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## **EU ETS post-2030 architecture**

Swedenergy collects and gives voice to around 500 companies that produce, distribute, sell and store energy. Our goal is to develop the energy industry – for the benefit of all, based on knowledge, an overall view of the energy system and in cooperation with our environment.

### **Summary**

- Swedenergy fully supports an ambitious EU climate target and the intermediate 2040 target of 90 percent emission in line with the 1,5-degree target set by the Paris Agreement. Efforts to limit climate change must accelerate and the 2040 target will pave the way toward the EU goal of climate neutrality 2050.
- The level of ambition in the EU emission sectors must be aligned with the overall climate targets. This implies ensuring a fair distribution of climate targets between ETS1, ETS2, ESR and LULUCF and that all sectors contribute to the target.
- Swedenergy advocates for the linear reduction factor will be kept at -4.4 percentage points after 2030 and that permanent carbon removals are fully integrated into ETS1 and waste incineration into ETS1 or ETS2.

### **Swedenergy fully supports an ambitious 2040 climate target in line with science**

Swedenergy is a strong supporter of an ambitious EU climate target in line with the 1,5-degree target set by the Paris Agreement. Global warming is a threat to mankind and extreme weather phenomena are more frequent with severe consequences. Efforts to limit climate change must accelerate and an intermediate 2040 target of 90 percent emission reduction will pave the way towards climate neutrality 2050. Furthermore, the investor community will get more predictability and confidence about the EU's decarbonization path ahead. It should also lay the foundation for the development of an ambitious, cost-effective, and highly supportive EU 2040 legislative framework.

Swedenergy advocates a net 2040 target with the inclusion of carbon removals.

Full and timely implementation of the existing legislation is key to meeting the new 2040 target. Swedenergy encourages EU policymakers to maintain the RePowerEU pace, which represents a speedier transition towards climate-neutrality than what could be achieved through the implementation of the 'Fit for 55' Package alone.

## **Public acceptance and/or support for climate change mitigation policies is key to reaching the targets**

As we move towards more ambitious targets, climate change mitigation policies will be increasingly stringent. The viability of more stringent climate policies and the achievement of climate neutrality depend not only on their efficiency but also on their (re)distributional impacts and public perception. Therefore, public support, or at least acceptance, for these policies is vital. Policies with negative social consequences must be followed by policies ensuring a just transition. Otherwise, there is the risk of a severe backlash when targets are questioned or even reduced.

## **Burden sharing**

ETS1 is a key decarbonization driver and thus it must be ensured that its level of ambition is aligned with the overall climate targets. It is also important to ensure a fair distribution of climate targets between ETS1, ETS2, ESR and LULUCF and that all sectors contribute to the targets. Swedenergy accepts that ETS1 has a higher ambition compared to non-ETS1 sectors. The exact ambitions for ETS2, ESR and LULUCF must be thoroughly analyzed with regard to e.g. cost efficiency and public acceptance. ETS1 should remain at its current ambition.

## **Linear Reduction Factor post 2030**

Swedenergy's assessment is that stakeholders in Sweden, both industry and decision makers have the expectation that the linear reduction factor (LRF) will be kept at -4.4 percentage points after 2030. This implies that no more allowances will be allocated to the market around 2039. Swedish industry and policymakers have made a bet on this and industry is currently in a rapid transition to phase out fossil CO<sub>2</sub>-emissions. Therefore, Swedenergy advocates that the LRF post 2030 is kept at -4,4 percentage points.

## **Include permanent carbon removals in ETS1**

Carbon removals (CDR) will play an indispensable part in reaching the EU's climate neutrality goal for 2050. Hence it is urgent that carbon removals are incorporated in the EU 2040 climate target and fully supported by the policy framework that will be developed in the next step. At the same time, carbon removals must not in any way replace or reduce the efforts to mitigate emissions by phasing out fossil fuels. Efforts to increase emission reductions must accelerate and CDR must be deployed at scale at the same time.

However, prohibiting emissions in ETS1 from 2039 as the above proposed LRF would lead to could be costly and damage European competitiveness. Therefore, Swedenergy advocates a balanced and timely integration of permanent carbon removals (CDR) into ETS1. This is also essential for the liquidity of the EU allowance market.

An aspect to consider regarding the timing of inclusion is that it should be done as early as possible as CDR installations have long lead times due to permitting times, building supply chains and establishing CO<sub>2</sub>-storage sites.

Only permanent CDR:s should be allowed into ETS1 as they will ensure climate benefits due to the stable and long permanence compared to e.g., CDR:s from carbon farming.

