European Lime Association A.I.S.B.L.
Association Européenne de la Chaux
Europäischer Kalkverband

Member of IMA-Europe
Transparency register ID: 780146710855-91

07 September 2015

Views of the lime industry on Commission 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

The European Lime sector (represented by EuLA, the European Lime Association) is detailing in this feedback paper its opinion on the publication by the European Commission of a proposal revising the EU ETS Directive.

While EuLA supports the aim of the EU ETS as a cost competitive instrument to reach GHG reductions at EU level, we believe that a number of key concepts of the highest importance for the lime sector are lacking from the proposal of the European Commission:

- Lime installations should receive full **carbon leakage protection** at the level of the benchmark. The carbon leakage risk assessment criteria should include a comparison of the cumulative costs of energy and carbon in the EU with transport costs from abroad, in particular from EU neighboring countries.
- The **cross sectoral correction factor (CSCF)** should be deleted in order to ensure that there are no direct and indirect costs at the level of the most efficient European installations in sectors at risk of carbon leakage.
- The **benchmarks** should be realistic and updated maximum once per period, based on a data collection, and being representative of technologies that have been implemented in the market. The update methodology proposed by the Commission, based on an uniform rate, does not take into account each sector specific situation.
- The **allocation methodology** should be closely aligned with real production levels. Instead of an update every five years, the allocation should be based on the production data of the year n-2.
- The compensation for **indirect CO2 costs** should be harmonized at EU level. It should furthermore fully off-sets indirect costs (100% of the CO2 cost-pass through in electricity prices) at the level of the most efficient installations in all Member States and reflects most recent production levels
- The revenues from auctioning earmarked for **innovation** should be re-directed towards the industry for low carbon technology support and should be used by Member States to stimulate economic growth and relevant R&D investments. Innovation funding under EU ETS should be allocated to energy intensive sectors, especially for the deployment of CCS (carbon capture and storage) and CCU (Carbon Capture and Utilisation) technologies.

Background information

1. Carbon leakage protection

The risk of carbon leakage will remain a big concern after 2020 in the absence of an internationally accepted and legally-binding agreement establishing an equivalent carbon burden similar outside the EU (allowing for a level playing field at industry level).

This is why EuLA supports that all Energy Intensive Industries should receive full protection at the level of the benchmark.

The carbon leakage list must only be updated at the beginning of each trading period, in order to provide certainty and stability.

Also, since the risk of carbon and investment leakage remains as acute as ever for EU industry, introducing differentiation in the level of protection could lead to unequal and incomplete protection for sectors at risk, and could have negative repercussions on EU industrial value/supply chains.

Finally, the carbon leakage risk assessment criteria should include a comparison of the cumulative costs of energy and carbon in the EU with transport costs from abroad, in particular from EU neighboring countries.

