in Section 2.3, and is summarised as follows:

- **Comprehensiveness**: the solution is comprehensive as it covers all of the main categories of policy overlap at an EU and MS level, with both the assessment of the overlap and neutralising intervention occurring on an on-going basis. Using a 'policy pays' principle for cancellation, ensures that the MS internalises the effect on the ETS in their national policy decisions.
- **Timeliness**: the mechanism acts promptly to neutralise the impact of new overlapping instruments with the first quantification on a forward looking *ex ante* basis in 2019 and the first intervention in 2021. Direct cancellation of allowances will also tend to more rapidly impact the supply/demand balance in the EU ETS (and hence prices) compared to other less direct options for intervention levers.
- **Accuracy**: the quantification of the measure is performed on an *ex ante* basis, starting in 2019, which may be perceived to be inaccurate. However the regular nature of the quantification and intervention process as well as the inclusion of an *ex-post* readjustment every two years from 2021 onwards, should help to keep the measure closely aligned with reality.
- **Predictability**: the solutions are predictable as responsibilities across various actors are well defined; the quantification and action are strongly linked and enshrined in proposed regular reporting.
- **Feasibility**: the broad scope of the mechanism and the potential for a considerable impact on the EU ETS could create political resistance. However, the feasibility of implementation of the mechanism is increased through the tie into existing reporting requirements within the proposed Governance Regulation.

The Policy Coherence Mechanism fits within the framework of existing and proposed legislation with specific amendments identified

The on-going Governance Regulation process represents a key opportunity to include an assessment of the implications of policy overlaps on the EU ETS since its objective is to increase coherence amongst Member States and their various policy instruments in the 2030 climate and energy policy framework. However, currently the Governance Regulation drafting does not contain articles specifically targeting policy overlaps or measures related to emissions trading apart from in the annexes. This omission appears at odds with the Commission's language elsewhere in the Governance Regulation inviting coordination among the policy instruments supporting the five pillars of the Energy Union.

The ETS Policy Coherence Mechanism has been designed with the current proposal for the Governance Regulation in mind, most notably its reporting framework. By tying into the reporting framework therein, the mechanism can be enacted almost entirely through a series of amendments to the Commission's Governance Regulation Proposal, with a single amendment only to a paragraph of the ETS Directive. The amendments are summarised in Section 3 with a detailed side-by-side text provided in Annex A. These proposed amendments are fully comprehensive; it may be more appropriate to start discussions with a more concise set focussing on a few essential amendments.

1. BACKGROUND

Box 1 Key chapter messages

- This report proposes a mechanism and associated amendments to protect the EU ETS from future overlapping policies.
- The financial crisis, overlapping policies, offset credits and investment leakage are the main drivers of the current oversupply, which depress carbon prices and thereby have prevented an effective signal for decarbonisation. This potentially limits Europe's ability to follow a cost-effective decarbonisation trajectory.
- The impact of policy overlaps on the operation of the EU ETS is significant:
  - While existing EU-level overlapping policies are expected lead to more than 1 billion tonnes of additional emissions reduction between 2008 and 2020, the proposed increase of the energy efficiency and renewables targets are expected to reduce demand and potentially increase the oversupply by nearly another billion tonnes from 2021 to 2030.
  - Additional policy interventions by individual MSs may also have a considerable impact.
- The current proposals to reform the EU ETS are encouraging, but no proposal adequately addresses the pertinent issue of overlapping policies.
- The Governance Regulation represents a key opportunity to include the implications of policy overlaps on EU ETS since its objective is to increase coherence amongst Member States (MSs) and their various instruments.

1.1 Purpose of this report

Failure to account for overlapping policies has contributed to weak carbon prices, limiting Europe's ability to follow a cost-effective decarbonisation trajectory.

In collaboration with our clients (Fortum Oyj, Statkraft AS and Vattenfall AB[1]), we have developed an ETS Policy Coherence Mechanism to improve coherence amongst policies by adjusting the ETS to account for the future effects of both EU and Members State overlapping policies.

For the purpose of this report we consider 'overlapping policies' to be:

- current and future EU-level or MS policies that incentivise emission reductions in ETS sectors through other means than a carbon price, thus leading to lower demand for EUAs, and are either not in place or are in place but at a weaker level at the time of setting emissions reduction targets under the EU ETS;
- which when introduced or strengthened, will significantly impact the demand for allowances in the EU ETS.

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1 Operating in the whole value-chain of the deregulated Nordic and integrated European power market, these three major Nordic energy companies highlight the importance of a predictable, market-based and harmonised EU climate policy. Each company is strongly committed to making EU power generation CO2-neutral by 2050 at the latest.

This report describes our proposed mechanism and addresses the following questions:

- What is the approximate size and impact of overlapping policies on the EU ETS?
- How can the impact of overlapping policies be accounted for and remedied? What criteria do we use to evaluate the effectiveness of each different approach? What are their respective pros and cons?
- Based on the preferred approach, which articles should be amended in relevant legislation and how?

1.2 The risks of a persistent oversupply in the EU ETS

In this section we describe the drivers of the current oversupply and estimate the contribution from overlapping policies.

1.2.1 Drivers of the current oversupply

The Paris Agreement aims to keep global temperature increase "well below" 2°C and to pursue efforts to limit it to 1.5°C. This means emissions must peak as soon as possible, and to achieve net-zero emissions within the second half of this century[2].

Reaching this goal, while avoiding unnecessary costs, is likely to require a rapid shift in investment away from traditional fossil-fuelled assets and towards low-carbon technologies.

The EU is well positioned to pursue a least-cost decarbonisation pathway, thanks to the EU ETS putting a limit on overall emissions from covered installations which is reduced each year. Within this limit, companies can buy and sell emission allowances as needed. This 'cap-and-trade' approach gives companies the flexibility and technology neutrality they need to cut their emissions in the most cost-effective way.

However to date, and despite numerous improvements (for example the ETS reform in 2009, backloading, and the MSR decision), the EU ETS has failed to fulfil its ambition of being the EU's cornerstone decarbonisation policy. Rather, a number of factors have severely impacted its effectiveness leading to the current market surplus of ETS allowances:

- **Financial crisis**. The global financial crises in 2007-2008 followed by a sluggish economic recovery resulted in lower industrial output and subsequently lower emissions under the EU ETS. However, the ETS cap was determined under the assumption of continued economic growth and lacks supply flexibility in response to a recession. While emissions decrease, there is no effective price signal for continued investments in low carbon assets. This response is to be expected in a well-functioning cap and trade scheme however it highlights the lack of supply flexibility and means appropriate long-term investment signals may not be maintained during a recession, or potentially for a sustained number of years thereafter.
- **Overlapping policies**. Overlapping policies reduce the demand for abatement since the emissions reduction occurs for other reasons than the CO_2 price, making it easier for installations to meet their obligations under the cap. This lowers the CO_2 price incentive to reduce emissions and is likely to be more expensive for society as a whole given the abatement is not market driven and therefore signals for selecting the

2 The Paris Agreement. United Nations, 2015.

lowest cost decarbonisation option are reduced. The estimated impact of overlapping policies to date and in the future is discussed in Section 1.2.3 and Annex B.

- **Offset credits**. The EU ETS was designed to allow operators to use a limited number of international offsets in the form of CDM or JI credits[3] to meet their annual compliance obligations. This limit has been set at ~1.6 billion tonnes of emissions to 2020 (approximately equal to the current oversupply) with participants so far using around 1.5 billion of their allowed entitlements. Such abatement[4] by definition occurs outside of the monitoring framework of the EU ETS.
- **Investment leakage**. The EU ETS cap only applies to emissions produced in Europe. Emissions produced outside of Europe, which arise from the production of goods and services to fulfil EU demand are not included[5]. Hence the transition of European economies from manufacturing-based to service-based, but the continued consumption of goods will lead to declining verified emissions reported under the EU ETS, but arguably leaves global emissions unchanged or even increased.

1.2.2 Policy overlap reduces the demand for allowances

The associated weak price signal and perceived ineffectiveness of the EU ETS to date has created significant uncertainty surrounding its ability to deliver genuine CO_2 emission reductions in the long-run. While the costs of other policies such as renewable energy investment programmes are often higher and less transparent than a carbon price, these policies are perceived to bring about definitive emission reductions "for free", despite the likely additional cost for society and the geographical displacement of freed up EUAs and CO_2 emissions under the cap.

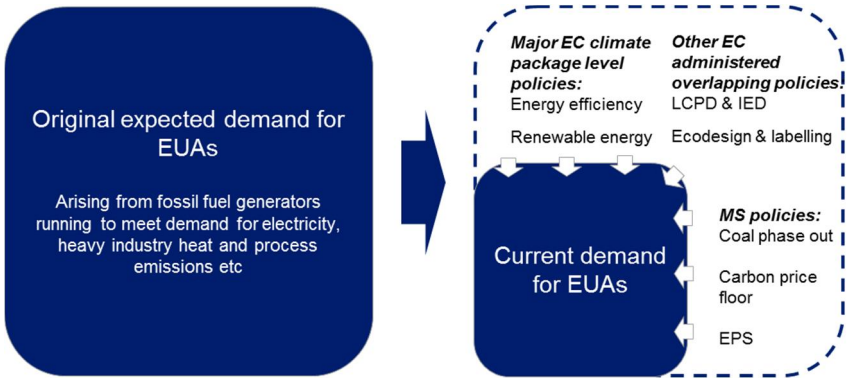
Figure 3 illustrates the various types of overlapping policies and their ability to reduce demand for allowances under the EU ETS.

3 Clean Development Mechanism (CDM) and Joint implementation (JI) are the two project-based mechanisms permitted under the EU ETS. The CDM involves investment in emission reduction or removal enhancement projects in developing countries that contribute to their sustainable development, while JI enables developed countries to carry out emission reduction or removal enhancement projects in other developed countries.

4 Where we refer to 'abatement', this is short-hand for emissions reductions.

5 As such it is arguably misleading to refer to the EU ETS as a 'pure cap and trade' scheme – a 'quasi-cap and trade' scheme may be more appropriate.

Figure 3 – Various overlapping policies decrease demand for EUAs



For illustration only, precise scale of the overlap is to be determined.
LCPD; Large Combustion Plant Directive. IED; Industrial Emissions Directive. EPS; Emissions Performance Standard.

All decarbonisation that occurs within the scope of EU ETS reduces the demand for EUAs, with the carbon price reflecting the expected marginal cost of the most expensive abatement measure needed to comply with the ETS cap. When decarbonisation occurs even in the absence of a carbon price it appears as 'free'[6] in the ETS, for instance because of additional subsidies or regulations.

A too low carbon price increases the propensity for MSs to call for stronger EU wide measures or introduce their own domestic policies which exacerbates the problem further. As a consequence, the EU ETS has failed to provide the long-term price signal required for investment in the energy sector. As a consequence, the European electricity sector is now a hybrid of coal on the one-hand, and subsidised renewables on the other - a "black-green" system which misses out on a lot of CO_2 price driven fuel-switching, market based build-out of mature RES, and energy efficiency. This situation is clearly some distance from a notion of a least-cost decarbonisation pathway.

An overlap can only be assessed by comparing emissions under that policy with an appropriate baseline. When discussing the overlaps it is imperative to establish what baseline one is comparing against. With this in mind, a review of existing literature, including EC policy assessments, highlights the extent of the impact of policy overlaps on the EU ETS. A full list of the literature reviewed as part of this report is contained in Annex B.

1.2.3 Policy overlap is a major contributor of the current oversupply

None of the EU ETS reform proposals to date have sought to directly address the impact from overlapping policies. However, numerous studies (see Annex B.2 and B.3) suggest that overlapping policies could have a significant impact on Phase 4 of the EU ETS if not properly accounted for:

- It is estimated that the stricter 2030 targets (relative to when the 2030 cap was set) for the EED (4.9pp increase) and the RED (0.5pp increase), equates to an additional

6 Of course in reality this abatement has a cost to society, manifested in the form of higher consumer energy bills for example. Furthermore, since this abatement is planned by governments rather than relying on a market-orientated approach, this cost to society is likely to be higher than the lowest-cost solution.

overlap of 875Mt and 115Mt respectively for the period 2021 to 2030[7,8]. This is 52% and 7% of the current 2016 surplus respectively.

