Position Paper

Revision of the Emissions Trading System (ETS)

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SGI Europe welcomes the European Commission's ambition to strengthen and extend the Emissions Trading System (ETS), one of the main European instruments to fight climate change. It has progressively been improved in the past via the Market Stability Reserve (MSR) to reduce emissions and deliver a CO2 price that drives investment in low carbon technologies. A meaningful carbon price will drive cost-effective energy transition by promoting investments in renewable and low-carbon technologies. Such a revision will also help internalise externalities, particularly for road and air transport, contributing to the reduction of emissions. It will also contribute to establishing a level-playing field between transport modes and reduce the unfair advantage of road over cleaner modes such as rail.

In this context, SGI Europe has welcomed the following:

- the efficient cap reduction proposed through the combination of sufficient rebasing and the augmentation of the Linear Reduction Factor (LRF);
- the reinforcement of the MSR, which makes the EU-ETS more resilient to exogenous shocks;
- the integration of the maritime sector in the original EU-ETS;
- the creation of a separated ETS for buildings and road transport complementing existing sectorial measures together with the establishment of the Social Climate Funds and other measures needed to mitigate the impact on end consumers;
- we welcome the fact that the EU Commission continues to refrain from including plants for the thermal incineration of municipal and hazardous waste as well as sewage sludge incineration plants in the existing EU ETS

However, SGI Europe puts into question the following issues:

- Whilst the extension of the EU ETS to renewable and low carbon hydrogen production facilities goes in the right direction, the inclusion of hydrogen in the carbon leakage list may lead to competitive disadvantages for low-emission alternatives. Hence, **SGI Europe, therefore, calls upon the EU legislators to lower the threshold to 10 tons (around 20 MW electrolyser) 15 tons of hydrogen OR to completely delete the production of hydrogen from the carbon leakage list** and instead propose appropriate climate protection measures ;
- A **clear differentiation of CHP systems between the EU ETS and ETS II is needed**; the pricing of the fuel of CHP systems within the framework of ETS II, which are already subject to the EU ETS I, must be avoided in any case.
- While supporting the Commission to have a separate building and transport ETS, SGI Europe underlines the importance of **implementing the right accompanying measures when establishing these new ETS proposals**. These measures will contribute to ensuring social equality, especially for vulnerable households in need of protection, and avoid a reduction in mobility. Hence, SGI Europe welcomes the establishment of an EU Social Climate fund.
- To incentivise highly efficient CHP, the **free allocation should be available in the current ETS I and the new ETS II**. SGI Europe proposes to limit the yearly reduction rate to 2 % from 2026 and reinsert the deleted paragraph (4) under Article 10a.

Rising electricity prices should not question the ambition of the reform. The EU ETS market's integrity must be preserved to maintain investor confidence and ensure an effective transition. While SGI Europe fully understands the crucial need to protect vulnerable consumers against high energy prices for the short term, SGI Europe pleads for a sustainable and cost-efficient way to divest Europe from fossil fuels through the support of the EU ETS.

For this reason, SGI Europe has developed the following recommendations to strengthen the EU ETS that can support Europe in this energy transition:

Auction revenues and Innovation and Modernisation Fund:

SGI Europe supports better regulated and nationally adjusted rules to ensure Member States can spend all their EU ETS auctions revenues on activities in line with the climate objectives. We also welcome the increase in the size of the Innovation Fund, which is today one of the central EU's instruments to bring innovative low-carbon technologies closer to the market. Finally, the increase of the Modernisation Fund will be a crucial tool to support the low-income Member States in decarbonising their economies.

Revision of the benchmark for hydrogen production:

SGI Europe welcomes the European Commission's intention to revise the scope of the benchmarks and adopt a technology-neutral approach to ensure a level playing field for low-carbon activities. The extension of the EU ETS to renewable and low carbon hydrogen production facilities goes in the right direction. It could provide a positive boost to the uptake of the electrolysis route.