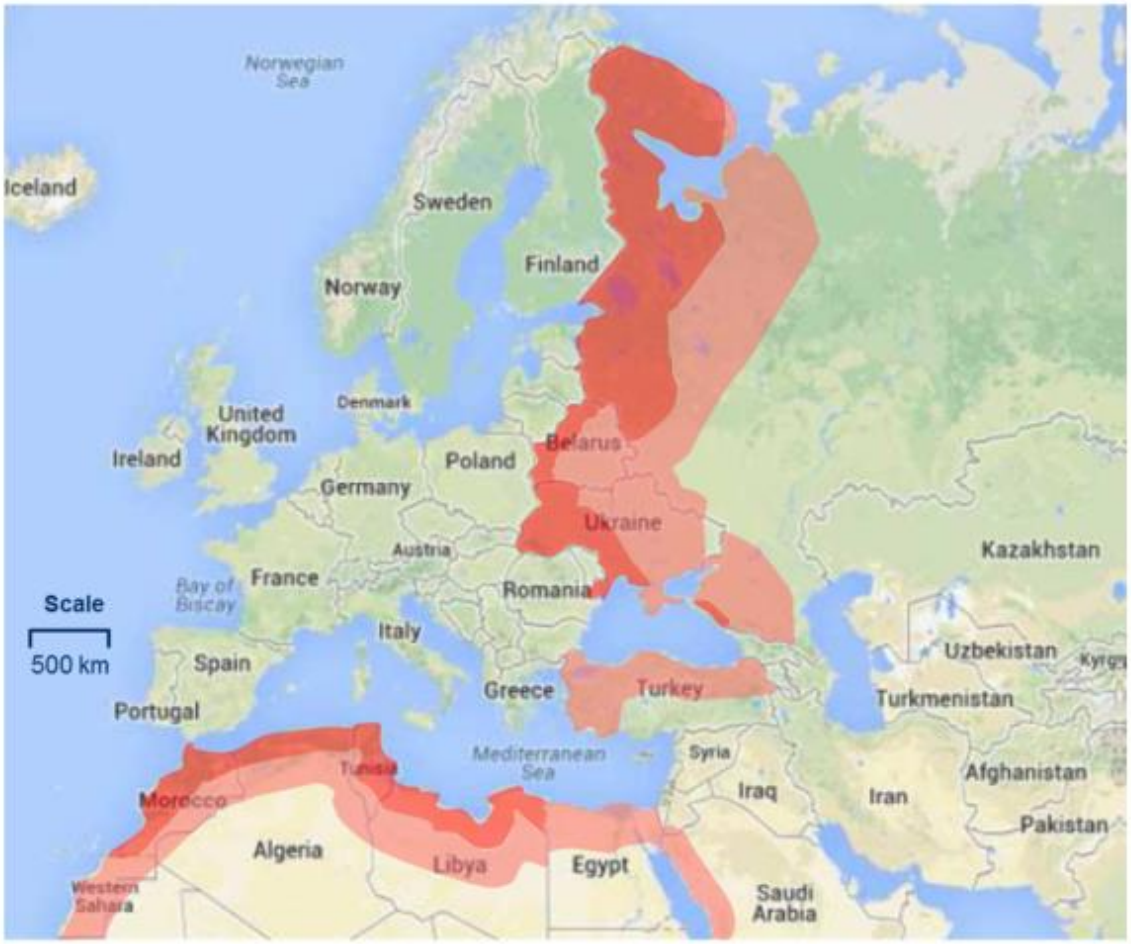
1.1. Importance of transport costs

To be competitive, the leitmotif of the lime industry is production cost. When assessing investment options, the profitability is assessed against production costs, rather than against market prices. The important element in the equation is transport cost. One need to consider the cumulative cost of energy and carbon in the EU and compare it with transport costs from abroad. If there is a price differential then there is an incentive for the industry to relocate its production outside of the EU, and for clients to import.

The issue of transport costs is a key element for the lime sector, when evaluating its competitive position. In 2013, NERA compared the energy and carbon costs of lime production in the EU to 10 other countries or regions, and compared any cost differences to the costs of transporting lime between these foreign sources and the EU.

Based on different scenarios, they established the following maps showing zones outside of the EU that threaten domestic lime suppliers.