- The EC's impact assessment for the EED projects a 35% decrease in the carbon price, from €42/t to €27/t, in response to the policy overlap from the strengthened EED alone, including a 30% target for 2030, compared to the EU ETS price projected when setting the original 2030 EU ETS cap[9].
- In addition MSs may introduce a variety of policies that overlap with the EU ETS, either as part of a wider EU level policy implementation such as the Industrial Emissions Directive, or completely independently such as the phase-out of coal/lignite in Germany. Projections for the impact of MS-level policy overlaps show they could also be very significant e.g. sensitivity analysis by ICIS Tschach Solutions and Thomson Reuters reveals:
  - an accelerated phase-out of coal/lignite in Germany would decrease carbon prices by ~15%; or
  - by as much as ~35% if such a policy was applied on an EU-wide basis – a price impact on par with that caused by the strengthening of the EED and RED combined[10,11].

The situation would have been different if the above policies, measures or interventions were coupled with a comparable reduction in the EUA auction supply. Taking account of this overlap would protect the EU ETS and ensure that the measure has an environmental benefit from a system (and global) perspective.

The existing EU ETS reforms are encouraging but do not address the policy overlap problem specifically. We have not found compelling evidence in the literature that reforms such as the temporary increased MSR intake from 12% to 24% will address the issue sufficiently. We therefore examine the potential to develop a specific mechanism to ensure policy coherence directly that ties into the proposed Governance Regulation, an introduction to which is provided below.

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7 A utilities perspective on the progress towards a single market, CEZ Group, presented at Platts 8th Annual Power Summit 21 March 2016.

8 Wake Up!: Reforming the EU Emission Trading Scheme, FTI Consulting, 2017.

9 Impact assessment accompanying the document Proposal for a Directive of the European Parliament and of the Council amending Directive 2012/27/EU on Energy Efficiency. European Commission, November 2016.

10 Options to strengthen the EU ETS. ICIS Tschach Solutions, October 2016.

11 Sidelined or in the driver's seat? ETS interaction with other policies. Thomson Reuters, April 2017.

1.3 The Governance Regulation as a key tool to address policy overlap

A series of interventions have aimed to tackle the EU ETS imbalance[12] alongside calls for additional (and sometimes conflicting) carbon pricing schemes to the EU ETS (such as national carbon price floors) from a range of European stakeholders. The ongoing legislative process to review the EU ETS contains a number of initiatives to reduce the market surplus. The Commission Proposal from 2015 sought to accelerate the rate at which the cap tightens, supported by both the European Parliament and Council in their trialogue positions. Both bodies include provisions for cancelling some allowances already channelled into the MSR and also broadly agree to double the intake rate of the MSR for a certain number of years.

However, none of these initiatives safeguard the effectiveness of the ETS against the effects of overlapping policy instruments. Even the doubled MSR intake rate would only affect the functioning of the carbon market under its current architectural parameters. While the European Parliament has passed amendments calling for an assessment of how "other Union and national climate and energy policies" affect the carbon market, there are a number of disadvantages to be considered. First, there is no automatic trigger for the Commission to publish such a report, and it would only be accompanied by a legislative proposal "if necessary". Second, even if some measure would eventually be adopted, it would be geared towards the 2030 and 2050 targets, making its impact very late. Finally, and probably most relevantly, the Council has not expressed yet whether it supports such an initiative within the narrower framework of the ETS review. Therefore, given the political pressure to increase the targets of overlapping instruments, it seems necessary to take up the matter within a broader discussion of European climate and energy policy. The 2016 Proposal for a Governance Regulation of the Energy Union presents an ideal opportunity to do this.

The Proposal for a Regulation of the Governance of the Energy Union (Governance Regulation) was introduced by the European Commission in November 2016. This is a new regulation with the purpose to ensure that the objectives of each of the five dimensions of the Energy Union (energy security, the internal energy market, energy efficiency, decarbonisation, and research, innovation and competitiveness[13]) are met through a set of coherent and coordinated actions. The Proposal for a Governance Regulation as it stands largely ignores the carbon market. The 2014 Council conclusions and the 2016 Clean Energy Package propose to increase the 2030 target for energy efficiency, and some stakeholders are calling for a higher renewable energy target, as well. However, there are no provisions in the Proposal that would safeguard the functioning of the EU ETS against such changes. This is despite the fact that the carbon budget for the ETS was calculated as part of a quantitative exercise that included more modest targets for these two initiatives.

The main purpose of the Proposal is to establish feedback loops to ensure the Union stays informed about its progress towards its objectives on energy and climate, and that it

12 Such measures include the agreement to eliminate offset use, the backloading decision in 2013 resulting in the delayed auctioning of 900 million EUAs, and the establishment of the MSR in 2015.

13 "Memo: New Energy Union Governance to deliver common goals". European Commission, November 30, 2016 (p. 1).

is able to take action should it seem unable to meet those goals. Therefore the Commission proposes to consolidate data flows between the MSs and itself for the purpose of monitoring progress; not only towards the goals of the Energy Union but also towards the EU's commitments on the international arena. Beyond these data flows, the Commission also proposes to be granted the authority to take action in case it detects insufficient progress towards the Energy Union goals either at the level of an individual MS or of the Union as a whole.

MSs would submit to the Commission three sets of reports describing their proposed strategic objectives and progress towards achieving them:

- Long-term emission strategies: To be submitted every ten years starting 2020, covering goals over a 50-year perspective in view of the EU's commitment under the Paris Agreement.
- Integrated National Energy and Climate Plans (INECPs): To be submitted every ten years starting 2019, with updates after five years, covering national objectives for the five dimensions of the Union, a description of the current situation, and an assessment of the policies and measures planned to bridge the gap.
- Biennial progress reports: To be submitted every two years starting 2021, showing progress towards the targets stated in the INECPs.

On the basis of those reports, the Commission would be empowered to:

- Issue recommendations to MSs if their biennial progress reports show that the MS are not on track to meet the objectives of their integrated plans, or if all integrated plans do not add up to sufficient progress towards the objectives of the Energy Union.
- Take corrective action at Union level in the case of insufficient progress towards the objectives of the Energy Union.
- Publish an annual State of the Energy Union Report.

A timeline of the various reporting information flows is provided in Table 1. We conclude that it should be relatively easy to also incorporate the processes associated with our proposed Mechanism into this framework, considering the reporting obligations which are already being established by the proposal for EU Energy Union Governance regulation.

Table 1 – Proposed timeline of information flow under Governance Regulation

	Document	Due date	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
Member States	Long-term emission strategy	15 Mar			✓										✓
	Integrated national energy and climate plans	01 Jan		✓					✓					✓	
	Biennial progress report	15 Mar				✓		✓		✓		✓		✓	
Commission	State of the Energy Union report	31 Oct				✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
	Assessment of Member State submissions	31 Oct				✓		✓		✓		✓		✓	
	Recommendation to individual MSs	31 Oct				✓		✓		✓		✓		✓	
	Union level action to ensure Energy Union goals	N/A							✓						

Accounting for overlapping policies would tie into these proposed reporting requirements and so would not need new procedures/flows.

Given the widely reported problem of policy overlap on the EU ETS, the direction of the current Governance Regulation Proposal seems to sit at odds with EC's intention of improving coordination among the policy instruments supporting the five pillars of the Energy Union. The emphasis on ensuring that the Union would meet the upgraded targets for renewable energy and energy efficiency while largely excluding consideration of the EU ETS, instead suggests that the carbon market faces potential relegation from its position as Europe's flagship instrument on climate change.

We therefore propose a direct mechanism – the ETS Policy Coherence Mechanism – to address policy overlap acting through amendments to the Governance Regulation Proposal.

2. ETS POLICY COHERENCE MECHANISM

Box 2 Key chapter messages

- Any approach to account for and remedy the effect of policy overlaps must have a prescribed scope, quantification methodology, and mechanism for administering the intervention and we outline the different options for each building block.
- An effective mechanism must be timely, comprehensive, accurate, predictable, and feasible.
- We propose an ETS Policy Coherence Mechanism with the following features:
  - It covers all proposed policies at the EU and MS-level that may reduce emissions.
  - MSs must carry out an *ex ante* assessment of policy overlap every 2 years from 2019 onwards based on their Integrated National Energy and Climate Plans and associated biennial reports, with an *ex post* readjustment to ensure the correct volume is cancelled over time.
  - An equivalent amount of allowances must be cancelled from upcoming auctions from 2021 onwards on a 'policy pays' basis.
- The mechanism performs well against our criteria particularly as we have taken a number of actions to create a streamlined approach, such as tying into existing reporting requirements set out in the Governance Regulation proposal.
- Using the 2019 Integrated National Energy and Climate Plan as the baseline represents a reasonable compromise between accuracy and ease of implementation.

2.1 Building block approach and mechanism selection criteria

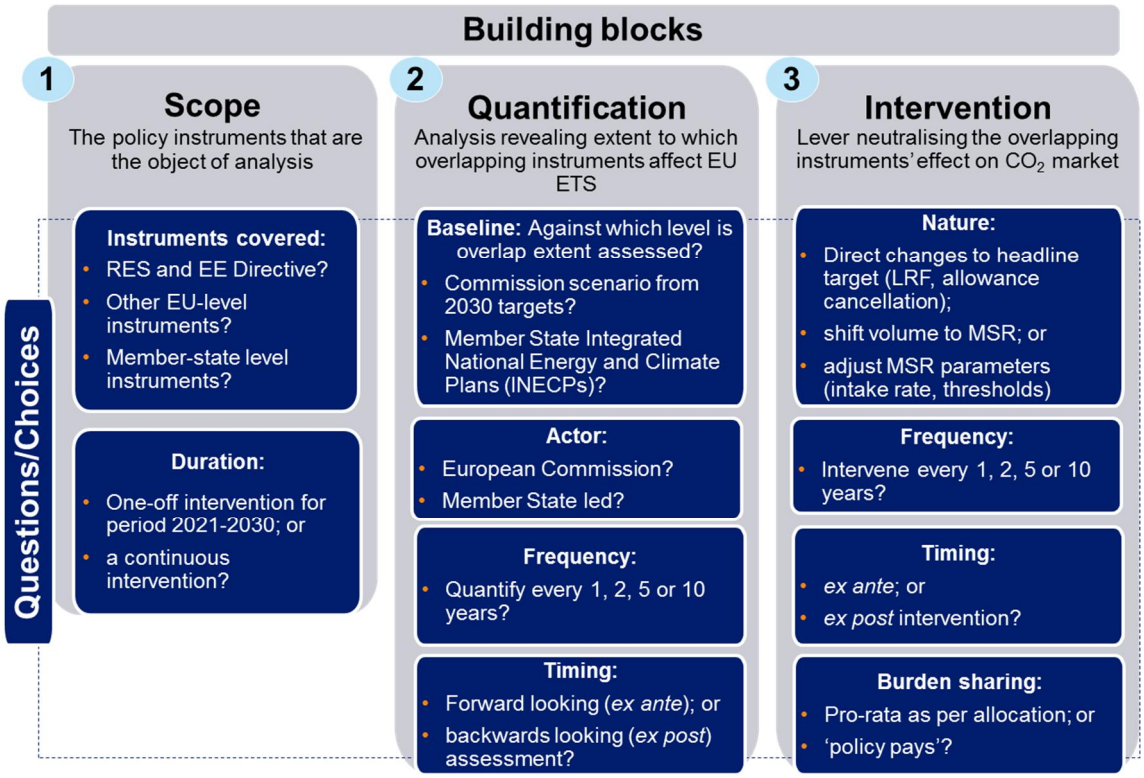
The design of a mechanism to address the issue of policy overlap has been broken down into three building blocks (scope, quantification, intervention) that represent the various levels at which independent design decisions must be taken. Each building block contains a variety of choices:

- scope: the coverage of the mechanism, i.e. the policy instruments overlapping the EU ETS and thereby interfering with its functioning;
- quantification: evaluation of the effect of overlapping policies on the EU ETS; and
- intervention: the lever neutralising the overlapping instruments' and policies' effect on the carbon market.

These building blocks are joined together to create a complete mechanism – an overview of the blocks, key questions/choices and the primary options are shown in Figure 4 below.

In principle, the building blocks are designed such that selecting any single option for any element under a given block does not prejudice the selection of options under a different building block. However, it is likely that the individual choices as well as the overall design will affect the effectiveness of the overall mechanism.

