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RHI position on the European Commission proposal on the ETS

RHI is clearly committed to climate protection and energy and resource efficiency

RHI, the global market leader in high-grade ceramic refractory materials, is clearly committed to climate protection and energy and resource efficiency. As energy intensive industry we contribute to these goals by continuously investing in innovative technologies and processes designed to reduce GHG emissions and increase energy efficiency. In 2013 and 2014 combined, RHI spent a total of approximately **32 million euros on environmental measures, which corresponds to roughly 15% of the total investments**. In addition, an energy management system for the systematic saving of energy is in place throughout the RHI Group.

Commission Proposal on ETS and RHI recommendations:

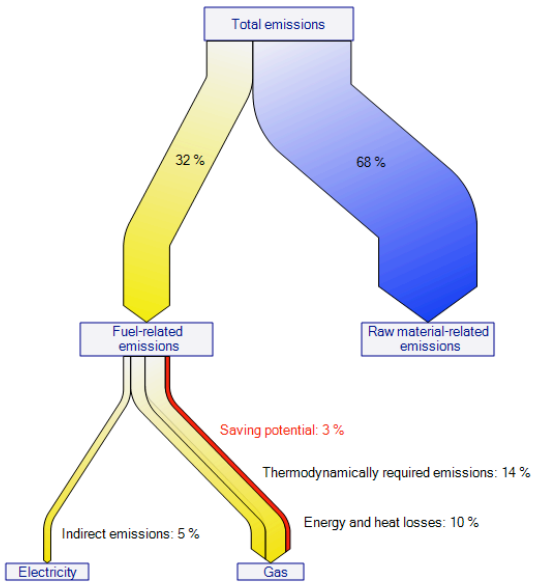
On July 15th 2015 the European Commission has presented its proposal for the EU ETS revision[1], which is to determine the rules for the 4th ETS trading period 2021-2030. The proposal is a centrepiece of the 2030-policy framework for climate and energy agreed by the European Council in October 2014 with the binding target to reduce EU overall GHG emissions by at least 40% by 2030. **Sectors covered by the EU ETS will have to reduce their emissions by 43% compared to 2005.**

Against the background that RHI's production is covered by 4 sectors/subsectors under the ETS, RHI would like to put forward the following policy recommendations:

1. Emissions due to raw materials must be excluded from the ETS

Roughly ⅔ of the CO_2 emissions in RHI refractories production are related to the raw material; ⅓ is fuel-related. The emissions that come from the raw material, e.g. the raw magnesite, are inherent in the material (decomposition of carbonates) and **can neither be substituted nor avoided**.

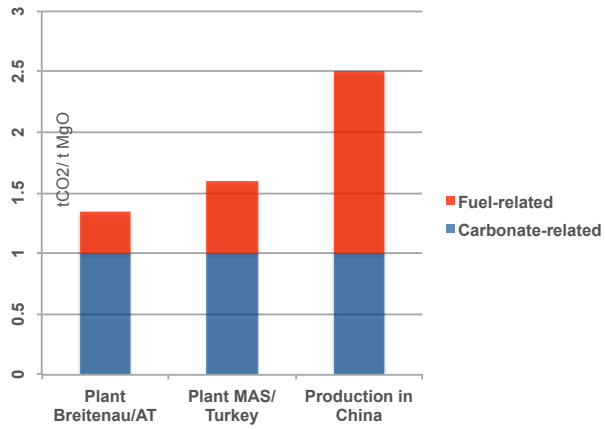
Even with the most innovative technology, hardly any CO_2 can be saved *(see chart to the right: the saving potential is around 3%).*



[1] Proposal for a Directive amending Directive 2003/87/EC to enhance cost-effective emission reductions and low-carbon investments, COM (2015) 337 final; 2015/148 (COD)

Comparison of emissions in Magnesia production

- **Raw material related** (carbonated) emissions are the same
- **Fuel related** emissions: **A factor of +400%** when comparing Breitenau (AT) to China



A reduction in emissions can only be achieved by **limiting or shifting production**. This is primarily due to the fact that technologies such as CCS[2] are not mature or not permitted in EU member states.