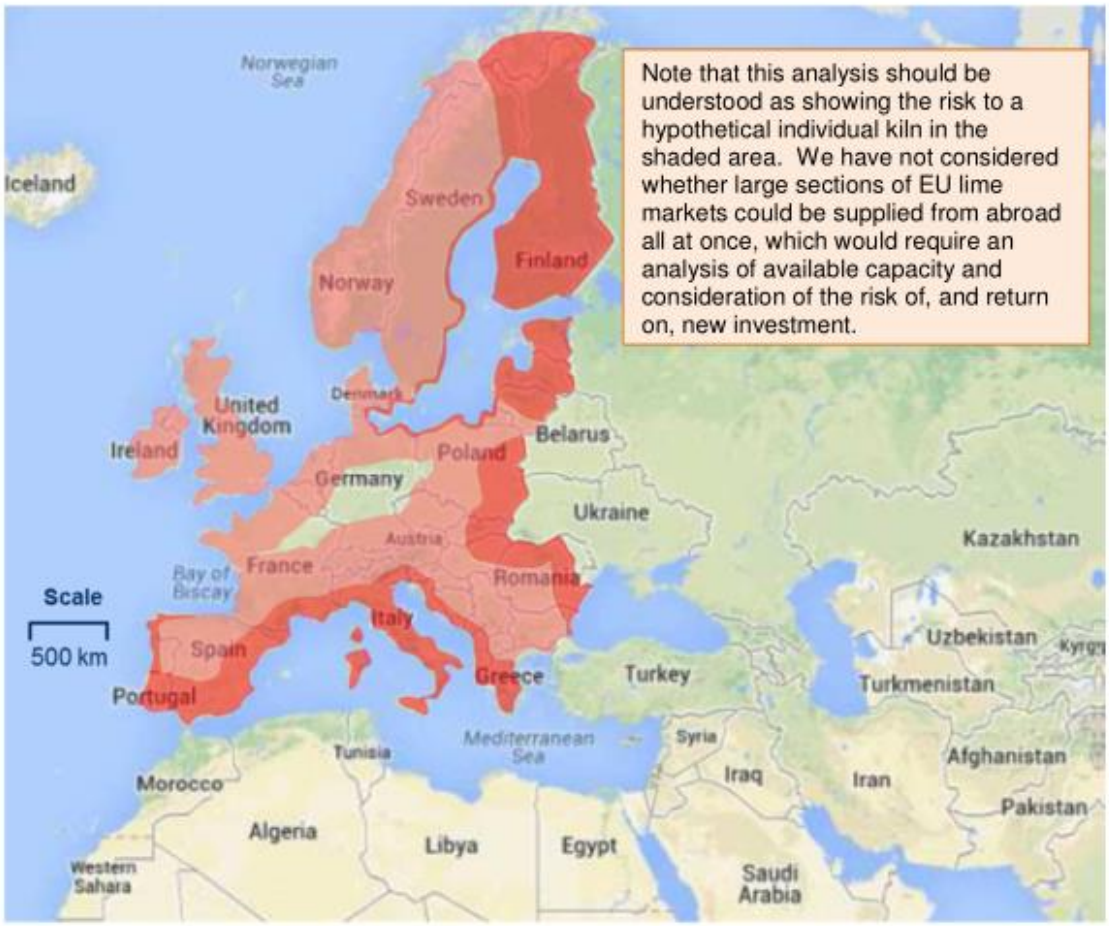
Figure 4.2
Graphical Analysis of Transport Cost Equivalent – Increased Threat



Source: NERA Analysis
Note: The darker red shaded zone represents the area from within which a lime kiln, situated outside of the EU, might be able to export to the EU for the same, or lower cost (based on transport, energy and carbon costs) as an EU based lime kiln located on the border under the Central Case scenario.. The lighter red zone shows the additional area under the Increased Threat scenario.

Also, based on their analysis, they produced a map showing the lime kilns at risk within the EU.

