EUROFER
The European Steel Association

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EUROFER contribution to the public consultation on the European Commission proposal for ETS post 2020

The steel industry represents a fundamental component of the European economy. With 500 production sites employing 330,000 highly skilled people across 24 member states, a healthy steel sector benefits European society as a whole and contributes to significant emission reductions and energy efficiency gains through its innovations, products and product applications.

The 2030 climate and energy framework agreed by heads of state and government on 23-24 October 2014 set ambitious unilateral targets but provided also clear guidance on carbon leakage provisions to be developed in the reform of the Emissions Trading System (ETS). The European Council called for "*appropriate levels of support for sectors at risk of losing international competitiveness due to climate policy*" in order to ensure that the most efficient installations in these sectors do not face "*undue carbon costs"*.

In its current form, the European Commission proposal presented on 15 July fails to deliver the European Council's mandate and is at odds with the goals of the European Commission's Agenda on Jobs, Growth and Investment. It puts at risk the viability of our industry, which has been recognised, even in the Commission's own impact assessment as one of the few sectors at very high risk of carbon leakage due to its high carbon intensity and exposure to international trade.

Due to the continuation of the cross sectoral correction factor and the introduction of a linear reduction of benchmarks, the European steel industry, including the most efficient producers, will be confronted with a drastic and unbearable shortage in free allowances. Furthermore, the proposal does not provide the necessary legal certainty that indirect carbon costs passed through in electricity prices will be offset in all member states. Since the steel industry is close to the technical limits and has very limited abatement potential by 2030, the companies will not have the "make or buy" option and the costs from the EU ETS will result in a tax on production which deters growth and jeopardises the competitiveness of European manufacturers. In addition to that, the sector would be exposed to the indirect costs of the EU ETS on its upstream value chain such as lime and industrial gases.

More generally, the proposal does not contribute to a predictable legal framework as essential elements to assess its impact on industrial competitiveness (e.g. carbon leakage list, benchmarks, cross sectoral correction factor, state aid guidelines on financial compensation) will be known very late (by the end of 2019) and through secondary legislation.

Against this background, we urge policy makers to amend the Commission's proposal according to the comments below in order to ensure that we have the legal certainty of truly 100% free allocation and offsetting of indirect costs in all member states at the level of the 10% most efficient installations.

Caps on free allocation and auctioning

The Commission proposal defines the preservation of a fixed quantity of auction volumes (i.e. 57% of the total ETS cap) as the primary objective of the reviewed ETS Directive. As a result of that, free allocation for carbon leakage sectors is limited and subject to the cross sectoral correction factor, which remains and might increase after 2020. In effect, this means that auctioning is counted as more important than global competitiveness, growth, jobs and investments in Europe. On the contrary, the primary concern in the distribution of allowances between auctioning and free allocation must be ensuring there are enough allowances available to properly protect industries at risk of carbon leakage. Consequently, the cap on free allocation

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should not be retained in order to avoid the continuation of the cross sectoral correction factor after 2020. This is also in line with the interpretation of the European Council conclusions from different lawyers.

If the caps on auctioning and free allocation are maintained, they should be based on a more consistent and transparent methodology. Firstly, they should not be calculated according to the historical share of emissions between power and manufacturing industry but reflect the real abatement potential of the two sectors in the future. Considering the wide availability of low carbon technologies in the electricity sector, the cap on auctioning should be lower than the proposed 57% share and should be reduced with a higher yearly rate. Secondly, the calculation based on historical data should be consistent with policymakers' original intentions on the use of allowances. Unused allowances from 2013-2020 New Entrants Reserve (NER) as well as unused allowances due to partial or total cessation of activities were originally meant to be allocated for free to industry. Therefore, these allowances should not be counted in the post 2020 auctioning cap. Last but not least, the industry cap should include any unused allowances from the third trading period (and possibly from the Market Stability Reserve) to avoid or limit the cross sectoral correction factor. No (NER) allowances should be used for non-compliance sectors, like renewables.

Carbon leakage protection from direct and indirect costs

In line with the European Council's mandate, the protection of industries at risk of carbon leakage is a clear priority of the post 2020 ETS. This should be translated into an overall set of rules (on free allocation's cap, carbon leakage eligibility, benchmarking, activity levels, financial compensation) ensuring 100% free allocation at the level of the 10% most efficient installations and full offsetting of indirect costs for sectors at high risk of carbon leakage.

The Commission proposal fails to deliver this result. Due to cross sectoral correction factor and the new reduction factor on benchmarks even best performers will be confronted with a significant shortage in free allowances.

