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" https://ec.europa.eu/transparency/regdoc/?fuseaction=feedback&docId=3079130

1 Commission's proposal needs a significant upgrade

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 at the benchmark level, namely at the 'best 10% performance level'. Instead of creating multiple reserves with diverse purposes and arbitrary dimensions, one reserve for all needs should provide sufficient free allowances available for production, investment, innovation and growth of EU manufacturing industries (compatible with ETS total cap of allowances). Carbon leakage risk prevention measures should be based on technically and economically achievable benchmarks, on actual production, and addressing both direct and indirect carbon costs.

With the 15 July 2015 EU Commission's proposal for ETS reform, the competitiveness of EU industry would be severely undermined. Keeping the industry in Europe, as main economic driver and jobs source, needs a significant upgrade of this ETS reform proposal. Such upgrade should also ensure a healthy investment climate to enable industrial growth.

Companies that face international competition must not face carbon cost beyond agreed benchmarks and technological capabilities that their non-EU competitors don't have. Such additional European costs influence production and investment decisions; with a perspective of high and increasing EU carbon costs, energy intensive industry cannot produce and invest in Europe.

In the current ETS scheme (2013-2020), support is given to those sectors that are at risk of losing competitiveness. This is done at an already strict benchmark level. Only few of those companies can meet that benchmark. Perversely, even these best performers are not receiving the emisiion rights they need since these are being reduced with a reduction factor (cross-sectoral correction factor 'CSCF').

With the proposed scheme, fewer sectors would be eligible for benchmark-level, free allocation and, regardless of whether technological progress has been made, the benchmarks would be made even stricter: The Commission proposes a haircut of -1%/annually from 2008, entailing for 2021-2030 -15% to -20% (possibly modified by + or - 0.5%/y only). For most industries -15% to -20% is an unrealistic reduction . For many sectors the emissions are even unavoidable and the stricter benchmarks can therefore never be reached. On top of that, the Commission proposal would still retain the reduction factor (CSCF) which could potentially kick in during the 4th trading period. This would mean that even the best performers do have to bear carbon costs and face an unlevelled international playing field.

Industry has given constructive and workable input throughout the 2014 stakeholder consultations to the EU commission to effectively reconcile climate action and cost efficient decarbonisation while at the same time ensuring competitiveness and encouraging industrial growth in Europe. The current EU ETS reform proposal needs a significant upgrade to ensure reconciling EU's growth and climate agendas so that energy intensive industries such as the EU chemical industry has a future in Europe

[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 Main issues with Commission's proposal

Benchmark- and output-based free allocation is the lifeline of European industry that is exposed to carbon leakage risk. The 4th phase of the EU ETS must be designed in such a way that carbon leakage risk can be avoided effectively and that efficient growth is not suppressed. A sufficient allocation reserve must be established so that best performing manufacturers that invest and produce at realistic, technical and economical achievable benchmark levels can have access and can rely on so that they will not incur additional carbon costs.

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

According to the COM proposal, allocation to industry will shrink every year, given the declining allocation, more and more stringent benchmark levels, the retained reduction factor (CSCF). This allocation elimination will mean increasing carbon costs even for the best performers. 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.

The concept of declining free allocation for industry is also in contrast with the October 2014 Council Conclusions that stressed the need for full protection against carbon leakage. In this statement of the Heads of State, the limit on allowance issuance covers combined "free allocation and auctioning".

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

In the current (phase 3) scheme free allocation is based on strict benchmark levels. Only 5% of companies could meet that level in 2008. 95% already have carbon costs, provided constant manufacturing volumes. With the COM proposal, the benchmarks would be made even stricter with an arbitrary factor: -1 %/y from 2008, entailing for 2021-2030 -15 % to -20% tightening of the benchmark relative to 2008. For most industries this is an unrealistic reduction rate that they cannot achieve. For many sectors, part of the emissions are even unavoidable and the stricter benchmarks would develop beyond the theoretical limits, hence can therefore never be reached.

There is no proper link between the compensation and technological progress as requested in Council Conclusions, except for an upwards or downwards 0.5% 'correction' of prescribed benchmark reduction

2.2 Recent production based free allocation

The October 2014 Council Conclusions request a better alignment of free allocation with changing production levels.

Our reading of the Commission proposal is that an alignment with changing production levels would only happen once every 5 years and with a time shift of 3 years (i.e. 2021-2025 activity level fixed on 2013-2017 figures)[2]. Furthermore, this alignment is conditional. The Commission's proposal does not meet the Council Conclusion's demand:

[2] July 15, 2015 Commission proposal (8): "A list of installations covered by this Directive for the five years beginning on 1 January 2021 shall be submitted by 30 September 2018, and lists for the subsequent five years shall be submitted every five years thereafter. Each list shall include information on production activity, transfers of heat and gases, electricity

The time gap between allocation and the considered production is still significant and will not reflect the real dynamics of economic development.