Figure A.2
Potential EU Kiln Locations at Risk – Increased Threat

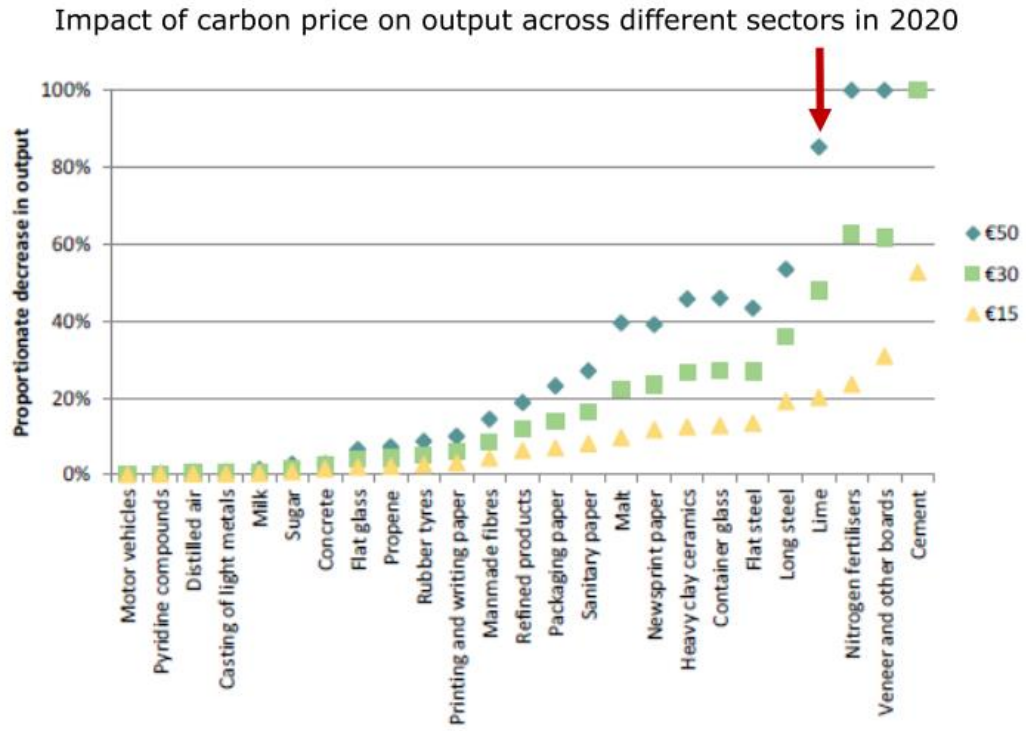


Source: NERA Analysis
Note: The darker red shaded zone represents the area to which a lime kiln, situated on the border with the EU or at a foreign port, might be able to export its product at a lower cost (based on transport, energy and carbon costs only) than an EU based lime kiln. The lighter red shaded zone shows the additional area under the Increased Threat Scenario.

Note that the shaded region in each map indicates only the *potential* to compete with an EU-based kiln at a particular location based on energy, carbon, and transport costs. The map should *not* be interpreted as implying that all lime production within the shaded region is likely to be displaced by foreign competition all at once, as this would require very large investments in new foreign capacity whose profitability we have not assessed.

1.2. Stakes for the European Lime Industry

Without any protection against carbon leakage and for a price of CO2 at 15 €/t, the Lime industry could face a proportionate decrease in output of 20% (i.e. a delocalization of 20% of the production)[1].



Source: Vivid Economics with Ecofys, Carbon leakage prospects under Phase III of the EU ETS

2. Industrial emissions cap (CSCF)

The revised EU ETS should ensure that there should be no direct and indirect cost at the very least at the level of most efficient European installations in sectors at risk of carbon leakage.

The Cross Sectoral Correction Factor (CSCF) is fixing the total cap for industry in the total basket of allowances, which means that even the best performers face a shortage in free allocations. This turns the EU ETS into a penalty system instead of an incentivizing one.

This is particularly true for lime production, which is carbon intensive (over two third (68%) of its CO_2 emissions comes from process emissions), and which is also limited by thermodynamic limits (the current most efficient kilns energy consumption are close to the minimum energy required to produce lime).

This is why EuLA calls for a deletion of the CSCF.

[1] Vivid Economics & Ecofys study "Carbon leakage prospects under Phase III of the EU ETS"

Also, a major concern for the lime industry is the acknowledgment by the EC on the particularity of process/raw materials emissions. Process emissions are understood for the sector as the emissions that cannot be avoided due to the intrinsic properties of the raw material. EuLA believes that these emissions should be excluded of the EU ETS (or receive 100% free allocation), as they are linked with the raw material and the quality of the product, and are therefore unavoidable.