The structural solution to ensure appropriate protection for carbon leakage sectors is to remove the cap on free allocation so that the cross sectoral correction factor is deleted as well. If the cap on free allocation was retained, different levels of free allocation should be applied to the various levels of carbon leakage exposure in a way that the cross-sectoral correction factor is not necessary. This would ensure full protection to the most at-risk sectors. As acknowledged in the Commission's impact assessment, the steel industry is one of the few sectors at very high risk due to its high carbon intensity and exposure to international trade. Therefore, the shortage in free allowances due to the cross sectoral correction factor and the artificial benchmark reduction factor represents a severe threat for the competitiveness and viability of the sector.

Furthermore, the methodology for determining the carbon leakage list must be sufficiently flexible to solve statistical anomalies which are not consistent with the real boundaries of the relevant sectors. For example, sinter production is sometimes classified as mining activity under the NACE code 0710, for which eligibility assessment is not possible due to the lack of data on Gross Value Added. However, it must remain in the list as it is an integral part of the steel manufacturing process which is at high risk of carbon leakage.

Carbon costs passed through in electricity prices are also a major threat for the competitiveness of electro-intensive industries at risk of carbon leakage, like steel. This risk is even higher in the post 2020 scenario due to the expected increase in the carbon price.

Despite this, the Commission proposal does not provide the necessary legal certainty that indirect carbon costs will be offset in all member states. In fact, nothing has changed on the substance as the modification of the word 'may' into 'should compensate' is merely stylistic. This is in breach

with the mandate of the October Conclusions that “both direct and indirect carbon costs will be taken into account … to ensure a level-playing field”.

Benchmarking

The Commission proposal fails to deliver the European Council’s mandate that benchmarks must be reviewed *“in line with technological progress”*. This request is fulfilled only if the benchmarks are evidence-based and in line with the technical and economic feasibility. The proposed approach by the Commission (i.e. linear reduction of 1%/year by default and 0.5% or 1.5% as a derogation) results into an arbitrary reduction of the current benchmark values, which has the same effect of the cross sectoral factor, as it cuts free allocation below technically and economically feasible levels. It also fails to capture the real abatement potential of sectors decarbonising faster than 1.5%/year. In addition, the proposal does not reduce the administrative burden as it requires the collection of data anyway.

In line with the European Council’s mandate, benchmarks should be based on real data from industry taking into account the whole amount of CO2 from waste gases occurring unavoidably with the steel production. This means also that the current benchmark for hot metal cannot be used as a reference for post 2020 because it is not based on real data, is below technically and economically feasible levels and is recently being legally challenged in several member states.

Furthermore, benchmarks should be updated at most once per trading period and not updated midway through in order to provide more predictability for participants and guarantee an appropriate reward for those that have invested in emissions reductions.

Finally, the collection and processing of data should involve industry’ representatives to ensure the accuracy and reliability of the exercise.

Production levels

The overall set of rules on free allocation, including the ones on the reference activity/production levels, should not deter industrial growth and investments. In this sense, using more recent production levels rewards production increases in Europe while reducing the risks of over allocation in case of reduced activity. The proposed approach by the Commission (i.e. additional free allocation from NER for significant production increases) does not provide sufficient legal certainty as core elements like the threshold for defining significant increases will be only defined in the delegated act. Using more recent production levels (for instance, two year old data) would achieve a better such result.

Promotion of research and development

An ambitious climate and energy policy requires strong support for research and innovation in order to develop breakthrough low-carbon technologies. This kind of industrial investment has a very long time horizon as large-scale and economically feasible results will not be available before 2030. In this sense, the extension of the innovation fund to industry is welcomed, but making the funding mechanism dependent on carbon price fluctuations has serious flaws with regard to predictability. In addition, funding opportunities should be available for the whole range of technologies, including Carbon Capture and Storage and Carbon Capture and Use, and the overall set of ETS rules needs to promote them.

Possible link to other trading systems

Climate change is a worldwide challenge. Therefore, the most appropriate solution is an international legally binding agreement with commitments from major economies. This would also ensure a global playing field for industry. In the absence of such agreement, the overall design of the EU ETS needs to incentivise the possible link to other trading systems. In line with this principle, the continuation of the use of international certificates should be explored.

Better regulation

The proposal does not deliver the legal certainty and predictability that are needed for long-term investments as it increases the complexity of the legal framework. More transparency is needed in the decision-making process to explain how and if the input from stakeholders to the consultation is taken into account. In addition, a more detailed and accurate assessment of the impact of the final Commission proposal on industry is necessary to appreciate fully the challenges we are facing. These are essential steps to implement concretely the better regulation agenda and to develop well-designed legislation in Europe.