The high cost of permanent CDR:s ensures that the risk of mitigation deterrence is very low. Hence, an inclusion of permanent CDR:s will not replace or reduce the efforts to mitigate emissions but will be used to offset hard to abate emissions. However, to ensure that mitigation deterrence does not happen, some kind of safeguard might be appropriate.

Swedenergy also welcome a deeper assessment of the use of CDR trading. Tradable assets for CDR:s, for example from waste incineration or bioenergy, could provide good investment incentives in these areas. There are good examples of projects going in this direction in Sweden.

### **Ensure ETS can account for overlapping policies**

ETS1 remains the most important and cost-effective tool for cutting emissions. However, efficiency and cost effectiveness of ETS1 is affected by overlapping policies that also drive emission down. National coal phase-outs, the renewable energy directive and the energy efficiency directive are worth mentioning here.

It would be best not to introduce policies overlapping with ETS1 but instead pave the way for a cost-efficient transition in ETS1 by e.g. making permitting processes faster and reducing risks. However, as new policies with overlapping effect on ETS1 will probably be developed, it must be ensured that ETS1 can account for overlapping policies that would potentially have a negative impact.

### **Political interventions**

Risks are high in the ongoing climate transition as investment needs to phase out fossil fuels in companies which are covered by ETS1 are both large and need to happen fast. Hence, stable rules and functionality which creates credibility for the ETS1 is vital. From that perspective, the intervention measure front-loading allowances in 2022 originating from RePowerEU was unfortunate and has reinforced the perception of political risk. Ad hoc political interventions must therefore be avoided in the future.

### **Market stability reserve (MSR) reforms**

The MSR has had a positive effect on the stability of ETS1 and has created a strong price signal for phasing out emissions. However, as the cap is declining the MSR parameters need to be updated in order to properly reflect new market conditions and stay relevant. The MSR functionality should be volume based. Swedenergy advocates lowering the upper threshold to reflect the reduced emissions and lower hedging needs in the post-2030 system. The exact levels should be determined through analysis to ensure market functioning. Furthermore, the MSR intake rate should be kept at 24 percent for the ETS1 to be resilient to a rapid lowered demand.

If CDR:s are included in ETS1, an analysis on MSR functionality should be considered. The purpose of the analysis would be to avoid the risk of a swift supply increase of CDR:s into the ETS1 which would weaken the price signal.

### **Waste incineration should be included in ETS1 or ETS2 and harmonized**

Currently only three member states have mandatory EUA surrender for waste incineration in the ETS1. This results in uneven conditions of competition regarding waste treatment and inefficiencies. EU should harmonize the conditions of waste incineration within EU between different technologies and member states creating a level playing field. Also, the MRR-requirements should be harmonized.

Hence, Swedenergy advocates that the EU Commission report, mandated by Art 30 (7) of the revised EU ETS directive, should comprise a full harmonized inclusion of all waste incineration installations into either ETS1 or ETS2. Landfills should however not be included but banned altogether to avoid leakage. Going forward with inclusion, a level playing field for the competition of waste is created as well as a harmonized pricing of emission for all waste treatment technologies.

Remaining fossil emissions from waste incineration when all reasonable efforts have been made to reduce and recycle plastics must be permitted to be counterbalanced using permanent CDR:s regardless of if waste incineration is included in ETS1 or ETS2.

### **Future merger/linkage of ETS1 with ETS2 and/or other emissions systems**

Swedenergy is in favor of a strong ETS1 including new sectors and/or other emission systems, with ETS2, the UK ETS and the Paris Agreement Crediting Mechanism from article 6 as strong candidates. An expansion must be based on a thorough assessment of the current barriers to render the ETS1 trading system efficient. Changes should also be introduced transparently, in order not to jeopardize the visibility needed for investment in electricity generation, district heating and industrial decarbonization.

### **CBAM must support industry using clean energy**

When introducing the Carbon Border Adjustment Mechanism (CBAM), care should be taken not to harm existing European industry that uses clean energy. As long as the EU's main international trading partners do not make equivalent efforts to price CO2 in order to reduce GHG emissions, carbon leakage remains an important issue. However, industrial actors are key for the electricity sector and for European value creation. Thus, their competitiveness must be safeguarded through the correct utilization of carbon leakage measures.

In addition to the products included in CBAM, Swedenergy advocates for an inclusion of plastics.

Furthermore, the issue of exports from the EU regarding carbon costs and lower competitiveness for EU industry is a gap to be filled.