Borealis AG
IZD Tower | Wagramer Strasse 17-19 | AT-1220 Vienna | Austria
Registered organisation ID: 24298121313-54
Lieven.stalmans@borealisgroup.com

8 September 2015

Response to the Commission's EU ETS reform proposal of 15 July 2015

Response to the legislative proposal: COM(2015)337/F1: "Proposal for a DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Directive 2003/87/EC to enhance cost-effective emission reductions and low-carbon investments"
Submitted online via https://ec.europa.eu/transparency/regdoc/?fuseaction=feedback&docId=3079130

In short:

Some first prudent steps in the right directions but more ground to cover yet to enable growth!

We welcome that the Commission proposal recognises:

- Exposed sectors should receive free allocation based on benchmarks to prevent carbon leakage
- An industry reserve is needed for new entrants and production growth….
- Allocation to companies needs to be oriented to recent production output (5 most recent years)…
- Updated benchmarks need to better reflect progress made…
- The issue of indirect carbon costs needs to be addressed…
- Innovation needs support (enlargement of NER 400 towards innovative industrial projects)…

However, concrete COM proposals are insufficient and fall short of providing desired results. These proposals will only increase carbon costs and carbon and investment leakage risks for EU companies. The yearly share of free allowances for industry is capped at 43% of the total allowances (i.e. 57% auctioning), which decrease by 2.2% per year between 2020 and 2030. Herewith some sort of (new) Cross Sectoral Correction Factor (CSCF) is maintained. The benchmarks for allocations, already based on the most carbon efficient installations (top 10%), are by default reduced arbitrarily by 1% per year from 2008, without taking into account empirical values.

Borealis along with much aligned voices amongst EU manufacturing industries has given constructive and workable input throughout the 2014 stakeholder consultations to the EU commission. The current EU ETS reform proposal is a start but needs a significant upgrade to ensure reconciling EU's growth and climate agendas so that energy intensive industries including the EU chemical industry have a future in Europe.

1 EU Commission's proposal needs a significant upgrade | Main issues

In line with the October 2014 European Council Conclusions[1], Carbon leakage risk prevention needs to be the first priority of the ETS revision. The most important outcome of the ETS reform should be that most efficient installations will not face additional, undue costs (direct or indirect carbon costs) and receive full free allocation/financial compensation at the level of realistic benchmarks, namely at the 'best 10% performance level'. Less efficient companies will be encouraged to improve their greenhouse gas emission performance since they will in comparison be undersupplied with, and will have to buy the necessary emission rights on the carbon market.

1.1 Commission proposal puts even best performers at risk of carbon investment leakage

According to the COM proposal, free allocation to industry will shrink every year, given the declining industry cap. In order to align the shrinking allowances amount with what can be given to industry the COM proposes more and more stringent benchmark levels, retains the cross-sectoral correction factor[2] (CSCF) eventually reducing free allocation and further reducing the number of sectors on the carbon leakage list. These measures of allocation elimination will mean increasing carbon costs even for the best performers. Such costs will increase by 70% for sectors falling off the list. These additional costs reduce EU industrial competitiveness even of the best performers and discourage investments, in contradiction to the EU's growth and employment agenda.

1.2 Recent production based free allocation – in-built delay

The October 2014 Council Conclusions request a better alignment of free allocation with changing production levels.
The Commission proposal envisages an alignment that would be depending on thresholds, with changing production levels only once every 5 years. The time gap between allocation and the considered production is still significant and will not reflect the real dynamics of economic development.
The COM proposal suggests setting of important allocation rules separately by the Commission without full participation of EP, Council and stakeholders.

1.3 Carbon leakage criteria off-purpose

The thresholds for both quantitative (0.2) and qualitative assessment (0.18) could be seen as arbitrary and unjustified. Documentation is missing that would demonstrate convincingly a relation to alleged cost pass-through capacities and an improved carbon leakage risk prevention. In fact, the new criteria seem to remove numerous sectors currently seen at risk of carbon leakage from the list. In turn, 70% of their current carbon leakage protection would be given up increasing risk of losing international competitiveness. For the qualitative assessment, in particular, there should be NO threshold.
The effect of these measures on total ETS sector emissions volume is negligible (a few percent of the total free allocation) : just for reducing administrative burden seems not a good enough reason for kicking sectors off the list and exposing them and entire value chains to the risk of carbon leakage. Other options such as removing minor emitters from the ETS scope should be considered.

---

[1] Quote from 23 October 2014 Council Conclusions: "The benchmarks for free allocations will be periodically reviewed in line with technological progress in the respective industry sectors. Both direct and indirect carbon costs will be taken into account, in line with the EU state aid rules so as to ensure a level-playing field. In order to maintain international competitiveness, the most efficient installations in these sectors should not face undue carbon costs leading to carbon leakage. Future allocations will ensure better alignment with changing production levels in different sectors. At the same time, incentives for industry to innovate will be fully preserved and administrative complexity will not be increased."

