9 September 2015

Proposal for a Directive revising the ETS Directive (COM 2015/337)

AFEP and Cercle de l'Industrie's first comments

General comments

AFEP (French Association of Large companies) and Cercle de l'Industrie very much support the **continuity of the Emission Trading Scheme** (ETS) over 2021-2030 and the principle of the ETS, as an **essential tool** to combat climate change. Consequently, the Commission's approach making ETS the cornerstone of the EU climate policy is **very much welcome**. Companies will pay specific attention to the other forthcoming EU climate and energy legislation (Energy efficiency, renewable sources of energy, etc.), so that this principle be **maintained** and the whole package be **consistent**. It is fundamental that ETS remains the **relevant competitive instrument** to reduce emissions at the lowest costs, without overlapping with other instruments.

The safeguard of European companies' **competitiveness** *within* the EU and *outside* the EU are **equally crucial:**

- *Within the EU*, industrial sectors covered by ETS are playing a major role in the decarbonisation of the economy. ETS will be sustainable in the long term only if **efforts** between ETS and non-ETS sectors, and among the different categories of ETS sectors, **are appropriately balanced** and aim the decarbonisation of the whole economy.

- *Outside the EU*, the risk of carbon leakage, the opportunities of linking trading systems and the use of international credits will have to **be assessed after COP 21**, in the light of the emission reduction commitments from all major emitters (especially the USA and China). If those efforts are not comparable and not convergent, criteria for qualifying carbon leakage risk may have to be adapted and the use of international credits will need to be allowed with appropriate limits.

First detailed comments on the proposal for a Directive revising the ETS Directive

- **Fixed auction and free allocation shares**

AFEP and Cercle de l'Industrie understand that the Commission proposes **a fixed 57% auction share** to implement paragraph 2.9 of the conclusions of the October 2014 European Council. However, this paragraph has been promptly introduced by one Member State in the draft conclusions at the end of the discussion process between Heads of States and governments, with **no clear assessment of its impacts**. Nowadays, many Member States have **no position** on the interpretation of this paragraph, some of them *even* oppose to a fix percentage. Consequently, it appears that they did not give a mandate to the European Commission to set *any* precise and fixed percentage of auction share.

AFEP and Cercle de l'Industrie consider that such fixed percentage is not consistent with the Commission statement specifying that the allocation of free allowances will be **more dynamic** (see paragraph 7 of the detailed questions and answers). Furthermore, we insist on the fact that the 57% rate is based on trends and general assumptions presented in the impact assessment study. It is thus mostly a projection based on

available data. In order to allow a valuable and transparent debate, the economic model and data which have led to this percentage for 2020 must be disclosed and openly discussed by the European Parliament and the Council.

Besides, companies underline that the 57% auction share is presented without reference period (the whole phase IV, or each year), which make it difficult for companies to ascertain its implications.

- **Free allocation and benchmarks**

AFEP and Cercle de l'Industrie very much **support the maintaining of the current free allocation principle** in the proposed Directive, as prescribed by the European Council in October 2014. Furthermore, French companies **strongly support that the allocation of 30% of free allowances up to the benchmark for the industrial sectors be maintained** beyond 2020, and until 2030 (instead of a decreasing percentage from 30% in 2020 to 0% in 2027).

However, French companies are very much **concerned by the application of a decreasing flat rate** to the benchmark values (-1%/year):

- *Firstly*, this flat rate, which is **bluntly applied to all concerned sectors, does not meet the requirements** of the October 2014 European Council, which laid down that: "*the most efficient installations in these sectors **should not face undue carbon costs** leading to carbon leakage*". Strengthening the benchmarks value by -1% per year – whereas it is already very strict – would compel most sectors to implement **unrealistic breakthroughs** that are **far from being cost-effective**, thus generating undue costs. As we mentioned during the ETS consultation, companies believe it is important to update at sector or sub-sector level the current benchmarks **before** each five-year allocation period, **based on verified emissions** from the past years. A blunt -1%/year flat rate for all benchmark values, even if this rate may fluctuate in a corridor of 0.5%/year and 1.5%/year, is **unacceptable because it generates undue costs**.
- *Secondly*, the decreasing flat rate of -1%/year is not compliant with the European Council conclusions of October 2014 laying down that: "*The benchmarks for free allocations will be periodically reviewed **in line with technological progress** in the respective industry sectors*". By definition, the technological progress is not the same from one sector to another.
- *Thirdly*, the application of a decreasing flat rate to the benchmark values **undermines the bottom-up approach of benchmarks**, thus creating an important gap between the companies' efforts required inside and outside the EU. This measure will not incentivise companies to invest in the EU, therefore enhancing the risk of "investment leakage". A tailor-made solution is necessary.

AFEP and Cercle de l'Industrie also ask the Commission to specify whether the flat rate of -1%/year would apply to **all types of benchmark**, including heat, fuel, process or energy benchmarks.

