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EU'S CLIMATE AMBITION TO BE ALIGNED WITH THE PARIS AGREEMENT

- Fortum's position on the development of the EU climate policy

Following the successful attainment of a global climate agreement in Paris in December 2015, Fortum highlights the need to revisit and consider tightening the EU's climate policy both in the short and long term, including reforming the ETS. The legally binding Paris Agreement involving all major countries will result in a more level playing field in the global efforts to combat climate change and to reduce the risk of carbon leakage. Given the pledges by 195 countries, covering 98% of global greenhouse gas emissions, the preconditions for reconsideration of an upward adjustment of the EU 2030 emissions reduction target have, in our opinion, been met.

The following steps are needed in the development of the EU climate policy after Paris:

- The long-term target for 2050 to be specified as 95% based on the 1.5-degree goal.
- The 2030 emissions reduction target to be adjusted to 45-50% to be in line with the long-term target of 95% reduction.
- The target for 2040 to be specified by 2023.
- In line with the 95 % reduction target, the linear reduction factor (LRF) of the ETS to be increased to at least 2.6% from 2021.
- Extending the scope of ETS into the heating and cooling sector to be investigated in connection with the revision of the ET Directive and Effort-Sharing Decision.

Long-term goal to be specified

Fortum encourages the EU to specify its existing long-term target of 80-95% emissions reduction by 2050 from 1990 to reflect the Paris Agreement's aspirational goal to reach the 1.5 degree target. In our understanding, the 1.5 degree target would require about 95% reduction. Based on this long-term goal, the EU must establish a cost-efficient emissions reduction path with several milestones.

The Paris Agreement features a voluntary 'stocktake' of how national pledges are contributing to a long-term target in 2018 and a voluntary revisiting of pledges in 2020. Reconsideration of the EU's pledge including the long-term goal should, however, be done earlier, prior to the completion of the post-2020 EU ETS reform and Effort-Sharing Decision. An early decision on the long-term goal and intermediate targets is important in creating a stable and predictable framework for the post-2030 period. This is needed in the energy industry, in particular, where the investments for 2050 should be made during the next decade. The target for 2040 should be specified by 2023.

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More ambitious 2030 target

Based on the European Council's conclusions from October 2014, the EU aims to reach at least 40% domestic emissions reduction by 2030. The conclusions also specify that the EU will revert to this issue after Paris COP. Fortum considers the outcome of Paris COP2 clearly to fulfil the preconditions set for the increase of the EU ambition.

Substantial progress has been made towards the attainment of the EU 2020 targets for greenhouse gas emissions reduction; the EU reached and exceeded¹ its 2020 target for greenhouse gas emissions reduction already in 2014, six years ahead of schedule. According to a recent analysis², the EU may reach up to a 30% reduction by 2020. For this reason, the 2030 climate target should be adjusted to the level of 45-50% to be in line with the long-term goal of a 95% reduction. The other targets (renewable energy, energy efficiency) of the 2030 framework should focus on non-ETS sectors, because the climate target efficiently promotes renewable energy and energy efficiency in those sectors covered by the ETS.

Currently various member states are already adopting more ambitious national climate policies than the EU and adopting measures like carbon price floors to strengthen the ETS. Mixing the national- and EU-level policies is by far the largest risk for the ETS. From the macroeconomic point of view, it would be better to have stronger EU-wide steering rather than allowing these kinds of overlapping national measures.

Adjusting the EU 2030 target upward would imply sharing the additional emissions reduction between the ETS and non-ETS sectors. As both the Emissions Trading Directive and the Effort-Sharing Decision are up for review during 2016-17, this would offer a natural opportunity to split the increased 2030 overall target. In this context, a limited, one-off reduction of the ETS allowances or any corresponding flexibility measure between the ETS and non-ETS sectors should be decided before adopting the two legislative files.

The proposed linear emission reduction factor is insufficient to reach the 2050 target

The role of ETS as the cornerstone of the climate policy has to be strengthened. As many overlapping EU-level policies (renewable energy, energy efficiency) and national climate policies (e.g. closures of coal capacity, carbon price floors) have watered down the ETS from outside, strengthening the system is more than justified.

The proposed annual linear emission reduction factor (LRF) of 2.2% post-2021 will result in only an 84% reduction in the ETS in 2050 compared to 2005, significantly less than what is needed to reach the EU's 2050 target. For a cost-efficient and predictable trajectory towards the EU 2050 target, the LRF needs to be increased to at least 2.6% post-2020. The increased LRF would correspond to a 47% emissions reduction in the ETS and a 45% overall reduction in the EU by 2030. Further on, this would result in a 95% reduction in the ETS by 2050.

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Fortum has been advocating a strong ETS as the most cost-effective, technology-neutral and flexible tool to mitigate climate change. A robust and trustworthy ETS is able to reduce the risk of increasing national and divergent climate regulation and to reduce the need for subsidies for electricity production.

Scope of the ETS to be enlarged

Given the expected decarbonisation ambition within the EU's upcoming heating and cooling strategy and the large differences in the existing excise taxes on heating fuels across member states and in fuel types, there is room for improving the cost efficiency of emissions reduction in the heating and cooling sector. At the moment, the heating sector is partly within the scope of the ETS and partly within the non-ETS sector. Individual heating appliances in buildings emit approximately 600³ million tonnes of CO₂ annually. By extending the EU ETS to cover also this part of the heating sector, an efficient allocation of emissions reductions would be ensured.

The existing proposal for the amendment of the Emissions Trading Directive does not refer to the extension of ETS into new sectors (e.g. heating & cooling, transport). This opportunity should be promptly investigated in connection with the revision of the ET Directive and Effort-Sharing Decision. Adding new sectors to the ETS could enable EU decarbonisation in a more cost-effective manner.

¹ European Environment Agency (EEA) 2015: Trends and projections in Europe 2015

² Sandbag 2015: The EU is on track for a 30% emissions reduction by 2020

³ GreenStream Network Ltd 2015: Inclusion of the heating sector in the EU ETS

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