Figure 4 – Overview of building block approach



We have defined a number of criteria to evaluate the attractiveness of a particular mechanism design. Our focus is on the effectiveness of the mechanism rather than its overall political acceptability.

We deem an effective mechanism to be:

- Timely – the intervention should correct for the overlap as soon as possible;
- Comprehensive – quantification of the overlap should extend to a broad range of policies over a suitably large timeframe, and encourage consideration of the EU ETS in policy making;
- Accurate – both the quantification of the overlap, and the subsequent intervention in the market should accurately address the overlap implying regular updates as circumstances evolve;
- Predictable – it should be clear to market participants who/what/when/how the quantification of the overlap and the resulting intervention is conducted; and
- Feasible – the mechanism should be easily implementable with minimum additional burden on the parties involved.

More details on the criteria can be found in Annex C.

2.2 Description of our proposed ETS Policy Coherence Mechanism

2.2.1 Mechanism overview

Figure 5 gives a high-level overview of our proposed mechanism.

Figure 5 – A high-level overview of the ETS Policy Coherence Mechanism

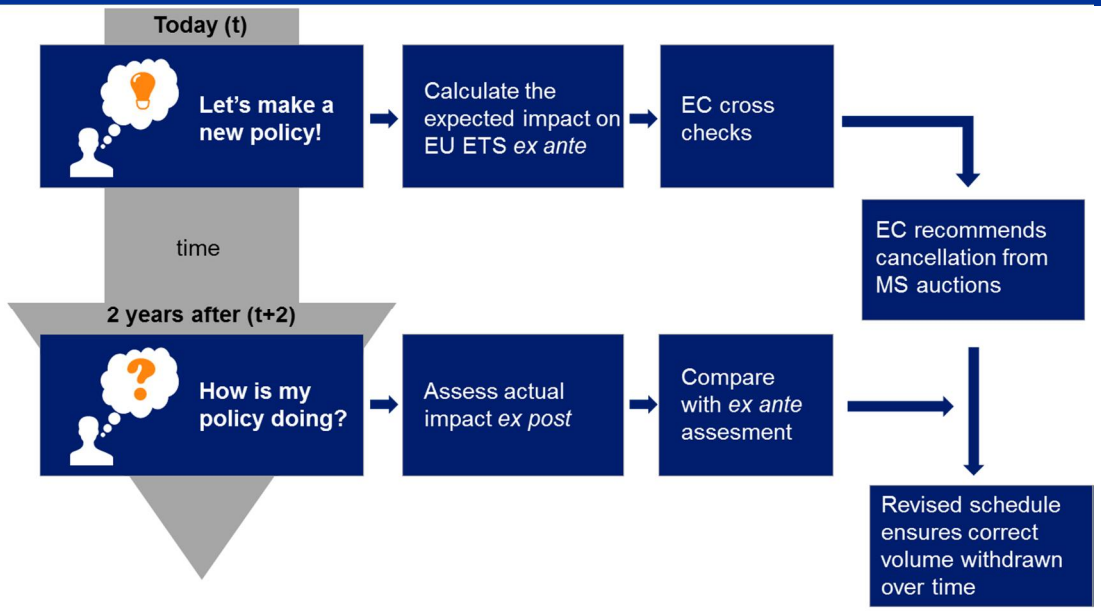


Table 2 provides more detail of the mechanism, broken down by building block and key elements. A detailed description of each building block and the main alternative options considered is provided in Sections 2.2.2 to 2.2.3.

Table 2 – Elements of the proposed ETS Policy Coherence Mechanism

Building block	Element	Selected option
1. Scope (i.e. coverage of mechanism)	Instruments	All national level instruments (including RES and EE), national transpositions of Union Directives, and instruments adopted by MSs, either introduced independently or in response to Commission recommendations
	Duration	Continuous for the entire duration of the Energy Union project
2. Quantification (i.e. assessment of effect of overlapping instruments)	Baseline	Existing measures in the 2019 Integrated National Energy and Climate Plans
	Actor	Member State, subject to verification by Commission, with possibility to reconcile discrepancies
	Frequency	Every two years from 2019 onwards
	Timing	*Ex ante,* but with an *ex post* assessment/re-adjustment to correct volume over-time
3. Intervention (i.e. lever used to correct effect)	Nature	Cancellation of allowances from upcoming auctions
	Actor	Member States, pursuant to recommendation by the Commission
	Frequency	Every year from 2021 onwards
	Timing	*Ex ante*
	Burden sharing	Cancellation requirement restricted to MS implementing overlapping instrument ("policy-pays")

Our mechanism can also include provision for when the EC takes measures to ensure that the Union's binding targets are met (including RES and EE). In this case we propose that the EC itself rather than MSs do the quantification, with the intervention occurring on a pro rata basis in accordance with MSs' current auctioning shares for allowances. All other mechanism elements would remain the same.

2.2.2 Scope

2.2.2.1 Instrument

We consider any energy or climate instrument ("policies and measures") that affects the carbon market surplus to be an overlapping instrument. However, we note that it will be important to include only policies which have significant impact on the CO_2 emissions in order to limit the administrative burden. All such overlapping instruments within the scope of the Governance Mechanism, both at the MS and Union level, are included but separated by category:

- Member State category: this includes Union Directives which must be transposed into domestic legislation. We also include overlapping instruments introduced by MSs, either independently or in response to Commission recommendations.
- Union category: Any "measures" taken directly by the Commission in the case of insufficient progress towards the objectives of the Energy Union. This includes measures taken to achieve the common 2030 targets for renewable energy and energy efficiency.

2.2.2.2 Duration

Just as the Proposal for the Governance Regulation is written flexibly to extend beyond 2030, we do not prescribe any expiration date to our Policy Coherence Mechanism. The explicit goal is to permanently protect the integrity of the carbon market against overlapping policy instruments, promoting policy coherence and environmental integrity.

2.2.3 Quantification and Intervention

The following section provides an overview of the quantification and intervention approach within our proposed mechanism. A more detailed description of the proposed quantification and allowance cancellation process is contained in Section 2.4.

2.2.3.1 Nature

The Mechanism works by means of interventions into the carbon market of sufficient magnitude to undo the quantified effect that any overlapping instrument may have on the carbon market:

- The quantification seeks to establish to what extent an overlapping instrument causes the carbon market surplus to increase.
- The intervention occurs by withholding allowances from future auctions and cancelling them. This contraction in supply counteracts the overlapping instrument's expected effect on the carbon market. The duration of the intervention takes the form of a schedule from the year after the quantification until the end of the ongoing Phase of the carbon market.
- Allowances are withheld and cancelled in a volume equal to the expected increase in the carbon market surplus. The Mechanism does not intervene in the case of overlapping instruments that decrease the surplus. We have included this aspect to preserve the direction of travel of the EU ETS as a climate policy instrument, which seeks to promote decarbonisation by a steadily increasing scarcity of allowances.

Cancellation of allowances is a direct way of dealing with the overlap. We considered moving the allowances to the MSR. However this approach would not rectify the problem indefinitely like cancellation, rather it would just alter the decarbonisation trajectory, but not the overall target. It could be argued cancellation leads to over-achievement of decarbonisation objectives. To avoid this concern, moving allowances to the MSR would be a possible back-stop alternative, albeit with weaker impacts on EU ETS prices.

2.2.3.2 Actors

The ETS Policy Coherence Mechanism seeks to include both MSs and the Commission in a balanced manner so as to minimise administrative burden and moral hazard[14], while maximising transparency, fairness, predictability and ease of implementation.

- For national level instruments the primary actors are the MSs. They conduct the quantification by continuing the current process under the Regulation 525/2013 ("on a mechanism for monitoring reporting greenhouse gas emissions"), which the Governance Regulation would replace. Under this process, MSs produce projections of emissions without measures, with existing measures and with additional measures –

14 Moral hazard occurs when one party takes more risks because a different party bears the cost of those risks.

which together constitute the basis of the quantification. To ensure accuracy and a coherent methodology across MSs the Commission would verify estimates. We have also included a process whereby the Commission and MSs can reconcile their positions in the case of disagreement about the existence and scale of the effect on the carbon market. Once the two parties reach agreement, the Commission establishes a schedule to withhold/ cancel allowances and communicates it through a Governance Regulation recommendation to the concerned MS, who then must comply.

- For Union level instruments, by which we primarily mean Union level interventions in case of insufficient progress towards the objectives of the Energy Union, the main actor conducting the quantification is the Commission. It is again the Commission who issues intervention recommendation to MSs. However, because it is Union-wide measures that the Commission must launch, a burden sharing agreement covering all Union MS may be necessary. Therefore, we propose that this intervention be only enacted subject to agreement by the European Parliament and Council through the common legislative procedure. Due to the requirement to intervene by cancelling further allowances, this agreement would most likely take the form of a new amendment to the ETS Directive.

We considered assigning the EC to quantify the extent of the overlap from the EE and RES Directives. However, this does not seem a sensible approach given MSs will include renewables and energy efficiency in their INECPs. Our choice of MSs doing the quantification, with EC oversight, seems to provide a good balance between the actors.

2.2.3.3 Baseline

The Policy Coherence Mechanism fixes the “projections with measures” from the year a planned overlapping instrument is first reported as the baseline against which to quantify its effect on the carbon market. This uses the pre-existing definition in the Proposal of this projection, which covers policies and measures that have been adopted and implemented. The effect of planned instruments is captured under “projections with additional measures” – another pre-existing definition in the Proposal. Naturally, as time goes on and “planned measures” are adopted and implemented, their effect on emission would by definition come to be captured by “projections with measures” instead. This would cause analytical problems, as from one quantification to another there would be a change in the set of instruments covered by this projection, making baselines from different years incoherent. By fixing the baseline to the year that that an instrument is announced, we avoid this problem. This enables comparability between interventions of different years, as well as the possibility to correct inaccurate interventions at a later point.

Each overlapping instrument is compared individually against the relevant baseline. We explicitly call for quantification to include a single instrument in its projections with additional measures. Consequently, while each year when quantification occurs there is a single “projection with measures” acting as a baseline, there are as many “projections with additional measures” as there are planned instruments. As time goes on and new quantifications take place, for any overlapping instrument the baseline remains fixed, but its original “projection with additional measures” is updated to eliminate inaccuracies, resulting always in the most precise interventions possible.

As alternative baselines, we also considered using EU wide reference scenarios (e.g. the GHG40 or Reference scenario published in the EC Impact Assessment from January 2014) for EE and RES Directive policies. Using the GHG40 scenario could have been sensible but it was unclear how this could be incorporated into existing reporting procedures. The MSs’ 2019 INECPs are a suitable baseline that also ties in nicely with reporting procedures so additional burdens are minimised.

2.2.3.4 Frequency

The Mechanism quantifies the effect of overlapping instruments every two years, occurring at the publication of biennial progress reports (in 2021, 2023, 2025, 2027, and 2029). Quantification also occurs on years when new integrated national energy and climate plans are published, starting with the first one, due in 2019[15]. This allows the Mechanism to capture the effects of the newest instruments, as well as quickly correct past interventions that have turned out to be inaccurate.

The Mechanism intervenes by removing every year a certain volume of allowances from the auction supply. This keeps the carbon market as insulated as possible against the possibility of an increasing surplus.

2.2.3.5 Timing

In order to be most effective in protecting the ETS from overlapping policies, both quantification and intervention occur on an *ex ante* basis[16]. The quantification seeks to assess the future effect of a planned instrument on the carbon market. The implementation starts as soon as a government starts implementing the instrument in question. This enables national governments to pursue their energy policy priorities in a sovereign manner without undermining the Union level carbon market.

2.2.3.6 Burden sharing

Allowances will be cancelled from upcoming MS auctions following a 'policy pays' approach for the policies introduced at a member state level i.e. the MS introducing the overlap must cancel from their own future allocation. In the case that the Commission directly introduces policies to intervene and ensure the Union's binding targets are met, allowances will be cancelled from upcoming auctions on a pro-rata basis in accordance with the MSs' auctioning shares. Our choice of MSs doing the intervention, with EC oversight, aims to provide a good balance between the actors.

2.3 Evaluation of our mechanism against the criteria

Table 3 summarises our evaluation of the proposed mechanism, showing it performs well against our criteria.