[2] Pending EU Court cases re. ETS III Cross sectoral correction factor, C191/14, C192/14, C295/14, C389/14, C391/14, C392/14, C393/14,
http://curia.europa.eu/jcms/jcms/Jo1_6581/?dateDebut=03%2F09%2F2015&dateFin=03%2F09%2F2015&typeU=U&typeP=P&numAffaire=&langueProc=&nomPartie=&juridictionC=C&opSearch=recherche

1.4 Limited access to reserve for manufacturing and industrial growth

A limited reserve of 400 m allowances is proposed to be made up of unallocated allowances from the pre-2020 trading period. While the reserve can be replenished (=flexibility) i.e. from plant closures, these allowances will only be made available for allocation to new entrants and/or "significant production increases" at unrealistically high thresholds...

1.5 Indirect carbon costs addressed, but not solved

The COM proposal seems to strengthen compensation but does not provide a clear solution.

1.6 Innovation funding

The extension of the NER400 to industrial projects is welcome but COM proposes to take away allowances for this purpose from the free allowances volume.

1.7 Lack of dedicated impact assessment | 'Better Regulation'

Other than declared as 'better regulation' objective of the Commission, the COM's impact assessment does not cover the impacts of the combined set of parameters that are put forward in the proposal. Next to that, the impact of the agreed Market Stability Reserve (MSR) is not being taken into account. Therefore, we look forward to a properly reworked impact assessment.
Furthermore, a number of provisions seem foreseen to be adopted by Delegated Acts and, to a lesser extent, by Implementing Acts. This transfer of power to the Commission on secondary legislation in the matters of the proposed revision (auctioning, free allocation and carbon leakage protection) raises transparency concerns for these highly important EU ETS system topics.

2 Upgrades to EU ETS Reform that reconcile EU's growth and climate agendas

The following upgrades of the ETS reform proposal are needed to safeguard future-proof carbon leakage provisions reconciling EU's growth and climate agendas:

1. The most important outcome of the ETS reform should be that Europe's most efficient installations will not face additional undue costs (direct or indirect carbon costs) and that companies should receive free allocation at the benchmark level, namely at the 'best 10% performance level'. Sufficient free allowances should be reserved and made available for production, investment and growth of EU manufacturing industries (below total cap of allowances). This requires the removal of any sort of cross-sectoral correction and will imply either using existing allowances reserves or reducing the auctioning volume depending on industry growth.

2. The 400 million allowances foreseen by COM for current manufacturing and growth may not be enough to encourage efficient growth and investment. Solution: Instead of creating multiple reserves for different purposes, simplify it by making the MSR and unused available as dynamic, flexible reserve: as source for EU manufacturing and growth to cover allowances needs and as sink for not needed allowances, i.e. in case of reduced output.

3. More dynamic, output-based allocation, to get to e.g. N-1 or N-2 year production as basis effective both ways: Efficient growth would be rewarded with free allocation, output reduction would lead to reduced allocation (= removal of current perverse ETS incentives). There should be no thresholds for access to allowances for growth!

4. Benchmarks should be updated in case of proven technological progress, based on actual data, once before the trading period. Most efficient installations should receive 100% of free allocation at realistic benchmark levels as a result. Unavoidable (process-) emissions cannot be reduced other than through reduction of EU production and should be recognized in realistic benchmarks. This excludes the application of arbitrary, linear (flat rate) reduction. The proposed arbitrary scheme to tighten the benchmark with -0.5, -1 or -1.5% per year shall thus only be applied if it is in line with actual achievable technological progress. An additional factor of 0% per year needs to be

part of the scheme if the actual progress of the best performers is significantly below -0.5% per year.

5. The new COM criteria do not convincingly address the risk of carbon leakage for EU manufacturing sectors in the absence of an equivalent carbon costs outside Europe. The chemical industry as a whole should remain on the CL list. There should be no arbitrary restrictions to the use of qualitative CL risk assessment.

6. Indirect carbon costs: Borealis along with the Council requests a harmonised solution either through financial compensation or free allocation – without disadvantaging existing solutions in Member States. In case compensation by Member States is preferred, a harmonisation is required by means of a mandatory compensation in order to safeguard the European level playing field.

7. We welcome the creation of an Innovation Fund of about 400 million allowances, with accessibility for industrial projects, but these allowances should be taken from the auctioning share of the cap.

Yours sincerely,

Lieven Stalmans
Borealis Group Manager Energy & Environment
+32 475 516 837
lieven.stalmans@borealisgroup.com