Association Européenne du Ciment
The European Cement Association
CEMBUREAU

Proposal for a Directive of the European Parliament and of the Council amending Directive 2003/87/EC to enhance cost-effective emissions reductions and low carbon investments

The cement industry's contribution to the 8 weeks consultation
15 July 2015 – 9 September 2015

With a view to creating a predictable legal framework and ensuring a stable long-term carbon price to foster investments in low carbon technologies one of the options that CEMBUREAU is advocating is a trading system with performance based free allocation and no cross sectoral correction factor (CSCF). Consequently the existing ETS framework should contain the following essential features:

- To ensure that free allocation plus auction amounts do not exceed overall EU trading system cap an adjustment may be necessary. The adjustment could be made either introducing flexibility between free allocation and the auctioning amount or implementing an allocation reserve as suggested by Ecofys in June 2014. Such reserve could be fed using the MSR and the allowances not allocated when free allocation is below the cap.
- A performance based free allocation for direct emissions to be provided by multiplying the benchmark by a historic activity level (HAL) which could be more closely aligned to recent production to avoid surplus allocation e.g. the average of the preceding 3 years.
- The benchmark would be calculated as the average of the XX% best performers of specific direct emissions and be updated periodically to ensure that it is relevant and challenging. The XX% should be set at an ambitious but reasonable level based on sound science and should not be distorted by statistical outliers.
- Access to free allocation is provided by being on a list of sectors which is created using the cumulative combination of a direct plus indirect emission intensity criteria.
- EU Compensation should be granted for indirect emission impact where carbon leakage vulnerability is a combination of direct plus indirect emission cost in a fair and predictable way avoiding an unlevel playing field within the EU.

Some of those features could be complemented or modified by rules allowing for the inclusion of, or cost equivalent to be applied to, importers. Exporters should be excluded.

The cement industry is ready to discuss such a design with policymakers from whom it requests open exchanges on and solutions to:

- Recognition that the burden share of emissions needs to be rebalanced between energy intensive sectors and other sectors such as transport and households; here it is essential that the benefits of cement and its downstream product concrete to a low carbon economy are recognised
- Recognition that the cement manufacturing sector has technical limitations on reduction and that reduction effort must take into consideration the real reduction potential within the 2020-2030 timeframe which lies in the reduction of emissions from combustion and not in the reduction of non combustion source streams.
- Recognition that the current ETS with a linear cut by the cross sectoral correction factor for energy intensive industry will de-industrialise Europe before it decarbonizes European manufacturing.

- Early design of the ETS for post 2020 so that certainty and predictability can be maintained.
- Recognition that the emissions CAP can be met by adjusting the auction amount or through a reserve so that the environmental goal is maintained.
- Hypothecation (earmarking) of revenues from allowance auctions and direct innovation support to those sectors facing the greatest abatement challenges
- Introduction of a fair EU compensation for indirect cost of CO_2 coming from electricity.

Although the Commission Proposal is a step in the right direction, and does acknowledge the importance of a continued carbon leakage protection, it is disappointing in that it maintains the CSCF. Even if the Commission claims its use will be minimized, the allocation to the best performer would be drastically reduced through the combined application of the CSCF with a flat percentage-based benchmark adjustment. Furthermore the CSCF impacts most those activities with non-combustion source stream emissions (process emissions).

As currently proposed the ETS amendments do not uphold the clear guidance given by the European Council in October 2014 that the most efficient installations in energy-intensive sectors should not face undue carbon costs leading to carbon leakage. It was clearly the intention of Heads of State and Government to incentivise industry to invest in low carbon technologies while maintaining growth and jobs in Europe.

We feel that this balance has not been struck and EU cement manufacturing competitiveness will be negatively affected. Best performers need full free allocation to be able to further invest and other operators need benchmarks that are based on technological feasibility so that they have a realistic chance of achieving the same performance as the benchmark plants.

CEMBUREAU believes that the following improvements to the proposal are required:

- **Inappropriate cut on free allocation**: the Commission's proposal to fix the amount of auctioning is based on what is, in our view, an incorrect reading of Article 2.9 of the European Council Conclusions of 23 October 2014. Based on two legal opinions received, we contend that the Member States intended to give priority, in paragraphs 2.4 to 2.8 of the same Conclusions, to the need for free allowances to ensure that the best performers were not submitted to undue carbon costs for both direct and indirect emissions. In our interpretation, there is a cap on the overall amount of allowances but NOT on the amount of free allowances. By assuming an approach with a fixed amount of auctioning, the Commission concludes that the number of free allowances is limited and must be reduced through a combined application of the cross-sectoral correction factor, a percentage-based reduction of the benchmarks and updating the HAL. This approach again creates legal uncertainty for EU industries as it is contradicting with the European Council's request that the best performer should not bear undue carbon costs. The benchmark principle of ETD article 10a(1) and 10a(2) is undermined for best performers and in fact replaced by a twofold linear limitation of the required carbon leakage protection, which induces additional cost even for best performers. The emissions cap for the EU ETS can be met by adjusting the auction amount or by the creation of a reserve so that the environmental goal is maintained. By not reducing free allocations to installations below the benchmark plant the Commission can ensure that the operators in the EU ETS with the greatest ability to pass through the cost of carbon take the greatest burden. The benefits of this approach are twofold; firstly it ensures that the cost of meeting the climate change targets is spread as wide as possible via electricity prices which ensures that all areas of the economy make a contribution; secondly it allows the EU to meet its growth objectives by encouraging manufacturing to remain in the EU rather than relocating to lower carbon constrained economies.

- **Maintain the benchmark principle:** The fundamentals of the benchmark principles of ETD article 10a(1) and 10a(2) should be maintained. For that purpose; benchmark should be set on the basis of real data collection of the best performers once per period. Benchmarks should be set on the basis of robust and verified data collection and should not be artificially reduced. Assumptions on future linear trends are unachievable for sectors with a significant share of non-combustion source stream emissions (process emissions). When setting the benchmark and in order to ensure a level playing field in the waste market, emissions from co-incineration should be accounted with a zero emission factor.

- **Full free allocation for non-combustion source stream emissions (process emissions):** Cement industry's medium term cost effective CO_2 abatement potential is limited to combustion emissions which account for only one third of specific emissions per tonne of clinker. Two thirds originate from calcination of lime stone and are irreducible (without CCS, CCU). Therefore, these process emissions require full free allocation throughout the fourth trading period and most likely also beyond.

- **Compensation for indirect costs:** the same procedure as the proposed new design for the evaluation of sectors at risk of carbon leakage must be put in place for the definition of sectors eligible for compensation for indirect costs, using the cumulative combination of a direct plus indirect emission intensity criteria in a fair and predictable way avoiding an unlevel playing field within the EU.

- **HAL to be more closely aligned to recent production levels**: The proposal is a step in the right direction as allocation decisions will be made for a period of 5 years instead of 8. The proposal clearly defines the right framework to reflect on for a more dynamic allocation but thresholds should be adequate and reference years closer to

year N-2. Shorter periods and smaller thresholds should allow for the use of more recent production data.

- **Best performers should not face undue carbon costs:** CEMBUREAU welcomes the efforts made by the European Commission to recognize that energy intensive industries are at risk of carbon leakage. In addition, CEMBUREAU welcomes the fact that the carbon leakage test is a combination of direct and indirect is now independent from carbon price. CEMBUREAU insist that the institutions maintain the proposal for carbon leakage assessment with the addition of a qualitative analysis when needed but review their assessment of the cement industry cost pass through capacity which currently erroneously leads to the conclusion that cement producers would not face undue carbon cost.

  Indeed, the impact assessment considers that the minimum cost pass through rate identified in the literature for the cement industry is 35% which is to our view inaccurate. According to economic theory and to existing literature there is no evidence that the clinker and cement sectors are able to pass through their CO_2 costs to prices, mainly due to the increase of international competition which considerably reduces the scope for any cost pass-through to cement prices, particularly for producers in coastal areas. There is plenty of literature coming to these conclusions, particularly – among others - Walker (2006), BCG (2008), Sijm et al. (2008), Ponssard (2008), Climate Strategies (2014), NERA (2014), Dechezleprêtre and Sato (2014). Most of these studies do not provide conclusive or ultimate figures, but rather estimates – albeit reliable – given the complexity and the difficulty to demonstrate econometric relationships between carbon costs and cement prices. CEMBUREAU is ready to provide further information in the forthcoming legislative debate. In this context, CEMBUREAU calls on the European Commission for full transparency of the sectoral data used in its impact assessment.

- **Innovation and growth support** CEMBUREAU welcomes the Commission's focus on support for innovation. Having said that, there is lack of clarity on how the NER and Innovation and Growth funds will be primed and how many allowances are available for these purposes in total. CEMBUREAU believes that the NER and Innovation and Growth Funds should be primed using excess Phase III or MSR allowances, so that the level of benchmarked free allocation is not reduced further. The Commission's proposal appears to restrict support for innovation to carbon capture and storage, CEMBUREAU suggests that this is extended to cover the use of CO_2 from industrial carbon capture and use. In addition support mechanisms need to be available for switching to unconventional/technologically challenging fuel use in industrial processes particularly as more expensive fuel sources (driven by tighter benchmarks and other limiting factors in the Directive) adds to production cost and therefore increases the carbon leakage threat at high levels of fuel switching.