15 To safeguard the biennial quantification frequency, we do not call in the amendments setting up our mechanism for quantification to happen in the years when the integrated national energy and climate plans are updated (i.e. 2024, 2034, and so on).

16 *Ex ante* action is forward looking and hence proactive and preventing but subject to greater uncertainty/inaccuracy; while *ex post* action is backward looking and so reactive and correcting, but potentially more accurate.

Table 3 – Evaluation of our proposed mechanism against our criteria for an effective mechanism

Criteria	Pros	Cons	Summary
Timeliness	▪ Speedily neutralises new overlapping instruments by means of yearly interventions. ▪ Quickly corrects prior quantification errors thanks to biennial quantifications. ▪ Keeps the carbon market surplus in check even as policies that would increase it are implemented, thanks to *ex ante* quantification and intervention.	▪ No direct feature is included to account for the need to recalibrate every five years the EU's energy and climate instruments in response to the ratcheting mechanism for nationally determined contributions established under the Paris Agreement but by working within the Governance Regulation it fits within the overall direction of the Agreement. ▪ Not correcting for overlapping policies prior to 2019.	▪ The mechanism acts speedily. ▪ First quantification on an *ex ante* basis in 2019 and the first intervention in 2021. ▪ The use of direct cancellation of allowances will also tend to increase the speed of impact on the supply/demand balance in the EU ETS (and hence prices) compared to other less direct options for intervention levers.
Comprehensiveness	▪ Quantifies continuously all energy and climate instruments that affect the carbon market surplus. ▪ Using a 'policy pays' principle for cancellation, ensures that the MS internalises the effect on the ETS in their national policy decisions.	▪ All MSs receiving recommendations pursuant to this mechanism would forfeit some auctioning revenues. The rise in EUA prices due to a tighter supply would partially mitigate this problem through increased revenues from residual auctions. ▪ Not all MSs communicate emission projections to the Union level in spite of obligations under the Monitoring Mechanism Regulation (525/2013); for these, compliance with the Governance Mechanism will imply additional administrative burden.	▪ The mechanism is comprehensive as it covers all of the main categories of policy overlap at an EU and MS level, with both the assessment of the overlap occurring and neutralising intervention occurring on an on-going basis. ▪ Incentives are introduced on MSs to account for the impact on the EU ETS in policy decisions

Criteria	Pros	Cons	Summary
Accuracy	▪ Balances relationship between Commission versus MSs for national level instruments, and Commission versus European Parliament and Council, with the possibility to settle disputes. ▪ Enables quantification mistakes to be corrected relatively quickly. ▪ Charges MSs to be responsible for the effects of their individual instruments on the carbon market. Charges Union to decide a burden sharing agreement for overlapping instruments for which it has assumed collective responsibility. ▪ The frequent quantifications add some element of *ex post* timing, due to the ability to revise the setting of scheduled future intervention to account for inaccuracies in past quantifications.	▪ The reliance on *ex ante* quantifications implicitly creates uncertainty around the accuracy of the projection. Shifting to *ex post* quantification and intervention would mitigate this risk, but it would also expose the carbon market to increasing surpluses.	▪ The quantification of the measure is performed on an *ex ante* basis, which may be perceived to be inaccurate. ▪ However the regular nature of the quantification and intervention process should help to keep the measure closely aligned with the out-turn situation.

Criteria	Pros	Cons	Summary
Predictability	▪ Allows market participants to adjust expectations about future market behaviour thanks to the delay between quantification and intervention. ▪ Further creates certainty by announcing schedules of auction changes lasting to the end of the ongoing ETS Phase. ▪ Ensuring that the impact of overlapping instruments is neutralised, reduces policy risk.	▪ The possibility to revise the future settings of the cancellation schedule does create some uncertainty, but the delay between quantification and intervention mitigates this. ▪ Removing the possibility to revise schedules may have material consequences to the overall effectiveness of the mechanism.	▪ The interventions are highly predictable as responsibilities across various actors are well defined. ▪ The quantification and action are strongly linked and enshrined in pre-existing regular reporting.
Feasibility	▪ The mechanism ties into existing reporting requirements. ▪ It can be implemented almost entirely through amendments to the proposed Governance Regulation. ▪ We anticipate the 'policy pays' burden sharing approach will be seen as a reasonably fair and acceptable methodology by more stakeholders. ▪ The mechanism does not have an impact on the free allocation, which the energy intensive industry receives in order to prevent the risk of CO_2 leakage.	▪ The scope is broad which may cause some MSs to resist adoption.	▪ The mechanism is feasible as it is: – Implementable with the minimal amendments to a minimal number of directives. – Does not place a large administrative burden on the parties involved as it ties in to existing reporting requirements. – Designed to be fair on MSs and energy intensive industry.

2.4 Operation of the mechanism in practice

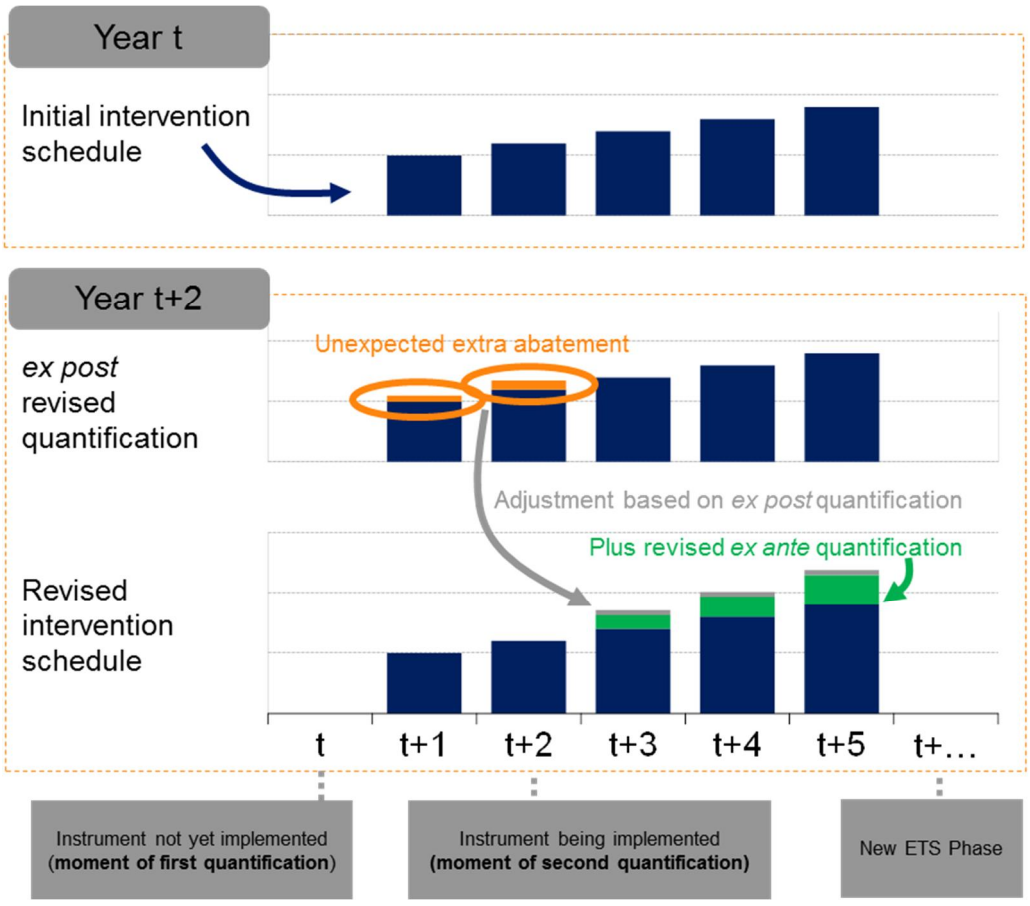
In this section we describe how the mechanism will work in practice. As discussed in Section 1.2.2, it is imperative to establish an appropriate baseline in order to accurately assess the size of an overlap. Our mechanism proposes to use the projected impact on emissions for each policy as recorded under the 2019 INECPs as the baseline, which by its nature will be zero for policies introduced after 2019.

In order to both have a timely effect on policy overlap and withdraw the correct volume of emissions over a period of time, we suggest:

- the initial quantification of the policy impact is undertaken on the basis of forward looking projections (i.e. on an *ex ante* basis) – under our proposal this would first take place based on the 2019 INECPs – and this volume of allowances is then scheduled for withdrawal/cancellation; and
- in order to ensure that the correct total amount of allowances are cancelled over a given EU ETS period, there is a regular backward looking re-assessment of the actual impact of each policy, with adjustments then made to the withdrawal schedule of the intervention to compensate for any change in policy performance.

Figure 6 shows the key steps in the process of quantification of the policy overlap and the intervention to neutralise the effects of each overlapping policy with a step by step process described below.

Figure 6 – Operation of ETS Policy Coherence Mechanism



Our proposed mechanism safeguards the carbon market from the effects of an overlapping instrument introduced by an EU member state as follows:

1. In year t a MS conducts *ex ante* projections of the effect on the CO_2 emissions and carbon market that a new planned future instrument will have.
   - The MS communicates its findings through the integrated national energy and climate plans or biennial progress reports to the Commission.
   - The Commission seeks to achieve agreement with the MS about the scale of the quantified effect on the carbon market.
   - Once there is a final view on this (6 months as per amendments including possible comitology), the Commission issues to the MS a schedule to withhold allowances from auctions and cancel them. The volume, equal to the agreed quantified effect, is distributed starting from the first available year t+1 until the end of the ongoing ETS phase.
   - The MS complies each year with the instructed schedule.
2. In the year t+2 the MS quantifies *ex post* if the instrument's effect on the carbon market was in line with its earlier expectation. No further changes are required if the answer is affirmative.
   - If the effect diverges in any way from the initial quantification, the MS communicates its findings about the scale of the effect (past and future) to the Commission.
   - Once the Commission agrees with the MS's new quantification results, it publishes an updated cancellation and auction schedule, adjusting the original intervention with two additional volumes of allowances accounting for past and future effects (in year t+3 onward). The MS complies each year with the updated schedule.

A similar process would take place under a scenario where the overlapping instrument had underperformed, such that actual emissions are above the 2019 projection with additional measures. In that case, the orange and grey bars in the figure (and potentially the green bars) would take on a negative value.

In the event that an overlapping policy is introduced directly by a Commission led Union level intervention (in the case of insufficient progress towards the objectives of the Energy Union) the Commission itself would be tasked with doing the quantification both at the *ex ante* and *ex post* stage. In this case the allowances would be cancelled on a pro-rata burden basis across member states rather than on a policy pays basis.

The legislative basis for the ETS Policy Coherence Mechanism process described above is embedded in a full series of possible amendments to the Governance Regulation – these amendments are summarised in Section 3 below.

3. SUGGESTED LEGISLATIVE CHANGES

Box 3 Key chapter messages

- The mechanism to account for future overlapping policies can be enacted almost entirely through amendments to the Commission's Governance Regulation Proposal.
- Our proposed amendments are fully comprehensive and it may be more appropriate to start discussions with a more concise set focussing on a few essential amendments.
- Only one amendment, to a paragraph of the ETS Directive is needed, in order to compel MSs to cancel allowances pursuant to the Commission's recommendation.

3.1 Key steps in the amendment process

A series of amendments are required with the Governance Regulation to enable our proposed ETS Policy Coherence Mechanism to function. Our suggested amendments listed here are fully comprehensive and it may be more appropriate to start discussions with a more concise set focussing on a few essential amendments. Our suggested steps in the process are as follows:

- **Recitals and Definitions:**
  - Assert that the EU ETS has been calibrated to deliver its policy signal in conjunction with other instruments with overlapping policy objectives. Accordingly, whenever the targets of these instruments change, the ETS must also be recalibrated if it is to have its intended effects (amendments A and B).
  - Assert that the effect of overlapping instruments on the carbon market (amendment C) and their influence on the carbon market surplus (amendment D) should be quantified.
  - Provide a definition for the overlapping instruments (amendment E) and the carbon market surplus (amendment F).
- **Quantification:**
  - Request MSs to quantify *ex ante* the effect of the overlapping instruments they implement due to both their own initiative and the transposition of Union level acts. The result of this quantification is to be communicated within MSs' 10-year integrated national energy and climate plans (amendments G-K) and their biennial progress reports (amendments L and M).
  - Request the Commission to verify the quantification within MSs' plans and progress reports (amendments N and O, respectively).
  - In the case that the Commission and the Member State agree that certain overlapping instruments cause the carbon market surplus to increase, request the Commission to establish a schedule to withhold allowances from future carbon market auctions and cancel them to undo this increase (amendment P, point 1). This schedule would be specific to the instrument in question, the implementing Member State, and the years when the instrument affects the carbon market (amendment P, points 4 and 5).
  - In the case that the Commission recommends to a specific Member State to implement additional overlapping instruments due to insufficient progress towards Energy Union objectives, request the Commission to quantify *ex ante* the

effects on the carbon market and establish a similar cancellation schedule (amendment P, point 2).