3. Revision of the benchmarks

The benchmarks should be updated maximum once, ahead of each trading period to provide planning certainty for participants, decrease the administrative burdens and provide an appropriate reward for those that have invested in emissions efficiency.

The process of establishing benchmarks must be as transparent as possible.

The update of the benchmark values should be based on data collection from the EU companies. The lime sector acknowledges the considerable administrative burden that the elaboration of the benchmarks has created. As a way to reduce this burden, EuLA suggests to:

- Check the 10% of the best performing installations in the EU to demonstrate whether there any technological breakthrough (This can be done by an independent consultant)
- Revise the benchmarks once per allocation phase and if proven advances have been made in technology

Finally, these benchmarks have to be representative for the sectors and based on technologies that have been adopted by the market. Over-ambitious benchmarks artificially increase costs to industry overall and de facto undermine the effectiveness of the carbon leakage provisions. The current rules are already very stringent, as benchmarks are set according to the average of the top 10% most efficient installations in the sector; hence, even without the cross-sectoral correction factor, around 95% of the installations have to purchase allowances.

4. Level of allocations

EuLA supports a system based on recent production instead of ex-ante approach.

Moving to an allocation methodology closely aligned with recent production levels would provide flexibility, fairness and avoid over allocation (i.e. tackle the "surplus").

For example, the reference period could be the rolling year n-2. The required production data are already available as verifiers have to ascertain the activity data needed for the allocation. The bureaucratic burden will be therefore minimal.

5. Treatment of indirect costs

The current implementation of carbon leakage measures to deal with indirect carbon costs has resulted in a fragmented approach as eligible sectors exposed to electricity price increases due to carbon costs may only receive from few Member States a partial financial compensation. This creates an uneven playing field in the internal EU market, and creates a disadvantage for those installations that are not receiving any, or only partial, compensation, vis-à-vis extra-EU competitors.

While designing the new system, several measures/principles should apply:

- EU-wide harmonized system, which fully off-sets indirect costs (100% of the CO2 cost-pass through in electricity prices) at the level of the most efficient installations in all Member States and reflects most recent production levels.
- Cost compensation could be assured using different complementary mechanisms (free allocation and/or harmonised financial compensation).
- Mechanisms should ensure predictability over the entire trading period by being described in the revised directive. The current system is unpredictable, as it relies on a state aid compensation assessment, and is granted annually, digressive and uncertain for future years.
- The eligibility assessment for such an EU-wide scheme should be based on a consistent methodology that identifies qualified sectors on the basis of their exposure to indirect carbon costs or their total electro-intensity.

6. Support for innovation

Due to the high share of process emissions in the lime production process, the deployment of CCS (carbon capture and storage) and CCU (Carbon Capture and Utilisation) technologies is the only currently available solution for the lime sector in order to reduce significantly its CO2 emissions. However the current state of efforts regarding the deployment of industrial scale pilot CCS projects has been largely insufficient.

EuLA therefore welcomes the extension of innovation support to industrial projects. However, it should not happen at the detriment of carbon leakage protection by reducing or limiting the amount of free allocation. Industry exposed to carbon leakage risk will struggle to invest or innovate without predictable efficient carbon leakage protection.

The revenues from auctioning should be reinvested for low carbon technology support, as foreseen in the ETS Directive, or energy efficiency, but more importantly they should be used by Member States to stimulate economic growth and relevant R&D investments. Innovation funding under EU ETS should be allocated to energy intensive sectors appointed in Annex I of the directive. The NER400 should be technology-neutral and refer instead to R&D and deployment of new technologies for those Annex I sectors.

The abatement possibilities of the lime industry (linked to its thermo-dynamic and, physical/chemical limits that cannot be overcome due to process emissions and lack of break-through technologies) should be taken into account (EuLA published a sectoral roadmap in December 2014).

A dedicated fund taking into consideration these abatement possibilities should focus on innovative technologies such as CCS and CCU.