THE PRINCE OF WALES'S

CORPORATE LEADERS GROUP

22 October 2015

Dear Ministers,

Re. Policy Orientation Debate, EU Environment Council, 26 October 2015

Business leaders from **The Prince of Wales's Corporate Leaders Group (CLG)** are aware that during your meeting in Brussels on 26 October you will be considering reforms to the ETS as well as environmentally harmful subsidies, including fossil fuel subsidies. Without actions to reform fossil fuel subsidies the effectiveness of carbon pricing is blunted.

Whilst we welcome reform of the EU ETS we do not believe that the Commission's ETS reform proposal will deliver a carbon price sufficient to maintain the EU ETS as the cornerstone of EU climate policy, nor will its auctions generate sufficient innovation funds to help industry decarbonise.

In short we do not believe that the current proposal will adequately strengthen the EU ETS to serve as the key tool to deliver Europe's climate objectives in the next decade. Specifically we highlight the following key issues:

1. **Carbon leakage needs to be targeted more effectively** – some companies will need more and others less. Provisions for carbon leakage may not adequately protect the industries most exposed to potential international competition and may over compensate others. Some propose a tiered approach where the most exposed receive 100% of the benchmark by way of free allocation, whilst other, less exposed industries receive smaller proportions of the relevant benchmarking.
2. **Benchmarks should be regularly revised** – the ratcheting proposed is an inadequate response. Technology innovation and application happens in step changes, not in a linear fashion. Therefore the revision is important to ensure that there is not an oversupply in future.
3. **More help for decarbonisation of industry through a larger innovation fund is fundamental.** For some industries there is an almost limitless amount of 'low hanging fruit' but for others there are huge challenges to decarbonise which will require significant investment in innovation.
4. **A shorter phase length or review to allow for correcting unintended consequences is necessary.** Given the unexpected issues that have required reform of the EU ETS to date (and we are less than three years into an eight year phase), a ten year phase is impractical and unrealistic. In order to be able to correct unintended consequences, phases should be five years in length. Business requires certainty on targets and timelines and to know governments are committed to keeping on track to reach these.
5. **The New Entrant Reserve for Phase IV should be taken from within the Phase IV Cap.** The proposal to fund the New Entrant Reserve from 400 million of the unallocated allowances of Phase III effectively increases the size of the Phase IV cap and moves us further off the 2 degree target.

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6. **The proposed linear reduction factor for the cap is not steep enough to get us to 2 degrees.** Furthermore, the proposal is silent on how the Commission would scale up ambition following Paris COP if other major economies agree to increase their level of ambition. The 2030 Climate Package Impact Assessment identified a Linear Reduction Factor of 2.4%. A successful outcome from the Paris COP should enable a move to this steeper factor.

If these issues are addressed we believe the EU ETS will help to provide the low carbon certainty and signals we need as businesses in order to transition cost-effectively, while protecting sectors at genuine risk of carbon leakage.

Nevertheless, we cannot just focus on ETS reform and increasing the carbon price without **eliminating fossil fuels subsidies due to their disruptive signal to investors and society at large.** Failure to act concurrently on these fronts represents inefficient use of government policy to unlock new, low-carbon investment.

As businesses we believe that there is a window of opportunity to eliminate direct subsidies now, as international oil prices are low, so the impact of reform on consumers will be less, and more easily mitigated for the poorest in society.

This is also a good time to be reducing unnecessary government expenditure. Fossil fuel subsidy reform (FFSR) is politically, socially and economically complex, with a series of barriers preventing progress, but the growing focus on this allows progress in this important area.

Ministers have been asked in advance of this meeting about which interest groups are drivers for successful environmentally harmful subsidy reform. We would like to take this opportunity to highlight the Friends of Fossil Fuel Subsidy Reform (FFSR), and specifically the Fossil Fuel Subsidy Reform Communiqué, which the CLG has supported and signed. The Communiqué puts a spotlight on the climate change mitigation potential of FFSR and galvanises international reform action at both national government and international organisation level.

We urge EU Member States who have not yet signed the communique to do so (joining existing signatories from the EU including Denmark, Finland, France, Germany, Italy the Netherlands, Sweden and the UK, as well as Costa Rica, Ethiopia, Morocco, New Zealand, Norway, Switzerland, the United States, as well as business groups like The Prince of Wales's Corporate Leaders Group and international organisations such as the International Energy Agency).

We look forward to continuing to work with you on these very important EU and global issues and wish you successful Council deliberations.

Yours sincerely,

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