- Establish a reconciliation procedure in case of disagreements between the Commission and individual MSs (amendment P, point 3).
- In the case of a similar Commission recommendation to the Union as a whole, also request the Commission to quantify *ex ante* the effects on the carbon market and propose a Union-wide cancellation schedule to be approved through the common legislative procedure by the European Parliament and Council (amendment P, point 7).

- **Intervention:**
  - Request Commission to communicate to MSs their individual schedules to withhold and cancel allowances by means of recommendations issued on the occasion of the yearly State of the Energy Union Report (amendment P, point 6, and amendment O).
  - Request MSs to comply with schedules issued by the Commission (amendment R).

3.2 Summary of individual amendments

These amendments proposed to deliver the mechanism process are summarised in Table 4 below organised by building block. The vast majority of these amendments take place in the Governance Regulation, with only one required outside of that Proposal, within the EU ETS Directive. See Annex A for a full list of proposed amendments in two-column format.

Table 4 – Proposed amendments: objectives and targets

Block	Element	Objective		Amendment	Target
Assert principles		Clarify that the EU ETS has been set with a specific set of targets for overlapping policies in mind		A	Recital 5
		Articulate effective collaboration of multiple instruments as a clear policy goal		B	Recital 17
		Assert role of EU ETS within the objectives for the Energy Union			
		Clarify that overlapping policies affect the EU ETS			
		Define what the carbon market surplus is		F	Article 2 – point 18b (new)
Scope	***Instrument***	Define what overlapping policies are		E	Article 2 – point 18a (new)
		Allow for definition of overlapping policies to expand			
		Specify carbon market as objective of quantification and intervention		C	Recital 18
	Duration	Assessment of overlapping instruments should not stop		Implicitly included	
Quantification	***Actor***	Establish MS responsibility to quantify	10-year INECP	G	Article 4
				H	Annex I, Part 1, Section A, Point 2.1
				I	Annex I, Part 1, Section A, Point 3.1
				J	Article 8.2
				K	Article 8a (new)
			Biennial Progress Report	L	Annex IV, point (c), nr. v
				M	Annex V, points (a) & (c)
		Establish Commission responsibility to verify quantifications from MSs	10-year INECP	N	Article 12
			Biennial Progress Report	O	Article 25.1
		Establish conciliation procedure in case of disagreement between Commission and MS		P (point 3)	Article 25a (new)

Block	Element	Objective			Amendment	Target
Quantification (continued)	***Frequency***	Quantify effects each second year at MS level, every 5 years at Commission level	National level instruments and national transpositions of Union level instruments		Explicitly included in Amendments G-M	
			Commission action at the Union level in case of insufficient collective progress towards Energy Union objectives		P (point 7)	Article 25a (new)
	Timing	Establish that quantification happens *ex ante*	10-year INECP		D	Article 2.5
					K	Article 8a
			Biennial Progress Report		Explicitly included in Amendments L-M	
	Baseline	Prescribe the emissions projection from the most recent INECP as baseline			Explicitly included in Amendments I and M	
Intervention	***Actor***	Determine volume to be cancelled	…to counteract the effect from national and Union level overlapping instruments		P (point 1)	Article 25a (new)
			…to counteract Commission recommendations	…by individual MSs	P (point 2)	Article 25a (new)
				…by Union as a whole	P (point 7)	Article 25a (new)
		Communicate volume to be cancelled	…to individual MSs		Q	Article 28.1
			…to Union as a whole		Explicitly included in Amendment P (point 7)	
		Cancel allowances	Individual MSs		R	ETS Directive Article 12.4
			Union as a whole		Explicitly included in Amendment P (point 7)	
	Frequency	Cancel allowances each year			P (point 4)	Article 25a (new)
	Timing	Ensure cancellation is primarily *ex ante*				
	Setting	Recommend cancellation to the extent it reduces supply-demand imbalance			Explicitly included in Amendment P (points 1, 2, 4 and 7)	
	Burden-sharing	MS responsibility for national level instruments and national transpositions of Union level instruments			Explicitly included in Amendment P (point 4)	
		Union responsibility for Commission action at the Union level in case of insufficient collective progress towards Energy Union objectives			Implicitly included in Amendment P (point 7)	

ANNEX A – PROPOSED AMENDMENTS TO LEGISLATION

Our suggested amendments listed here are fully comprehensive; it may be more appropriate to start discussions with a more concise set focussing on a few essential amendments.

A.1 Recitals

Amendment A

Proposal for a regulation

Recital 5

Text proposed by the Commission	*Amendment*
The European Council agreed on 24 October 2014 on the 2030 Framework for Energy and Climate for the Union based on four key targets: at least 40% cut in economy wide greenhouse gas ("GHG") emissions, at least 27% improvement in energy efficiency with a view to a level of 30%, at least 27% for the share of renewable energy consumed in the Union, and at least 15% for electricity interconnection. It specified that the target for renewable energy is binding at Union level and that it will be fulfilled through Member States' contributions guided by the need to deliver collectively the Union target.	The European Council agreed on 24 October 2014 on the 2030 Framework for Energy and Climate for the Union based on four key targets: at least 40% cut in economy wide greenhouse gas ("GHG") emissions, at least 27% improvement in energy efficiency with a view to a level of 30%, at least 27% for the share of renewable energy consumed in the Union, and at least 15% for electricity interconnection. It specified that the target for renewable energy is binding at Union level and that it will be fulfilled through Member States' contributions guided by the need to deliver collectively the Union target. ***It also agreed to deliver the domestic greenhouse gas emission target through reductions in the ETS and non-ETS sectors amounting to 43% and 30% by 2030 compared to 2005, respectively, based on Commission modelling envisaging a 26.5% share of renewable energy and a 25.1% improvement on energy efficiency by 2030.***

Or. EN

Justification

Brings the EU ETS into the focus of the Energy Union Governance.

Amendment B

Proposal for a regulation

Recital 17

Text proposed by the Commission	*Amendment*
The achievement of the Energy Union objectives should be ensured through a combination of Union initiatives and coherent national policies set out in integrated national energy and climate plans. Sectorial Union legislation in the energy and climate fields sets out planning requirements, which have been useful tools to drive change at the national level. Their introduction at different moments in time has led to overlaps and insufficient consideration of synergies and interactions between policy areas. Current separate planning, reporting and monitoring in the climate and energy fields should therefore as far as possible be streamlined and integrated.	The achievement of the Energy Union objectives should be ensured through a combination of Union initiatives and coherent national policies set out in integrated national energy and climate plans. Sectorial Union legislation in the energy and climate fields sets out planning requirements, which have been useful tools to drive change at the national level. Their introduction at different moments in time has led to overlaps and insufficient consideration of synergies and interactions between policy areas. ***This is of particular concern in the case of the European carbon market, the Union's flagship instrument ensuring the cost-effective decarbonisation of more than 10,000 installations that account for 40% of domestic greenhouse gas emissions, and whose supply-demand balance has proven to be sensitive to the effect of policies and measures with overlapping policy objectives.*** Current separate planning, reporting and monitoring in the climate and energy fields should therefore as far as possible be streamlined and integrated. ***Furthermore, the effectiveness of European policies and measures should be preserved even as the objectives, targets and contributions of one or more related policies and measures change over time. In particular with respect to the European carbon market, the Energy Union Governance should feature a permanent rule-based mechanism dynamically adjusting the EU ETS's design parameters to reflect any ongoing and future modifications in the targets of other policies and measures. This new Governance feature should be additional to, and not diluted by, the market adjustments implemented under Decision 2015/1814, which only seeks to***

restore market stability within a fixed set of architectural parameters.

Or. EN

Justification

Articulates that the Governance regulation shall ensure coherence between climate and energy policies. The ETS should be insulated from the effects of overlapping instruments whose targets have changed since the ETS was designed. Neither the legislative process revising the ETS Directive, nor the Proposals revising the renewables and energy efficiency Directives, contain mechanisms that can correct interferences between overlapping instruments. The Governance Regulation is the ideal act to include a Policy Coherence Mechanism to preserve the intended effectiveness of all Union and national acts.

Amendment C

Proposal for a regulation

Recital 18

Text proposed by the Commission	*Amendment*
The integrated national energy and climate plans should cover ten-year periods and provide an overview of the current energy system and policy situation. They should set out national objectives for each of the five key dimensions of the Energy Union and corresponding policies and measures to meet those objectives and have an analytical basis. The national plans covering the first period from 2021 to 2030 should pay particular attention to the 2030 targets for greenhouse gas emission reductions, renewable energy, energy efficiency and electricity interconnection. Member States should aim to ensure that the national plans are consistent with and contribute to achieving the Sustainable Development Goals.	The integrated national energy and climate plans should cover ten-year periods and provide an overview of the current energy system and policy situation. They should set out national objectives for each of the five key dimensions of the Energy Union and ***all*** corresponding policies and measures to meet those objectives and have an analytical basis. The national plans covering the first period from 2021 to 2030 should pay particular attention to the 2030 targets for greenhouse gas emission reductions, renewable energy, energy efficiency and electricity interconnection***, and how the policies and measures for meeting those targets affect the carbon market***. Member States should aim to ensure that the national plans are consistent with and contribute to achieving the Sustainable Development Goals.

Or. EN

Justification

Policies and measures leading to significant decarbonisation should be covered, and all of their effects on the EU ETS should be evaluated.

A.2 Definitions

Amendment D

Proposal for a regulation

Article 2 – point 5

Text proposed by the Commission	*Amendment*
'projections' means forecasts of anthropogenic greenhouse gas emissions by sources and removals by sinks or developments of the energy system including at least quantitative estimates for a sequence of four future years ending with 0 or 5 immediately following the reporting year;	'projections' means forecasts of anthropogenic greenhouse gas emissions by sources and removals by sinks or developments of the energy system including at least quantitative estimates for ***all years between the present and the last year of*** a sequence of four future years ending with 0 or 5 immediately following the reporting year**, expressed as *Mt of $CO2_e$***;

Or. EN

Justification

Creates the analytical basis for conducting ex ante projections for the effect of overlapping instruments for all years within a given ETS phase.

Amendment E

Proposal for a regulation

Article 2 – point 18a (new)

Text proposed by the Commission	*Amendment*
	(18a) 'overlapping policies and measures' refer to all Union and national level policies and measures other than the European carbon market implemented through Directive 2003/87/EC contributing to the limitation and reduction of greenhouse gas emissions stemming from activities

listed under Annex I of the same Directive, including but not limited to support mechanisms for renewable energy sources, energy efficiency measures, regulatory interventions affecting the operation of power plants relying on the combustion of fossil fuels, carbon price supports, and so forth;

Or. EN

Justification

Defines overlapping policies and allows for definition to expand beyond what is explicitly mentioned in the Governance Regulation Proposal. The definition matches the one provided in Art. 1.4 of Decision 2015/1814 [MSR Decision].

Amendment F

Proposal for a regulation

Article 2 – point 18b (new)

Text proposed by the Commission	*Amendment*
	(18b) 'carbon market surplus' refers to the cumulative number of allowances issued in the period since 1 January 2008, including the number issued pursuant to Article 13(2) of Directive 2003/87/EC in that period and entitlements to use international credits exercised by installations under the EU ETS in respect of emissions up to 31 December of a given year, minus the cumulative tonnes of verified emissions from installations under the EU ETS between 1 January 2008 and 31 December of that same given year, any allowances cancelled in accordance with Article 12(4) of Directive 2003/87/EC and the number of allowances in the Market Stability Reserve.

Or. EN

Justification

Brings the definition of the ETS surplus into Governance Regulation.