With a threshold to adjust allocation downwards, a perverse incentive would still remain to reduce production levels up to that threshold, leading to windfall profits and replacement of European production.

There should be NO threshold for more dynamic allocation, the high threshold would practically be removing the prospect of receiving real-time data based, fair allocation for manufacturing industries.and could repell desired investment and hamper efficient production growth in the EU.

More dynamic, output-based allocation, to get to e.g. 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 perverse ETS incentives).

Delgating the setting of important allocation rules to the Commission may reduce regulatory oversight, transparency . Full participation of EP, Council and stakeholders can best be safeguarded by determining clear principles in the Directive upfront.

2.3 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 for the Commission 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.

2.4 Access to reserve for manufacturing and industrial growth should not be limited

Industry welcomes the Commission's recognition of the need to have a more dynamic allocation according to the needs for production and growth. Ideally and for reasons of simplicity, a single reserve should be accessible and should give companies predictability for many years ahead through clear rules and provisions in the revised ETS Directive. Access should not be limited to large production expansions only but be open for all EU plants. The high thresholds of the actual ETS 2013-2020 should be removed. The reserve should also be used for free allocation at benchmark levels according to most recent output (dynamic). It should enable economic growth and recovery and avoid undue carbon costs for most efficient production – in full compliance with October 2014 European Council Conclusions.

The IA is lacking an analysis whether the 250 million allowances from the MSR would be sufficient to safeguard the intended EU industry growth. In our view, also the abt. 700 million[3] unallocated allowances should be counted as available reserve for industry.

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production and emissions at sub-installation level over the five calendar years preceding its submission. Free allocations shall only be given to installations where such information is provided."

[3] Answer on Question 8 in July 15 'Commission Fact Sheet, Q&A: "The recent agreement on the Market Stability Reserve (MSR) enables unallocated allowances to be transferred to the MSR in 2020. Under this rule, analysts estimate that some

2.5 Indirect carbon costs

Since EU power markets remain distorted and fragmented and marginal pricing creates carbon costs for power consumers even when electritity is carbon-free: Safeguard objective Nr. 1 and allow for solutions either through financial compensation or free allocation. Innovation funding

2.6 Innovation funding

The extension of the NER400 to industrial projects is welcome. Implementing measures need to explain better the eligibility criteria and the projects selection process. Carbon capture and reuse need also to be eligible for such funding.

2.7 Impact assessment does not match proposal

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 MSR is not being taken into account.Industry requests a reworked impact assessment aligned with the Commission's own principles.

550 to 700 million allowances may be transferred into the MSR in 2020. Following a request by the Parliament and Council to consider the use of unallocated allowances after 2020, the Commission proposes to use 250 million unallocated allowances from 2013-2020 to establish a reserve for new and growing installations."

3 ETS reform proposal need significant upgrade

The following upgrades of the ETS reform proposal are needed to truly take into account the European Council Conclusions[1]:

1. The most important outcome of the ETS reform should be that most efficient installations will not face undue costs (direct or indirect carbon costs) and receive full 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. This requires the removal of the 'cross-sectoral correction factor' and implies either using existing allowance reserves or reducing the auctioning volume depending on carbon leakage exposed industry needs. (Alliance: Luther 'legal opinion' on Council conclusion interpreted as 'free allocation to come first'.)

2. The 250 mio allowances foreseen by COM for current manufacturing and growth will not be enough. Solution: Instead of creating multiple reserves for different purposes, simplify it by making the MSR and unused allowances available as flexible reserve for EU manufacturing and growth to cover allowances needs whilst still respecting the overall allowances cap.

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

4. Updating of benchmarks in case of technological progress, based on actual data, once before the trading period. Most efficient installations should receive 100% of free allocation at the benchmark level as a result. Unavoidable (process-) emissions cannot be reduced other than through loss of EU production and should be recognized in realistic benchmarks.

5. No change to the CL list that will exclude important chemical subsectors from necessary allocation of free allowances. 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. (In principle, most efficient installations of any sector should receive allowances at benchmark level or be exempt from the ETS. Less energy-intensive sectors add administrative burden but do hardly matter in the context of the total amount of allowances.). The chemical industry should remain on the CL list. No arbitrary restrictions to the use of qualitative CL risk assessment.

6. Indirect carbon costs: Since EU power markets remain fragmented: Safeguard objective Nr. 1 and allow for solutions either through financial compensation or free allocation.