Response to Commission´s EU ETS reform proposal of 15/7/2015

28 August 2015

Introduction and General Statement

The October 2014 Council conclusions clearly highlight carbon leakage prevention to be the first element of the EU Emissions Trading System (ETS) directive revision. The Commission proposal, however, falls short of delivering on this condition, since it clearly implies an insufficient supply of free allowances to industry. Even the most efficient European installations will over the next trading period not have enough free allowances to operate on a competitive basis or even to grow at no net carbon cost. Access to sufficient free allowances is a lifeline for industry. Severing this will have grave consequences and lead to carbon leakage and damage the economy.

With the 15 July 2015 EU Commission's proposal for ETS reform, competitiveness of European industry would be severely undermined. European industry, with its efficient and continuously improved production, should be regarded as part of the solution to the climate challenge. However, keeping industry in Europe, as main economic driver and jobs creator, necessitates a significant upgrade of this ETS reform proposal. This upgrade must focus on the following:

- Best performers should receive 100 % of the benchmark without further reduction factors.
- No fixing of auctioning share, since this is not compatible with a carbon leakage proof implementation of ETS in a global environment without comparable burdens in competing regions.
- The reserve in the system should be used to facilitate allocation to best performers without any cuts.
- Realistic benchmarks both for product-specific and fall-back sectors should be set. Updating of benchmarks must respect the actual technological progress without applying an arbitrary benchmarking updating factor.
- The actual recent production data should be part of the allocation formula, without applying any thresholds.
- All sectors at risk for carbon leakage need to be included into the carbon leakage list. The arbitrary threshold for quantitative assessment (0.2) should be adequately justified. For qualitative assessment, there should be no threshold at all.
- Essential elements as auctioning, free allocation, carbon leakage protection need an ordinary legislative procedure to be rightfully amended and should not be delegated to Commission.
- Indirect carbon emissions and related costs must be included in the carbon leakage protection measures in a predictable and fair manner avoiding an unlevel playing field within the EU.

Without such significant upgrade IFIEC Europe raises its concern on energy intensive industries´ capacity to remain competitive internationally and attract investment in a system as proposed by the Commission unless and until equivalent costs are faced by the competitors of EU industries.

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Specific Comments

1 Fixed Auctioning Volume / Fixed Industry Cap

Free allocation must be designed in a way that carbon leakage can be avoided effectively. This means sufficient allocation for the most efficient manufacturers – namely those that produce at realistic, challenging benchmark levels.

The concept of declining free allocation is in general contrast with the October 2014 Council conclusions that stress the need for full protection against carbon leakage. The realistic potential in industries to reduce emissions has to be taken into account together with the wish and strategy of the EU to build economic recovery on a strengthening and growth of its industrial basis when designing the EU ETS in phase 4 under a challenging reduction target.

A declining free allocation for industry, created by unrealistic benchmarks being further reduced through reduction factors, adds costs even for the most efficient producers that have already reached efficiency and reduction targets by making investments. Still they have to bear additional costs. This cannot be called a forward-looking climate policy, especially since there are sufficient allowances in the system to create a positive investment signal for manufacturing industry by means of a guaranteed allocation at the level of the best performers.

Nevertheless, in its legislative proposal the Commission has fixed the auctioning share at 57 % and reintroduced a mechanism that would uniformly adjust free allocation although a reserve is available to avoid such correction. The Commission does so referring to the Council conclusions, arguing that paragraph 2.9 thereof would entail that the auctioning share should not be reduced in general. Quite in contrast, the Council conclusions state support of carbon leakage protection. Therefore, the calculation of the amount of allowances to be auctioned and their distribution has to be carried out only after the volumes of the free allocation have been determined which leaves the allocation methodology without the need for a reduction factor.

It is moreover contradictory to limit economic growth by limiting the amount of free allocation, while millions of allowances are put into a reserve.

2 Carbon Leakage Criteria

IFIEC Europe is sceptical about the proposed methodology with arbitrary thresholds to define carbon leakage risk and is in favour of maintaining the current carbon leakage criteria without any cross sectoral correction factor. This can be avoided easily by providing for a reserve for growth, which is to be feeded e.g. by surplus and / or Market Stability Reserve (MSR) allowances. European energy intensive industries (EII) have an overall positive carbon footprint (in terms of their life - cycle assessment: saving more energy and green house gas emissions than used in the manufacturing phase). This positive contribution to combat global warming should be taken into account while designing the new ETS directive.