A.3 Quantification

A.3.1 Member States

Amendment G

Proposal for a regulation

Article 4

Text proposed by the Commission	*Amendment*
Member States shall set out in their integrated national energy and climate plan the following main objectives, targets and contributions, as specified in Section A.2. of Annex I:	Member States shall set out in their integrated national energy and climate plan the following main objectives, targets and contributions, as specified in Section A.2. of Annex I:
(a) as regards the dimension "Decarbonisation":	(a) as regards the dimension "Decarbonisation":
(1) with respect to greenhouse gas emissions and removals and with a view to contributing to the achievement of the economy wide EU greenhouse gas emissions reduction target:	(1) with respect to greenhouse gas emissions and removals and with a view to contributing to the achievement of the economy wide EU greenhouse gas emissions reduction target:
i. the Member State's binding national target for greenhouse gas emissions and the annual binding national limits pursuant to Regulation [ ] [ESR];	i. the Member State's binding national target for greenhouse gas emissions and the annual binding national limits pursuant to Regulation [ ] [ESR];
ii. the Member State's commitments pursuant to Regulation [ ] [LULUCF];	ii. the Member State's commitments pursuant to Regulation [ ] [LULUCF];
iii. where applicable, other national objectives and targets consistent with existing long-term low emission strategies;	iii. where applicable, other national objectives and targets consistent with existing long-term low emission strategies***, including such that affect emissions stemming from activities covered by Directive 2003/87/EC [ETS]***;
iv. where applicable, other objectives and targets, including sector targets and adaptation goals;	iv. where applicable, other objectives and targets, including sector targets and adaptation goals;

Or. EN

Justification

This amendment is specific to the ten-year cycle tied into Member States' integrated national energy and climate plans. It imposes an explicit responsibility on Member States to mention in these ten-year plans any policies and measures affecting the EU ETS that they plan to introduce. The original Proposal left it open to interpretation based on language in Section A.2 of Annex I, Part 1 whether Member States had this responsibility.

Amendment H

Proposal for a regulation

Annex I, Part 1, Section A: National Plan

2. National Objectives and Targets

2.1 Dimension Decarbonisation

Text proposed by the Commission	*Amendment*
2.1.1. GHG emissions and removals (for the plan covering the period from 2021 to 2030, the 2030 Framework target of at least 40% domestic reduction in economy-wide greenhouse gas emissions as compared to 1990)	2.1.1. GHG emissions and removals (for the plan covering the period from 2021 to 2030, the 2030 Framework target of at least 40% domestic reduction in economy-wide greenhouse gas emissions as compared to 1990)
i. The Member State's binding national 2030 target for greenhouse gas emissions in the non-ETS-sectors, the annual binding national limits and the commitments under the LULUCF Regulation.	i. The Member State's binding national 2030 target for greenhouse gas emissions in the non-ETS-sectors, the annual binding national limits and the commitments under the LULUCF Regulation.
ii. If applicable, other national objectives and targets consistent with existing long-term low emission strategies. If applicable, other objectives and targets, including sector targets and adaptation goals.	ii. If applicable, other national objectives and targets consistent with existing long-term low emission strategies. If applicable, other objectives and targets, including ***both ETS and non-ETS*** sector targets and adaptation goals.

Or. EN

Justification

Same as Amendment G, adding explicit responsibility in Section A.2 of Annex I, Part 1 to list objectives that affect the EU ETS.

Amendment I

Proposal for a regulation

Annex I, Part 1, Section A: National Plan

3. Policies and Measures

3.1 Dimension decarbonisation

Text proposed by the Commission	*Amendment*
3.1.1. GHG emissions and removals (for the plan covering the period from 2021 to 2030, the 2030 Framework target)	3.1.1. GHG emissions and removals (for the plan covering the period from 2021 to 2030, the 2030 Framework target)
i. Policies and measures to achieve the target set under Regulation [ ] [ESR] as referred to in 2.1.1 and policies and measures to comply with Regulation [ ] [LULUCF], covering all key emitting sectors and sectors for the enhancement of removals, with an outlook to the long-term vision and goal to become a low-carbon economy with a 50 years perspective and achieving a balance between emissions and removals in accordance with the Paris Agreement	i. Policies and measures ***to restrict emissions of activities regulated under the ETS,*** to achieve the target set under Regulation [ ] [ESR] as referred to in 2.1.1 and policies and measures to comply with Regulation [ ] [LULUCF], covering all key emitting sectors and sectors for the enhancement of removals, with an outlook to the long-term vision and goal to become a low-carbon economy with a 50 years perspective and achieving a balance between emissions and removals in accordance with the Paris Agreement
[…]	[…]

Or. EN

Justification

Same as Amendment G, adding explicit responsibility in Section A.4 of Annex I, Part 1 to list instruments that affect the EU ETS.

Amendment J

Proposal for a regulation

Article 8.2

Text proposed by the Commission	*Amendment*
Member States shall describe in their	Member States shall describe in their

integrated national energy and climate plan their assessment, at national and where applicable regional level, of:	integrated national energy and climate plan their assessment, at national and where applicable regional level, of:
[…]	[…]
	(new)
	(d) a quantitative assessment of the extent to which each of the Member State's planned overlapping policies and measures affects the carbon market surplus, calculated in accordance with Article 8a.

Or. EN

Justification

Binds MSs to assess in the ten-year plans what effect each individual planned overlapping instrument has on the EU ETS.

Amendment K

Proposal for a regulation

Article 8a (new)

Text proposed by the Commission	*Amendment*
	Calculation of the impact on the carbon market
	1. For all overlapping policies and measures that are part of existing policies and measures as of 1 January 2019 the expected effect on the carbon market shall be calculated.
	2. For each of the planned overlapping policies and measures that have not been announced in a prior plan, strategy or report pursuant to this Regulation, this effect shall be calculated as the difference between:
	a. the to be published projections with additional measures, and
	b. the to be published projection

with measures.

3. ***For each of the policies and measures that have been announced in a prior plan, strategy or report pursuant to this Regulation, this effect shall be calculated as the sum of***

    a. ***the updated expected effect on the carbon market, calculated as the difference between:***

        i. ***an update to the latest prior projections with additional measures, also reflecting all variation in effect on the carbon market relative to the values expected at the time of the latest prior quantification, and***

        ii. ***the projections with measures published in the year the policies and measures in question were first announced.***

    b. ***A corrective term, calculated as the quotient of:***

        i. ***the variation in the outturn effect on the carbon market delivered relative to the effect expected at the time of the latest prior quantification, and***

        ii. ***the number of future years still remaining in the ongoing Phase of the EU ETS.***

4. ***For the purposes of paragraphs 2 and 3, separate projections with additional measures shall be calculated for each of the overlapping policies and measures, without any aggregation for multiple policies and measures.***

5. ***When updating calculations, Member States and the Commission shall strive to be consistent in the coverage of overlapping policies and measures that have been previously announced.***

Or. EN

Justification

Specifies an ex ante quantification methodology. The amendment uses "projections with measures", defined under Art.2.7 of the original to Proposal to establish a baseline for emissions without new overlapping instrument. This baseline is fixed to the year of the instrument is announced. The effect on the carbon market is calculated as the difference between that baseline and "projections with additional measures". Defined under Art. 2.8 of the original Proposal, "projections with additional measures" captures the effect of the new instrument. Paragraph 4 ensures that this quantification happens only for one instrument at a time.

Paragraph 3 allows for quantifications to be updated in case instruments over- or under-deliver. Because emissions can be affected by real world changes that have nothing to do with the instrument itself, the methodology keeps the original baseline through paragraph 3.a.ii. The element that changes is the projections of the instrument's effect, updated pursuant to paragraph 3.a.i. This procedure allows a continuous update of ex ante expectations against a fixed business as usual scenario.

Paragraph 3.b also allows for ex post corrections in the case that past quantifications turn out to be inaccurate. If experience during the years between quantifications reveals inaccurate projections, the mechanism introduces corrections in future years to correct for inaccurate past interventions. Paragraph 3.b.ii ensures that these corrections only take place during an ongoing ETS Phase, as the architectural features of future Phases are not known.

Although this amendment is placed in the part of the Regulation that affects the integrated national energy and climate plans, it is referenced later on for the purpose of Member States' quantifications on the occasion of the biennial progress reports.

Amendment L

Proposal for a regulation

Annex IV.c.v

Text proposed by the Commission	*Amendment*
- the results of ex ante assessments of the effects of individual ***[~~or groups of~~]*** policies and measures ***[~~on the mitigation of climate change~~]***. Estimates shall be provided for a sequence of four future years ending with 0 or 5 immediately following the reporting year, with a distinction between greenhouse gas emissions covered by Directive 2003/87/EC,	- the results of ex ante assessments of the effects of individual policies and measures ***contributing to the limitation and reduction of greenhouse gas emissions, calculated in accordance with Article 8a***. Estimates shall be provided for ***all years between the present and the last year of*** a sequence of four future years ending with 0 or 5 immediately following the

Regulation [ ] [ESR] and Regulation [ ] [LULUCF];	reporting year, with a distinction between greenhouse gas emissions covered by Directive 2003/87/EC, Regulation [ ] [ESR] and Regulation [ ] [LULUCF];
- the results of ex post assessments of the effects of individual [~~***or groups***~~] of policies and measures on the mitigation of climate change ***[~~where available~~]***, with a distinction between greenhouse gas emissions covered by Directive 2003/87/EC, Regulation [ ] [ESR] and Regulation [ ] [LULUCF];	- the results of ex post assessments of the effects of individual policies and measures on the mitigation of climate change, with a distinction between greenhouse gas emissions covered by Directive 2003/87/EC, Regulation [ ] [ESR] and Regulation [ ] [LULUCF];

Or. EN

Justification

Annex IV governs the reporting of instruments that Member States would do as part of their biennial progress reports, pursuant to Article 16 of the Proposal. This mirrors reporting obligations in the 10-year integrated national energy and climate plans, pursuant to Article 4. This amendment specifies that quantification should happen for each individual policy in the case of biennial progress reports, as well. It captures instruments that are not explicitly labelled as climate mitigation policies and measures, such as energy policy instruments.

Amendment M

Proposal for a regulation

Annex V

Text proposed by the Commission	*Amendment*
(a) projections without measures where available, projections with measures, and projections with additional measures;	(a) projections without measures where available, projections with measures, and projections with additional measures ***for all individual sources mentioned under point (b)***;
(b) total greenhouse gas projections and separate estimates for the projected greenhouse gas emissions for the emission sources covered by Directive 2003/87/EC and by Regulation [ ] [ESR] and the projected emissions by sources and removals by sinks under the Regulation [ ] [LULUCF];	(b) total greenhouse gas projections and separate estimates for the projected greenhouse gas emissions for the emission sources covered by Directive 2003/87/EC and by Regulation [ ] [ESR] and the projected emissions by sources and removals by sinks under the Regulation [ ] [LULUCF];
(c) the impact of policies and measures identified pursuant to Article 16(1)(a). Where such policies and measures are not	(c) the impact of ***individual*** policies and

included, this shall be clearly stated and explained;	measures identified pursuant to Article 16(1)(a) ***for all individual sources mentioned in paragraph (b).*** Where such policies and measures are not included, this shall be clearly stated and explained;
(d) results of the sensitivity analysis performed for the projections and information on the models and parameters used;	(d) results of the sensitivity analysis performed for the projections and information on the models and parameters used;
(e) all relevant references to the assessment and the technical reports that underpin the projections referred to in Article 16(4).	(e) all relevant references to the assessment and the technical reports that underpin the projections referred to in Article 16(4).

Or. EN

Justification

Annex V governs the reporting of the effects of the instruments that Member States would do as part of their biennial progress reports, pursuant to Article 16 of the Proposal. This mirrors reporting obligations in the 10-year integrated national energy and climate plans, pursuant to Article 4. This amendment reinforces that policies and measures must be individually quantified, and explicitly calls for quantifying the impact on the carbon market.

