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Proposal for a revised EU ETS

Ibec, the group that represents Irish business, welcomes the opportunity to comment on the proposal for the review of the EU ETS post-2020. We speak for over 7000 member companies across a range of industrial, commercial and non-profit sectors: home grown, multinational, big and small, spanning every sector of the economy. The organisation strives for business conditions that enable sustainable, economic growth.

The impact of this proposal in securing a strong, competitive industrial base cannot be underestimated. Getting the revision of the ETS right is critical for the future viability of Irish based energy-intensive industries. If the ETS is to remain the main tool for least cost emissions reduction while promoting investments in low carbon technologies, it must address the loss of competitiveness through effective, evidence-based measures to prevent carbon leakage. The international scope of our members' markets reinforces the need for least cost reduction, and long-term protection against carbon leakage for the most efficient installations in the EU (especially while there is no global level playing field).

Summary of Ibec response/request for further clarification:

1) **Maintain the current benchmark methodology.**
2) **What is the basis for applying a 1% annual linear reduction as a one-size-fits-all approach? Technological efficiency improvements do not and have not developed at the same rate for all industries.**
3) **The arbitrary annual reduction in allowances could be prevented through the inclusion of flexibility in the amount of free allocation using a reserve or auction adjustment. This could be done whilst maintaining the overall cap on emissions and therefore preserve the environmental integrity of the EU ETS.**
4) **100% free allocation must be guaranteed for non-combustion (process) source stream emissions.**
5) **The "fall back" provision is not defined in the document. Clarification is sought on how similar products would be treated post-2020.**
6) **A more recent baseline (i.e. 2016-2019) and a shorter period is necessary to better reflect and take into account changes in production levels.**

7) **The NACE-4 code will fail to recognise certain exposed sub-sectors. As a result, certain sub-sectors would be excluded from carbon leakage protection in spite of high levels of exposure to carbon leakage and intense international competition.**
8) **The European Commission Energy and Environment Aid Guidelines should be used as inspiration to strengthen the provision of compensation for indirect costs, using the cumulative combination of direct plus indirect emission intensity criteria. This will introduce a more uniform approach in the award of compensation thereby reducing the risk of distortion between member states.**

The proposal must be modified in the following areas to provide adequate protection for sectors vulnerable to carbon leakage and avoid discouraging industrial investment within the EU.

Benchmarks and free allocation

What is proposed? *In broad terms, the benchmark values for free allocation will be adjusted in order to avoid windfall profits and reflect technological progress in the period between 2007-2008, and reduce by 1% each year thereafter (a different methodology will be applied if the benchmark values differ from the annual reduction by more than 0.5%, whether higher or lower.*

Summary of Ibec position:

1) **Maintain the current benchmark methodology.**
2) **What is the basis for applying a 1% annual linear reduction as a one-size-fits-all approach? Technological efficiency improvements do not and have not developed at the same rate for all industries.**
3) **The arbitrary annual reduction in allowances could be prevented through the inclusion of flexibility in the amount of free allocation using a reserve or auction adjustment. This could be done whilst maintaining the overall cap on emissions and therefore preserve the environmental integrity of the EU ETS.**
4) **100% free allocation must be guaranteed for non-combustion (process) source stream emissions.**
5) **The "fall back" provision is not defined in the document. Clarification is sought on how similar products would be treated post-2020.**

Background
The proposed methodology does not adequately reflect the technological processes of different sectors and there does not seem to be a technological basis for the 1% reduction. Process emissions and combustion emissions need to be separated, as technological constraints in a number of sectors will limit the scope for reduction. Simply put, the manufacture of certain products cannot be made more efficient. For example, some sectors would be limited in type of fuel they can use, whether it is due to price, gas connection/network issues, and locational issues in terms of sourcing cheaper substitutes. For example, certain kilns used in the manufacture of cement or calcining lime are restricted to a limited number and type of fuels that they can use. Therefore, 100% free allocation must be guaranteed for non-combustion (process) source stream emissions.

According to our interpretation of the European Council conclusions of October 2014, there is a cap on the overall amount of allowances but not on the amount of free allowances. By assuming an approach with a fixed amount of auctioning, the Commission concludes that the number of free allowances is limited and must be reduced through a combined application of the cross-sectoral correction factor, a percentage-based reduction of the benchmarks and updating the historical activity level. This approach again creates legal uncertainty for energy-intensive industries as it is fails to adequately address the European Council's request that the best performer should not bear undue carbon costs. The proposal suggests that exposed sectors will instead face a twofold linear limitation of the required carbon leakage protection, which induces additional costs for even the best performers. The emissions cap for the ETS could therefore be met by adjusting the auction amount or by the creation of a reserve.

Some products are not covered by a benchmark and come under the "fall back" provision. However, this provision is not defined in the document and we would welcome proposals outlining how similar products would be treated post-2020.

Allocation based on recent production data:

What is proposed? *Production levels for 2013-2017 and 2018-2022 will be used to inform and update allocation for 2021-2025 and 2026-2030 respectively.*

Summary of Ibec position:

6) **A more recent baseline (i.e. 2016-2019) and a shorter period is necessary to better reflect and take into account changes in production levels.**

Background
The existing allocation system based on historical production has proven to be too rigid and distortive and a more dynamic allocation methodology is favoured. Recent production levels should be considered as an option for the allocation of free allowances in order to provide better protection against carbon leakage and to avoid problems

deriving from over or under allocation. However there are concerns about the revision period. A more recent baseline (i.e. 2016-2019) and a shorter period is necessary to better reflect and take into account changes in production levels.

To aid the data collection process, the European Commission should consider developing appropriate, user-friendly templates.

Carbon leakage

What is proposed? *There are new rules to define sectors at risk of carbon leakage. There is 100% of benchmark level for exposed based on quantitative and qualitative criteria and 30% of benchmark level for non-exposed.* In a change to the current methodology, sectors will be categorised at NACE-4 level.

Summary of Ibec position:

7) **The NACE-4 code will fail to recognise certain exposed sub-sectors. As a result, certain sub-sectors would be excluded from carbon leakage protection in spite of high levels of exposure to carbon leakage and intense international competition.**

Background
While industry welcomes the recognition and provision of carbon leakage protection for energy-intensive industries, the treatment of certain sectors as a whole (i.e. NACE-4) will exclude certain sub-sectors from necessary protection levels. As the current legislative proposal anticipates determining carbon leakage eligibility at NACE-4 sector level, this would result in the exclusion of certain sub-sectors in the dairy industry.

Sustainable farming practices of the EU produce high quality food of low carbon. Penalising certain dairy sub-sectors could have the undesired effect of driving farming and dairy produce manufacturing outside the EU, contradicting the EU's goal of reducing overall emissions.

Indirect costs

What is proposed? *There is no harmonised approach for compensating indirect costs which remains at the discretion of member states. The proposal reinforces that rationale for member states to compensate, by replacing "may" with "should".*

Summary of Ibec position:

8) **The European Commission Energy and Environment Aid Guidelines should be used as inspiration to strengthen the provision of compensation for**

indirect costs, using the cumulative combination of direct plus indirect emission intensity criteria. This will introduce a more uniform approach in the award of compensation thereby reducing the risk of distortion between member states.

Background

Energy-intensive industries do not appear to be on a level playing field for indirect costs. Therefore some member states will provide compensation while others will not, contravening the fundamental principle of common treatment regardless of location within the EU.