Also the addition of substances/ additives, that 'dilute' carbonate related emissions and therefore seemingly reduce emissions, is not possible, as RHI products must withstand the highest temperatures shatterproof.

A differentiated treatment is therefore necessary for raw material-related emissions.

As shown in the chart above, raw material-related (carbonate related) emissions *(in blue)* are the same worldwide, whereas fuel related emissions *(in red)* **differ significantly depending on production site**.

Therefore**, raw material-related emissions should be excluded from the ETS or granted full free allocation.**

2. Installations in carbon leakage sectors should receive free allocation corresponding to 100% of the Best Performer

It is a common misperception that the **most efficient, best performing installations under carbon leakage** receive 100% free allocation to remain competitive. This is what the text of the directive acknowledges and the current systems claims.

Fact is, however, that all installations, even the most efficient ones, are receiving a **strongly reduced allocation because of the (1) Linear Reduction Factor (LRFF) that is at 1,74% and will increase to 2,2% every year.**

Additionally the (2) Cross Sectoral Reduction Factor can be applied. This factor was 5.73% in 2013 and will increase linearly to 17.56% in 2020. On top of this, the draft foresees a **(3) yearly standard rate reduction of the benchmark.**

The application of all these factors **reduces free allocation in a way, that even the best performers in the sector will face a reduction of 40% and more in 2030.** For RHI, this would mean an increase in production cost of sintered magnesia (1 ton) of 15% up to 19%.

Instead of protecting industry from the risk of Carbon Leakage, such policy is leading to an **increased risk of relocation to countries with less ambitious (or no) climate policy goals implemented** *(see also chart above that illustrates great differences in emissions in different regions).*

And it is an evident contradiction to the stated goal to increase the share of industry on the BIP of the EU to 20% in 2020, restore investment levels and kick-start jobs and growth to safeguard international competitiveness.

[2] Carbon Capture Storage

To eliminate the need for the CSCF, RHI proposes to introduce an allocation supply reserve initially stocked with both the back-loaded and any unused New Entrant Reserve allowances from phase III.

3. Free allocation: (a) Fall-back benchmarks have to be continued for sectors with a large range of products as before. Furthermore, free allocation should also be based on (b) technically and economically achievable benchmarks that reflect real industry performance and on (c) the most recent and representative production levels.

a) Fall-back benchmarks have to be continued for sectors with a large range of products

RHI misses a **clear reference in the Commission proposal concerning allocation based on 'fall-back' approaches** for processes that are not covered by a product benchmark based on the heat benchmark, the fuel benchmark or process emissions. Due to the heterogeneity of RHI products, the fall-back benchmark was applied to many products/sectors/subsectors of RHI in the past.
RHI believes it is **necessary to clearly establish in the ETS review proposal that the option of allocations based on fall-back approach will be continued for the 4th trading period as before.**

b) Technically and economically achievable benchmarks that reflect real industry performance

RHI points out that **benchmarks must be set at a level that is technically and economically achievable for installations.** Current rules in the EU are already restrictive, as benchmarks are based on the average performance of the top 10% most carbon efficient installations.
The Commission proposal provides that the benchmarks for the determination of the free allocation to industry will be updated to reflect the technological progress realised over time in the relevant sectors. To this end, the Commission wants to apply a *standard rate* with the possibility of applying a *modified rate* in case technological progress in a sector is shown to *deviate substantially from the standard rate.*
RHI thinks that benchmarks should be based **on real industry data in Europe** in order to reflect the actual progress. Benchmarks should not result from a *standard* annual linear reduction as this is arbitrary and not in line with the principle of technical feasibility.