A.3.2 Commission

Amendment N

Proposal for a regulation

Article 12

Text proposed by the Commission	*Amendment*
The Commission shall assess the integrated national energy and climate plans and their updates as notified pursuant to Articles 3 and 13. It shall assess in particular whether:	The Commission shall assess the integrated national energy and climate plans and their updates as notified pursuant to Articles 3 and 13 ***in a report submitted to the European Parliament and Council no later than October 31 of the year when it receives the respective notifications***. It shall assess in particular whether:
(a) the targets, objectives and contributions are sufficient for the collective achievement of the Energy Union objectives and for the first ten-years period in particular the targets of the Union's 2030 Climate and Energy Framework;	(a) the targets, objectives and contributions are sufficient for the collective achievement of the Energy Union objectives and for the first ten-years period in particular the targets of the Union's 2030 Climate and
(b) the plans comply with requirements of Articles 3 to 11 and the Commission	

recommendations issued pursuant to Article 28***[.]***	Energy Framework; (b) the plans comply with requirements of Articles 3 to 11 and the Commission recommendations issued pursuant to Article 28; ***(c) the accuracy of Member State estimates of the effect of national level overlapping policies and measures on the supply-demand balance of the EU ETS, or, in absence of such estimates, conduct its own assessment of the same impact;*** ***(d) the effect of Union level overlapping policies and measures on the supply-demand balance of the EU ETS.***

Or. EN

Justification

Binds the Commission to verify within one year all MSs' quantifications from the ten-year plans about the likely effect of the overlapping instruments on the EU ETS.

Amendment O

Proposal for a regulation

Article 25.1

Text proposed by the Commission	*Amendment*
By 31 October 2021 and every second year thereafter, the Commission shall assess, in particular on the basis of the integrated national energy and climate progress reports, of other information reported under this Regulation, of the indicators and of European statistics where available:	By 31 October 2021 and every second year thereafter, the Commission shall assess, in particular on the basis of the integrated national energy and climate progress reports, of other information reported under this Regulation, of the indicators and of European statistics where available:
[…]	[…]
	(d) the accuracy of Member State estimates of the effect of national level overlapping policies and measures on the supply-demand balance of the EU ETS, or, in absence of such estimates, conduct its own assessment of the same

impact;

(e) the effect of Union level overlapping policies and measures on the supply-demand balance of the EU ETS.

Or. EN

Justification

This amendment is the counterpart for the biennial progress reports for the verification conducted in response to the 10-year integrated national energy and climate plans. The Commission shall verify the assessment conducted by MSs about their individual overlapping instruments, as well as conduct its own assessment of Union level instruments.

A.4 Intervention

Amendment P

Proposal for a regulation

Article 25a (new)

Text proposed by the Commission	*Amendment*
	Article 25 a
	Follow-up in case of overlapping policies and measures affecting the carbon market surplus
	1. If pursuant to Article 12.c, Article 25.1.d or Article 25.1.e of the present Regulation the Commission concurs with a Member State's assessment that any individual overlapping policies and measures implemented by that Member State cause the carbon market surplus to increase, it shall communicate to the Member State in question a schedule to withhold allowances from future auctions and cancel them in a volume sufficient to undo this effect on the carbon market surplus.
	2. If pursuant to Article 27.2 or Article 27.3 of the present Regulation the

Commission recommends that a given Member State implement any overlapping policies or measures that increase the carbon market surplus, it shall recommend to this Member State a schedule to withdraw allowances from future auctions and cancel them in a volume sufficient to undo this effect on the carbon market surplus.

3. ***In the case of disagreement between the Commission and any Member State about the volume of allowances to be withheld from auctions and cancelled in accordance with the schedules communicated pursuant to subparagraphs 1 or 2 of this article, the two parties shall strive to reconcile their differences bilaterally by producing a jointly agreed upon estimation of the effect of the concerned overlapping policies and measures on the carbon market and a schedule to withhold allowances from auctions and cancel them. The time limit for reaching such an agreement shall be within three months of the Commission announcing its original findings. Failing such agreement, the matter shall be referred to the Energy Union Committee mentioned in Article 37 without undue delay. If this committee fails to reach agreement within a time frame of three additional months, the Commission's original quantification and recommended schedule shall prevail.***

4. ***The schedules mentioned in subparagraphs 1, 2 and 3 of this article shall not:***

    (a) include allowance volumes to be withheld and cancelled in response to any other overlapping policies and measures implemented in the Member State in question,

(b) include allowance volumes to be withheld and cancelled in response to overlapping policies and measures implemented in any other Member States, and

(c) cover years when those overlapping policies and measures no longer increase the carbon market surplus or lie beyond the ongoing Phase of the EU ETS.

5. The schedules mentioned in paragraphs 1, 2 and 3 of this article shall not recommend to any individual Member State to withdraw and cancel allowances for overlapping policies and measures that:

(a) do not increase the carbon market surplus, or

(b) the Member States in question are not individually responsible for.

6. The Commission shall communicate the schedules mentioned in paragraphs 1, 2 and 3 of this article to the concerned Member States by means of the recommendation issued pursuant to Article 28.

7. If pursuant to Article 27.1, paragraph Article 27.5 or a delegated act in accordance with Article 36 for the establishment and functioning of the financing platform referred under point (c) of Article 27.4 of the present Regulation the Commission initiates any Union level measure that increases the carbon market surplus, it shall make a proposal to the European Parliament and the Council for a new Union level act specifying a schedule to withdraw allowances from future auctions and cancel them in a volume sufficient to

undo this effect on the carbon market surplus within the ongoing Phase of the EU ETS. This proposal shall be accompanied by an impact assessment quantifying the effects of such measures on the carbon market based on information reported under this Regulation, indicators and European statistics where available. No such measure shall be implemented before the Union adopts an act explicitly authorising it alongside the intervention undoing the expected effect on the carbon market surplus.

Or. EN

Justification

Paragraphs 1 and 2 obligate the Commission to communicate cancellation schedules to Member States in response to overlapping instruments implemented at the initiative of either the Member State governments or Commission recommendations.

Paragraph 3 provides a conciliation procedure to address potential disagreements with the Commission's recommendations.

Paragraph 4 creates a duty to cancel allowances if any policy or measure results in a net increase of the ETS surplus. The Commission communicates this duty to Member States through paragraph 6. Member States cannot diminish their duty to cancel by netting off policies and measures that decrease the surplus against ones that increase it.

Furthermore, under paragraph 5, in order to maintain the direction of travel towards decarbonisation, instruments that decrease the ETS surplus do not cause any intervention into the carbon market.

Finally, under paragraph 7, Member States must adjust their auctioning schedules for the instruments that their governments are individually responsible for, while in the case the instruments for which it or all EU MSs are collectively responsible for the Commission must propose a method for collectively sharing this burden. Such would be the case of Commission interventions in the case of insufficient progress towards the 2030 goals for renewable energy and energy efficiency, or other Union-level acts.

Amendment Q

Proposal for a regulation

Article 28.1

Text proposed by the Commission	*Amendment*
The Commission shall as appropriate issue	The Commission shall as appropriate issue

recommendations to Member States to ensure the achievement of the objectives of the Energy Union.	recommendations to Member States to ensure the achievement of the objectives of the Energy Union ***and to neutralise the effect of overlapping policies and measures that would increase the carbon market surplus.***

Or. EN

Justification

The Commission shall communicate cancellation schedules to Member States in response to both the 10-year integrated national energy and climate plans, and the biennial progress reports.

Amendment R

Proposal for a regulation

Article 49a (new)

Text proposed by the Commission	*Amendment*
	Article 49 a
	Amendment to Directive 2003/87/EC
	In Article 12 of Directive 2003/87/EC, paragraph 4 is amended as follows:
	"4. Member States shall take the necessary steps to ensure that allowances will be cancelled at any time at the request of the person holding them, or at the recommendation of the Commission under [Article 28] of the Regulation [XX/20XX] [this regulation] in accordance with the recommended schedule."

Or. EN

Justification

Member States shall implement the cancellation schedules as communicated by the Commission.

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ANNEX B – EU ETS OVERSUPPLY: EVIDENCE FROM LITERATURE REVIEW

In this section we present the findings of a literature review to determine the approximate size and impact of overlapping policies introduced to date and in the future (Table 5 below for the full list of publications). We focus on policies led at the EU level, as well as their impact on EU ETS emissions as a whole rather than on the specific emissions or individual policies of a member state.

Table 5 – Literature review publications

Study of the EU 2030 Energy Package for OED (Norwegian Energy Ministry). Pöyry, 2014.
Market modelling of the implications of overlapping renewables, energy-efficiency and emission reduction targets for International Paper. Pöyry, 2017.
Overlapping policies with the EU ETS. International Emissions Trading Association (IETA), 2015.
Policy interaction between the EU Emissions Trading System and the Renewable Energy Directive. CEPS, 2016.
Understanding and Managing EU ETS Policy Interactions. Sandbag, 2015.
Wake Up!: Reforming the EU Emission Trading Scheme. FTI Consulting, 2017.
Energy efficiency and the ETS. ITRE, 2013.
EU ETS Reform. Eurelectric, 2016.
Options to strengthen the EU ETS. ICIS, 2016.
A utilities perspective on the progress towards a single market. CEZ Group, 2016.
Sidelined or in the driver's seat? ETS Interactions with other policies. Thomson Reuters, 2017.
The need for a dynamic adjustment of supply in order to ensure the resilience of the EU-ETS. EDF, 2016.
Towards a successful coordination of climate-energy policies. EDF, 2017.
Impact assessment accompanying the document 'A policy framework for climate and energy in the period from 2020 up to 2030'. European Commission, 2014.
2017 State of the EU ETS Report. RCST, Wegener Center, Nomisma Energia & I4CE, 2017.

B.1 Policy overlaps up until 2020

In this section we look at levels of abatement achieved from 2008 to date and estimated to 2020.

Relative to a business as usual baseline, renewable energy has provided the most carbon savings under the ETS to date. Estimated contributions range between 37%[17] and 40%[18] with further investment expected to be a major driver of future carbon reduction[19].

However much of this abatement was anticipated when the 2020 targets were set as it is extremely challenging to align three parallel targets (renewables, energy efficiency, and greenhouse gases). In the case of renewables, this means only the over-achievement represents an additional policy overlap.

IETA estimates that the impact of these changes impacting EE and RES would reduce demand for allowances by 1125Mt from 2008 to 2020 (915Mt from EE, 210 from RES). This equates to approximately 23% and 5% respectively of the anticipated total required abatement from stationary emissions over that period[20]. This brings the total overlap to ~1.1bn tonnes by 2020 (28% of the total required abatement in Phase 2).

IETA assumes that at the time the Phase 2 cap was designed, only a 10% energy efficiency 2020 target was set, but this was then increased to 20%, hence the estimation for *additional* overlap not already included in the cap. On the renewable energy side, they assume the 20% RES target was already incorporated into the cap for 2020, but that the overachievement of RES from 2008-20 will lead to an additional 300TWh of renewable generation not included in the cap.

IETA's numbers are corroborated by other studies e.g.:

- In the first 10 years of the ETS (from 2005-15) it is estimated by CEPS that the RES Directive reduced demand for allowances by 130-140Mt[21].
- Emissions reductions from the RES Directive were estimated at ~50Mt by 2010[22] by CDC.
- On energy efficiency, the EC estimated that the binding measures under the EED would reduce primary energy consumption by around 17% across the ETS scope

17 Understanding and managing the EU ETS policy interactions. Sandbag, June 2015.

18 Introducing short term flexibility in the EU ETS to assure its long-term credibility: a multi-criteria analysis of policy options. CDC Climat, July 2014.

19 2017 State of the EU ETS Report. ERCST, Wegener Center, Nomisma Energia & I4CE, 2017.

20 The denominator for this equation was calculated by taking the annual cap minus the 2007 cap; these annual abatement numbers were summed for the period 2008-2020 to give an estimation of the total required abatement.

21 Policy interaction between the EU Emissions Trading System and the Renewable Energy Directive. CEPS, October 2016.

22 Energy efficiency, renewable energy and CO_2 allowances in Europe: a need for coordination. CDC Climate Brief, September 2012.

until 2020[23,24]. This would correspond to ~450Mt compared to ~650Mt if the 20% target was reached[25].

B.2 Policy overlaps from 2021 to 2030

Since the 2030 cap was set, the Council conclusions in 2014 and the 2016 Clean Energy package (often referred to as the Winter Package) increased:

- the renewable target upwards by 0.5pp to 27%; and
- the energy savings target by 4.9pp to 30%.

Table 6 summarises the projected impact of this increased ambition.