- **Dynamic allocation and significant production variations**

AFEP and Cercle de l'Industrie very much welcome the Commission statement specifying that the allocation of free allowances will be **more dynamic** (see paragraph 7 of the detailed questions and answers). However, French companies understand that the reference years for production to define free allowances for 2021-2025 will be 2013-2017. This creates an eight-year gap between average years, which will maintain an important risk of disconnection with the effective production level. Such a disconnection is already happening with the calculation of allowances for 2013-2020 based on production years 2005-2009, creating a gap of 9.5 years between average years. AFEP and Cercle de l'Industrie encourage the Commission to adopt a real dynamic approach in practice and **take into account the production data of the year X-1** for the calculation of free allocations.

AFEP and Cercle de l'Industrie also consider that the **thresholds** applied for significant production increases within a same capacity **should be more incentive**, avoiding gaps between thresholds, so as to stick to the reality of production levels.

- **Carbon leakage list**

French companies understand that the new list will include only sectors at risk of carbon leakage that will ultimately receive 100% free allowances up to the benchmark. The other industrial sectors will thus receive 30% free allowances for the whole period 2021-2030.

In order to contribute to an open, valuable and balanced debate, companies ask the European Commission to **clarify the calculation of the new criterion for carbon leakage**: *first* how is it possible to mix in a same formula computation euros and kg of CO_2 emissions, and *second* how the 0.2 threshold has been set.

The official carbon leakage list and the list of sectors eligible for the compensation of indirect costs **must take into account not only the activities at a 4-digit level** (NACE-4 code), but also at **a more detailed scale**, avoiding non ETS participants (e.g. : prodcom 8 level).

- **Cross-sectoral correction factor**

Companies underline that the current impact assessment **should better define the impact** of this factor on the competitiveness of companies. The proposal should specify whether this factor will be applied or not for district heating and CHP installations. It has to be reminded that the calculation method is currently considered in a reference for a **preliminary ruling by the European Court of Justice**.

- **Unallocated allowances**

According to the Market Stability Reserve (MSR) Decision, unallocated allowances will be placed in the reserve in 2020. **All of** them should be earmarked and used to **address the risk of carbon leakage and maintain the European industrial competitiveness** (e.g. dynamic allocation of free allowances and significant production increases over the period 2021-2030). Unallocated allowances will give room for manoeuvre and must be dedicated to avoid any undue costs for the European industry.

- **Indirect costs compensation**

AFEP and Cercle de l'Industrie underline that the need for compensation of indirect costs is emphasised ("should" instead of "may") in the proposed Directive. This is a **positive step** towards more convergence between Member States' efforts. Yet, more still needs to be done. The compensation of indirect emissions should be **harmonised at EU level** to avoid distortions between Member States and ensure a level playing field within the EU. The allocation of additional free allowances (without deduction of free allowances for direct emissions) for energy-intensive companies should have been more pragmatic.

- **Innovation Fund and low carbon technology financing**

French companies **support the Innovation Fund** dedicated to low carbon technologies. This fund must be accessible for all kind of actors without discrimination. Low carbon technologies should be financed until the pilot phase with demonstrators.

Apart from the use of auction revenues already planned in the current proposal and possibly used to cover the cost of the UE registry, companies consider **it is of utmost importance that the proposal makes compulsory the use of the revenues from auctions in favour of low carbon technologies**.

- **Complementary issues**

- AFEP and Cercle de l'Industrie **strongly support** the fact that **allowances issued from 1 January 2013 will be valid indefinitely**. It is a critical step towards a more stable and predictable system, which gives a positive signal to investors over the long term.

- Testing a **"Border carbon adjustment"** for the cement industry should be an additional option to address the risk of carbon leakage, taking into account the results of COP 21 and the convergence of Parties' commitments.

- **Modernisation Fund:** reliable technologies which may benefit from this fund should be made public in order to ensure transparency.

- **The Commission should report** to the Council and the Parliament, one year before each allocation period, **on the state of the European competitiveness resulting from the implementation of ETS** and other climate and energy legislation through a « fitness check », thus assessing:

    - the cumulative costs of the various legislation for the different categories of sectors (industry, energy, non-ETS),
    - the investment leakage,
    - the consistency between the different EU climate and energy legislation, so that the ETS remains the cornerstone of the EU climate change policy by fostering low carbon investments.

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About AFEP (French Association of Large Companies)

The purpose of AFEP is to present the views of large French companies to the European Institutions and the French authorities, mainly with regard to the drafting of non-sectoral legislation (on the economy, finance, taxation, company law, financial information and markets, competition, intellectual property rights, consumer affairs, social protection, employment legislation, environment and energy, corporate social responsibility, etc.).

In 2015, AFEP represents more than 110 of the top private sector companies operating in France. The companies which belong to AFEP have 8.5 million employees and a combined turnover of 2 600 billion euros.

As a major force for analysis and proposals, AFEP is also a prime forum for contacts between member firms and public authorities, which consult the Association when considering plans for reforms or regulations. Senior officials in the European Union and French administrations regularly take part in meetings organised at the head office of the Association, enabling direct and constructive dialogue to take place.

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About Cercle de l'Industrie

Based in Paris and Brussels, Cercle de l'Industrie is a forum for dialogue and exchange. It brings together the Chairmen of large businesses in all industrial sectors and policy-makers. In 2015, member companies of Cercle de l'Industrie had a turnover of around 865 billion euros; they employed 2.7 million people.

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