However, SGI Europe points out that hydrogen producers emitting CO2 receive free certificates due to the explicit inclusion of hydrogen in the carbon leakage list. As a result, fossil hydrogen is not subject to a CO2 price, and consequently, the cost gap to green, renewable or low-CO2 hydrogen cannot be bridged. This may lead to competitive disadvantages for low-emission alternatives.

While SGI Europe supports expanding the use of electrolysis, we do not see with the Commission's approaches the necessary promotion for an adequately level playing field about renewable and/or green hydrogen compared to fossil or low-CO2 hydrogen. As proposed, the effects will be limited: the production threshold at 25 tons of hydrogen a day (corresponding to an electrolyser between 60-100MW depending on the efficiency) will exclude many electrolyser units. **SGI Europe calls upon the EU legislators to lower the threshold to 10 tons of hydrogen a day and implement the necessary changes** in the benchmark as soon as possible before the second half the phase IV in January 2026. **Alternatively, SGI Europe proposes to completely delete the production of hydrogen from the carbon leakage list** and instead propose appropriate climate protection measures in the context of the directive for a Carbon Border Adjustment Mechanism.

New ETS for buildings and road transport:

SGI Europe welcomes the proposed establishment of a new emissions trading system for buildings and road transport. The establishment of a new emissions trading scheme can lead to a level playing field between road and cleaner modes of transport and between different heating systems with fossil fuels. However, there are still some questions about how this provision should be designed. **It will be essential to put the proper accompanying measures to ensure social equality, especially for vulnerable households in need of protection**. Hence, SGI Europe welcomes the establishment of an **EU Social Climate fund.**

Although the building and road transport sectors are to be transferred to a new ETS from 2026, at the same time, the national targets for these sectors in the Effort Sharing Regulation (ESR) will remain. As a result, it is unclear how the Commission intends to avoid any double burdens. It is also questionable how the prescribed monitoring and reporting obligations can be met in both systems without additional bureaucratic effort. The overlap between the existing and the new ETS, and therefore a double burden, must be avoided in this context.

After all, the effects of a new ETS II depend very much on future CO2 price forecasts, which from today's perspective are difficult to make. In addition, awareness measures for final consumers about energy saving and energy system adaptation should be carried out. Particular attention should be paid to social compensation measures via the newly established social climate fund.

Avoiding double burdens on co-generation (CHP) facilities:

Clear differentiation between the EU ETS and ETS II is needed concerning CHP systems. The pricing of the fuel of CHP systems within the framework of ETS II, which are already subject to the EU ETS, must be avoided in any case. Furthermore, according to the proposed law, CHP plants that feed-in heat into a district heating system with a total rated thermal input of more than 20 MW would no longer benefit from an exemption and receive free certificates until 2030 but experience a shortage of free certificates.

In 2026 the European Commission foresees an update of the benchmark values used for calculating the free allocation from 1.6 % to a maximum reduction rate of 2,5 % per year. Historically, the heat benchmark reflected the maximum reduction rate. This sharp increase adversely affects the profitability of the heat production from co-generation and industrial processes and puts those technologies at a comparative disadvantage compared to less efficient technologies.

To incentivise highly efficient CHP, the **free allocation should be available in the current ETS I and the new ETS II**. With the Commission's proposal to delete Art. 10a in paragraph 4, this would mean for the future no free allocations for district heating and high-efficiency co-generation in the current ETS I. This causes several problems. Firstly, this proposal would be technically unfeasible, as district heating depends on high efficient co-generation (here: the Commission does not suggest deleting Art. 10b paragraph 4, which states that allowances for district heating are not to be decreased). Secondly, it would also be incompatible with the Commission's intentions to increase high-efficiency co-generation and ensure equal treatment of all installations receiving a free allocation for heat production and district heating (recital 12).

The proposed update of the reduction rate by almost 1% seems, therefore, unreasonably high. Hence, SGI Europe suggests limiting **the yearly reduction rate to 2 % from 2026 and reinserting the deleted paragraph (4) under Article 10a.**

Finally**, we welcome that the EU Commission refrains from including plants for the thermal incineration of municipal and hazardous waste and sewage sludge incineration plants in the existing EU ETS.**