Table 6 – Projected impact on the EU ETS of increased RES and EE ambition announced in the Clean Energy package in the period 2021-30

Impact	Reference	Renewables	Energy efficiency	Total
Volume	CEZ[26]	137Mt (14Mt/yr)	1,031Mt (103Mt/yr)	1,168Mt
	FTI Consulting[27]	92Mt (9Mt/yr)	718Mt (72Mt/yr)	810Mt
Price	COMM[28]	*n/a*	From €42/t to €27/t (-35%)	*n/a*
	FTI Consulting[27]	*n/a*	*n/a*	From €37/t to €30/t (-23%)

The evidence in Table 6 suggests the stricter targets under the EED and the RED for the period 2021 to 2030, equates to approximately 31% and 4% respectively of the anticipated total required abatement from stationary emissions in that period[29]. Energy efficiency has a much larger overlapping impact because the change in scope was much

23 Energy efficiency and the ETS. ITRE/European Parliament, January 2013.

24 "Commissioner Günther Oettinger Welcomes Political Agreement on the Energy Efficiency Directive". EU Press Release, June 2012.

25 "Energy Efficiency, Renewable Energy and CO2 Allowances in Europe: A Need for Coordination". Climate Brief, no. 18, CDC Climat Research, September 2012.

26 A utilities perspective on the progress towards a single market, CEZ Group, presented at Platts 8th Annual Power Summit 21 March 2016.

27 Wake Up!: Reforming the EU Emission Trading Scheme, FTI Consulting, 2017.

28 Impact assessment accompanying the document Proposal for a Directive of the European Parliament and of the Council amending Directive 2012/27/EU on Energy Efficiency. European Commission, November 2016.

29 The denominator for this equation was calculated by taking the annual cap minus the 2020 cap; these annual abatement numbers were summed for the period 2021-2030 to give an estimation of the total required abatement.

larger (4.9pp rather than 0.5pp for renewables) compared to the EC baseline assumptions. Indeed it is telling that the EC's own figures project a 35% decrease in the carbon price, from €42/t to €27/t, in response to this policy overlap.

It should be noted that although there is good agreement on the direction of the impact in the literature, there remains some uncertainty to the absolute level. For example the Council's non-paper[30] downplays the importance stating "the scale of the impacts should not be overestimated"[31]. This is also supported by Pöyry's December 2014 assessment of the 2030 climate and energy package. Compared to a base case (assuming only pre-existing policies extending from 2020 to 2030) the new package reduced the projected 2030 carbon price by around 10%[32]. It is clear from this assessment that the projected scale of the impacts on the supply-demand balance and on carbon prices will depend on assumptions of the type of policies implemented, the assumed baseline, the price modelling and the sectors and fuels affected.

B.3 Exploration of other sensitivities for Phase 4

In addition to the EE and RES policies, MSs may introduce a variety of policies that overlap with the EU ETS, either as part of a wider EU level policy such as the Industrial Emissions Directive, or completely independently such as the introduction of the UK's carbon price floor. Given the uncertainty around the rules of Phase 4 and the variety of policies various MSs could introduce, it is helpful to explore some hypothetical future scenarios to understand orders of magnitude of such policies.

In 2016 Eurelectric commissioned a study to investigate options to strengthen the ETS[33]. They modelled a variety of scenarios to understand the impact of various hypothetical cases in Phase 4. The projected impacts on the 2030 carbon price are as follows:

- the phase-out of coal/lignite in Germany would decrease carbon prices by 15%;
- a combination of national measures resulting in higher renewable energy deployment would decrease carbon prices by 7%; and
- an EU wide energy efficiency target of 35% in 2030 (an increase of 5pp) would decrease carbon prices by 54%.

Once again this highlights that energy efficiency targets have an extremely large impact on the demand for carbon allowances. The study also shows that shifting the overlapping volume into the MSR can be an appropriate way to minimise the impact on the carbon price.

Other studies run through additional scenarios which provide some additional colour:

- Pöyry[34] sensitivity analysis revealed carbon prices in 2030 would decrease by:

30 Non-paper; A discussion paper which is not to form part of formal business.

31 Non-paper on the interaction of energy efficiency with ETS and Effort Sharing. Council of the EU, March 2017.

32 Study of the EU 2030 Energy Package (report to OED). Pöyry, December 2014.

33 Options to strengthen the EU ETS. ICIS Tschah Solutions, October 2016.

  - -64% if electricity demand were to stay constant from 2020;
  - -52% if a 'high' level (+30% by 2040) of renewables were deployed; and
  - -14% in the event of an early coal phase out (5 year reduced lifetime).

- Thomson Reuters anticipate that an increased EE target of 40% could decrease carbon prices by -26%; or a EU-wide coal phase out could decrease carbon prices by -35%, both relative to the currently reforms proposed by the European Council[35].
- EDF estimate that the MSR must absorb at least 4,000Mt in order to ensure that a price higher than €30/t could be reached before 2030[36].

In summary, there are numerous examples of potentially new overlapping policies that could be envisaged that will have a considerable impact on the EU ETS if mechanisms are not in place to account for them. There is little evidence in the literature reviewed that the proposed amendments to the EU ETS, including the various options for MSR introduction currently considered, will be sufficient to counteract such an impact.

34 Market modelling of the implications of overlapping renewables, energy-efficiency and emission reduction targets for International Paper, 2017, Pöyry.

35 Sidelined or in the driver's seat? ETS interaction with other policies. Thomson Reuters, April 2017.

36 The need for a dynamic adjustment of allowance supply in order to ensure the resilience of EU-ETS. EDF, June 2016.

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ANNEX C – CRITERIA FOR SYSTEMATIC MECHANISM EVALUATION

We have defined the following criteria to evaluate the effectiveness of a mechanism:

- timeliness;
- comprehensiveness;
- accuracy;
- predictability; and
- feasibility.

Some of the criteria tend to oppose one another e.g. a mechanism that is comprehensive in scope is inherently harder to quantify (and hence is less accurate), than a mechanism focussed on a few policies.

C.1 Timeliness

One of the most important questions about any potential mechanism will be, in the event of continued policy overlap, how quickly it can restore the supply-demand balance such that the EU ETS can adequately fulfil its function to provide an investment signal to decarbonise the European economy. This criterion is relevant for assessing the quantification and intervention building blocks – in particular their timing and frequency elements.

Where the supply-demand balance ought to lie is still a somewhat politically contentious question. The EU provided barely an indication in 2015, when the MSR Decision was established that the desirable range for the difference between cumulative supply and cumulative demand lie between 400 and 833 million EUAs. However, political considerations aside, it remains a fact that the carbon market has been oversupplied every year since 2009. The EC's latest figures (12 May 2017) state that there are currently 1.69bn tonnes CO_2 of EUAs in circulation by 31 December 2016. The surplus is expected to take a long time to sink between the safety margins of MSR Decision. This is because the regular yearly intake of excess allowances from auctions into the reserve is not slated to commence before 2019 and because the LRF, increasing from 1.74% to 2.2% post-2020, would likewise tighten supply only gradually. The raised numerical targets for the RES and EE Directives will likely further delay the date when carbon pricing can meaningfully guide investments in Europe.

Mechanisms that act in a timelier manner are likely to be more effective at shoring up the EU ETS as a strong decarbonisation driver. This can refer to mechanisms that act earlier (*ex ante* rather than *ex post*) or more frequently.

C.2 Comprehensiveness

In order to reassert the primacy of the carbon market as a driver of European climate policy any suggested mechanism ought to ideally be able to deal with the impacts of any overlapping instrument, irrespective of the time and level of its introduction. It should therefore also encourage the consideration of overlapping effects in the ongoing implementation of new energy and climate change policies. These considerations make this criterion relevant for the following elements:

- **Instruments**: Mechanisms' coverage should be as complete as possible under this element of the scope building block. Those that are tailored to neutralise the effect of a narrow range of instruments may only have a limited impact in terms of correcting the imbalance between the supply and demand of the EU ETS. The easier a mechanism can be extended to deal with additional overlapping instruments, the more potentially effective its design would be. Therefore, probably the most robust mechanisms would be ones that feature levers directly modifying either supply or demand in the EU ETS.
- **Duration**: It is easy to level criticism of discretionary regulatory intervention if under the duration of the scope building block the deployment of the mechanism is restricted to a single occasion. In contrast, it is easier to argue in favour of a mechanism if it represents a principled intervention that will reliably restore intended policy signals until the objective is attained. Therefore, we propose that mechanisms that are used at regular intervals, in a reporting framework that will exist for the long-term are likely to suffer the least opposition.
- **Burden sharing**: When a MS faces the cost of its own policy directly in its own allowance auction volumes (the policy pays principle) it will have the biggest incentive to incorporate this overlap into its own policy making decisions.

C.3 Accuracy

This criterion evaluates the overall accuracy of the mechanism. It is of particular relevance to the baseline element of the quantification building block and to the setting element of the intervention building block. Burden sharing among actors during intervention is also a salient aspect:

- As the objective of the Governance Regulation is to harmonise coordination among EU-level policy instruments supporting the five pillars of the Energy Union, an ideal mechanism would involve a balance between the various **actors** (the Commission and MSs) under both the quantification and intervention building blocks. From the point of view of quantification, this should take place at the level best equipped analytically to conduct it. As to intervention, sovereign MSs enjoy the right to introduce new policy instruments. Yet compared to a Union-level mechanism, these will necessarily have only a limited effect and may distort the common carbon market further. Conversely, it is also possible for a large MS to introduce an instrument that has so powerful effects that correcting them at the Union-level would require measures that would imply significant costs to other MSs. It is therefore important to find the appropriate level from which a mechanism should act.
- The **baselines** for *ex post* quantifications, being derived from outturn values, are less easily assailed than those of *ex ante* ones. The latter methodologies would need to employ clear, robust and non-controversial baselines to avoid political criticism.
- The **nature** of the intervention impacts the carbon market ideally in proportion to the imbalance that overlapping instruments have induced. If quantification assesses that there are stronger imbalances, there should tend to be more robust interventions – and *vice versa*. However, levers should bring more benefits than harm. Inaccurate interventions are likely to invite further corrections, potentially further weakening confidence in the credibility of the EU ETS as a policy instrument.
- **Burden sharing** should seek to impose costs and benefits on those most deserving. Correcting for the effects of a Union-level policy has cost implications for individual MSs. Equally, MSs are likely to be unwilling to consent to sharing at the Union level the costs of neutralising the spill-over effects of any exceptionally powerful domestic instrument introduced by a single MS.

C.4 Predictability

The ETS should be able to give a reliably consistent signal to investors about how the carbon price would evolve, under a given set of market assumptions. In the past, initiatives to correct the supply-demand imbalance such as the Backloading Decisions came under criticism for being discretionary regulatory interventions that prevented the market from working as it was supposed to and whose unforeseeable nature diminished long-term investor confidence in the ETS. This is why the Market Stability Reserve was designed in a way that would "preserve a maximum degree of predictability, [with] clear rules […] set for placing allowances in the reserve and releasing them from it".[37] This criterion therefore is salient for the actor, frequency and timing elements of both quantification and intervention building blocks:

- Selecting the appropriate **actor** responsible for quantification and/or intervention can make both building blocks seem fairer and more transparent, thereby diminishing the scope for moral hazard. Any mechanism can neutralise the effect of overlapping policies only if it is able to impose obligations on actors, so it is important to ensure that there is trust in the way it functions.
- The relationship between the **frequency and timing** elements of both quantification and intervention building blocks is a key component of predictability. It is vital that interventions do not take market participants by surprise, and that the timing of events is foreseen. The process stretching from the publication of the primary data over quantification to intervention should be long enough for stakeholders to be able to form an opinion about the likely outcomes of quantification and the corresponding measure to correct for the impact of overlapping policies.

C.5 Feasibility

The mechanism should be designed in a way to ensure it is practical to implement:

- The mechanism should be implementable with the minimal amendments to a minimal number of directives.
- This means it should not be over complex in design or exert additional administrative burdens on the parties involved. Indeed wherever possible it should keep the number of parties to a minimum and preferably tie in to existing reporting requirements.
- The implementation part of the mechanism should also be seen to act fairly between individual MSs. Furthermore the balance of power between the EC and the MSs should be acceptable to the parties involved.

[37] Decision (EU) 2015/1814, Recital 5.

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