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The newly proposed methodology is bringing intransparency and seems inadequately assessed. The thresholds are arbitrary. The indicator assumes a linearity in effect of the carbon leakage exposure; however, this may not be the case in every sector.

Carbon leakage risk is in several sectors especially severe not at NACE-code, but at PRODCOM-level. Such sub-sectors must therefore be part of the analysis and have the change to be on the list. This is in line with the Impact Assessment (IA) stating that the final composition of the carbon leakage groups might be shaped by assessments at sub-sector (Prodcom) level and that parts of sectors will be in a higher carbon leakage group based on such assessments (i.a. footnote 232 and 229).

The arbitrary thresholds for both quantitative (0.2) and qualitative assessment (0.18) should be adequately justified and adjusted in order to provide appropriate levels of support for sectors at risk of losing international competitiveness. For qualitative assessment, in particular, there should be no threshold.

3 Benchmarks

In the current scheme, compensation occurs already at a strict benchmark level. Only 5 % of companies could meet that benchmark in 2008.

With the proposed scheme, the benchmarks would be made even stricter: -1 %/a from 2008, entailing for 2021-2030 -15 % to -20%. For most industries this is an unrealistic reduction rate that they cannot achieve because they have already achieved large emission reductions in the past and the technical reduction limits in some cases are reached. For many sectors, the emissions are even unavoidable and the stricter benchmarks can therefore never be reached.

An arbitrary cut of benchmarks might lead to really absurd situations. Take e.g. the heat benchmark: when you apply an annual reduction of the existing benchmark, you will in future soon be at a situation when an efficiency factor of >100 percent would be required.

Therefore, IFIEC urges that the benchmarks must be based on actual technological progress of the sectors. An update should be done once before the start of a the trading period. No additional reduction factor should be applied. As a result, the most efficient installations should receive 100% of free allocation. Frequently updating of the benchmarks would kill the carbon signal for investment. If investments in emissions reductions lead constantly to less carbon leakage protection, the appetite to invest will diminish and the return on CO2 for investments will not be calculated in during the business plan development. EII are capital intensive sectors. Installations have long investment cycles, which means that installations cannot be replaced every few years.

There is a need for a thorough and transparent review of fallback benchmarks to remove red tape and improve feasibility by providing correct incentives for realistic emissions cuts based on the technological development in each sector.

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4 Production Growth

The proposal marks a step into the right direction, however, the advantages of a full ex post system will not be used. The arguments against such a system are long disproved by industry argumentation as follows:

COM arguments against ex post	**IE response**
Counterproductive incentives in case of fall-back benchmarks	This can be avoided by providing for an 'own benchmark' for the fallback installations, based on historic performance.
Considerable administrative burden on installations, Member States and the Commission	On installation levels: even lower burden (acknowledged by IA, see fn 205 on page 154), on Member States and Commission level: higher administrative burden only if combined with a fixed industry cap and the resulting need to calculate a correction factor, with a proper reserve for growth such burden could be avoided
Compromising business confidentiality of data	With a time gap of publication of such data or a kind of aggregation this argument could be cleared
Uncertainty about the need of a correction factor application	With a proper reserve for growth this would not be an issue

Since the arguments against ex post corrected allocation do not hold, there is no need to refrain from using the long list of advantages of such approach in the future EU ETS.

Therefore, to provide incentives to invest and avoid incentives to reduce production actual production should be the basis for allocation.

IFIEC Europe therefore opts generally for a more stringent way to comply with the conclusion of the October 2014 council to better align allocation with changing production levels.