c) Most recent and representative production levels

Free allocation should be based on the **most recent and representative production data available,** as it must reflect economic reality.
RHI therefore welcomes the European Commission proposal to move into that direction by allowing the use of more recent production data and thus making the system more flexible. RHI particularly supports that the free allowances will be provided for increases of production without adding capacity during the trading period. This allows a company/installation to grow and increase production without being punished. **RHI insists that this must also apply to a more integrated approach whereby a company acts as integrated producer**. The fact that this increases CO2-emissions in Europe is not an indicator for unmindful and environmentally harmful production standards. Generally speaking Europe has the most stringent environmental regulations. Shifting production to third countries means in most cases that emissions worldwide go up.

Administrative complexity and confidentiality should always be a concern and taken into account.

4. Exploring alternative instruments

Another essential point is the coverage of the ETS: the scope of the EU ETS covers both the power and industry sectors, **which differ significantly for their exposure to competition and ability to pass through the direct and indirect carbon costs**. In manufacturing sectors, low carbon prices are needed to reduce the risk of carbon leakage and loss of competitiveness, whereas in the power generation sector, higher carbon prices are required to induce low-carbon investments. Furthermore, the two sectors differ significantly with regard to technological abatement potential and ability to pass though carbon costs. Due to these differences**, differentiated and tailored-made systems for manufacturing and power sectors need to be designed according to their specificities**

Outlook

RHI is a backward integrated company **with strategically important products** for a very large number of European industries[3]. RHI is extracting its own raw materials in Europe. Here, we aim to **maximize resource conservation** and energy efficiency and to minimize CO_2 emissions in the extraction of raw materials beyond mandatory environmental standards. This has **clear environmental and socio-economic advantages in comparison to outsourcing and extraction in third countries.**

However, the current ETS and Commission proposal puts an **unreasonable disadvantage to extraction and treatment of raw materials in Europe for RHI[4].** We think that this is rather short-sighted, as outsourcing extraction to third countries would have the adverse effect of increasing emissions[5] due to considerably less strict environmental standards in many third countries.

Europe has taken a big step towards the climate conference 2015 by defining the 40% CO_2 reduction target in order to negotiate an international agreement.

However, RHI would like to encourage the Institutions to also honor its **commitment of environmental protection in the long term.** This means that backward integrated companies like RHI should not face an undue disadvantage by extracting and producing in Europe. **Unavoidable carbonate related emissions have to be excluded from the ETS.**

Such step would be **environmentally sound and responsible because it would incentivize extraction and production in Europe where environmental standards are high. At the same time it would contribute to consolidate the industrial base in Europe that is the prerequisite for R&D, jobs and growth and prosperity.**

[3] Customer industries of RHI are e.g. steel, glass, lime, cement, chemical, petro-chemical industries

[4] See point 1 in detail (page 1 of RHI position paper)

[5] If RHI would outsource its raw materials production to e.g. China this would mean an increase of 20% CO2 emissions per ton material produced due to less strict environmental standards.

Summary

1. **Emissions due to raw materials must be excluded from the ETS. They are inherent in the material and therefore are the same worldwide. Fuel related emissions however differ significantly. If decision makers want to be serious about environmental protection worldwide and a sound industrial base in Europe, they have to incentivise production sites with the least emissions.**
2. **Installations in carbon leakage sectors should receive free allocation corresponding to 100% of the Best Performer. The application of the Cross Sectoral Correction Factor (CSCF) reduces free allocation such that even the best performers cannot achieve the benchmark level. If current rules remain in place, the CSCF will increase to approximately 40% in 2030.**
3. **(a) Fall-back benchmarks have to be continued for sectors with a large range of products as before. Furthermore, free allocation should also be based on (b) technically and economically achievable benchmarks that reflect real industry performance and on (c) the most recent and representative production levels.**
4. **The EU ETS covers both the power and industry sectors, which differ significantly for their exposure to competition and ability to pass through the direct and indirect carbon costs. Differentiated systems need to be designed according to their specificities.**