In particular, the proposed option has the following deficits:

- 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 of 15 % there is still a disincentive to grow steadily within the EU (15 % means a permanent yearly growth of 3 % over a 5 year period, which is a very ambitious but unrealistic development path for the energy intensive industries).
- With a threshold of 15 % to adjust allocation downwards there is still an incentive to reduce production levels in the EU ETS sectors up to about 14.9 % and replace EU production by non-EU productions, which is not in line with an EU growth strategy and with the request of integrity of EU ETS.
- The feeding of the NER seems to be insufficiently granting certainty about receiving free allocation up to the end of the 4th trading period. It is therefore holding back potential

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investments in EU businesses. If the volume is not sufficient to cover the growth, a correction factor would be necessary to cut everybody's allocation. This would then also apply to the most efficient installations in a sector and contradict the Council conclusions:

The IA is lacking an analysis of how sufficient 250 million allowances from the MSR are to safeguard the intended EU industry growth in the proposed system, or how much allowances are needed to provide for efficient growth in the industrial ETS sectors. What we need in the global context, where the most important emitters today are emerging countries with growth perspectives far beyond the EU's, is a "breathing allocation system" acceptable to them. Such approach is realized in a consequent ex post system.

5 Indirect Compensation

Moreover, compensation for indirect CO2 costs is necessary. Direct and indirect emissions must be treated equally in the carbon leakage context since they are equally harmful for the investment climate.

The list of sectors eligible to indirect compensation should be determined by taking into account their direct and indirect exposure to carbon costs and their electro-intensity.

6 Innovation and Modernisation Funding

IFIEC Europe welcomes the Commission's focus on support for innovation and modernization in energy intensive industries but insists that carbon capture and reuse would also be eligible for such funding. Nevertheless, this fund cannot be created at the expense of free allocation, as seems to be proposed by the Commission.

7 Delegation of Powers

The Commission wants powers conferred to its own institution as laid out in the proposed insertion of Article 22a "Committee procedure" and the proposed replacement of Article 23 "Exercise of the delegation".

The new Article 22a refers to a committee procedure under Article 291 Treaty of the Functioning of the European Union (TFEU) with the power of the Commission to adopt "Implementing Acts" covering measures of non-essential nature, which are administrative and without political incidence. By implementing these acts the Commission shall be assisted by an Advisory Committee and an Examination Committee, in which only representatives of the Members States may give their advice.

Furthermore the newly proposed Article 23 refers to the Commission´s powers on "Delegated Acts" under Article 290 TFEU, meaning non-legislative acts of general application intended to supplement or amend certain non-essential elements of the basic legal act. The Commission lists in detail in paragraph 2 the powers they propose to gain, inter alia:

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- adopt a regulation on timing, administration and other aspects of auctioning (Art. 10(4)),
- set rules for harmonised free allocation of allowances also on additional allocation from the new entrants reserve of 400 million allowances for an innovation fund on industry, CCS and renewable energies open for Member States (Art. 10(a) (1) and 8),
- rights to adjust the carbon leakage rules by new criteria (Art. 10(b)),
- powers to set up an modernisation fund only for Member States with a GDP per capita below 60% of the Union average (Art. 10 (d)),

In general, the legislators should be very well aware of the consequences of transferring powers to the Commission on secondary legislation in the matters of the proposed revision of the EU ETS Directive. The lessons learned for industrial energy consumers in Europe in the past was, that whenever the Commission exercised especially its delegated powers solely, without further contributions from the legislators to the legislation process in terms of revising the EU ETS, secondary legislation meant strong interference in the market and divestment due to uncertain future investment possibilities.

Specifically, IFIEC Europe urges Member States, Council and European Parliament to duly assess the potential consequences of transferring the proposed powers via Delegated Acts in terms of auctioning, free allocation and carbon leakage protection to the Commission since in our point of view those measures are essential elements of the EU ETS Directive and need an ordinary legislative procedure to be rightfully amended.

8 International Climate Agreement

The further refinement of EU ETS needs to be done with taking into account the impact of the conclusions on the burdens of competing economies from the UN conference on climate change at the end of the year 2015 in Paris (COP 21).

COP 21 marks a decisive milestone to combat global warming effectively. Manufacturing industry offers its support for any productive measures, provided that there is a policy framework in place that ensures a level playing field between industries from all major countries, and cost effective policies that enable the development of the needed technological innovations.

Any international agreement to be reached must provide for a comparability of efforts in the major competing regions. Reduction targets alone cannot be the only criteria; the impact of burdens for manufacturing industries in global competition must be properly assessed when evaluating the comparability of efforts.

An energy intensive industry friendly EU ETS could be a good reason for other - even growing - economic regions in the world, to seriously follow the EU in its challenging climate change activities and consistent worldwide combat against global warming could be a realistic vision.

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