9 September 2015

Cefic Response to the Commission's EU ETS reform proposal of 15 July 2015

Response to the legislative proposal: COM(2015)337/F1: "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" https://ec.europa.eu/transparency/regdoc/?fuseaction=feedback&docId=3079130

1. COM ETS reform proposal provides opportunities for making the EU ETS fit for purpose

The following upgrades of the ETS reform proposal are needed to safeguard future-proof carbon leakage provisions thereby reconciling EU's growth and jobs and climate agendas:

1. The ETS reform proposals seem to address many of the industry's concerns by making free allowances available to cover emissions from current manufacturing, new entrants and output growth. The full effect of these proposals would depend on decisions that are yet to be taken in 'delegated acts'. However, it is already clear that the ETS reform proposals would fail to deliver by the use of arbitrary criteria to determine the eligible sectors and to set the benchmark standards for those sectors. Moreover, the proposed mechanism for a more dynamic system of allocation is based on an arbitrary five year review period and on arbitrary thresholds for production changes. These proposals can be simplified and made effective by moving to an output-based system using the MSR as a flexible reserve.

2. The ETS reform should ensure that EU manufacturers can invest and grow and rely on free allocation to the benchmark level of carbon efficiency. The ETS reform should safeguard that carbon-efficient EU installations - having invested in state-of-the-art technology - will not be required to bear additional direct and indirect carbon costs. Subject to the total ETS cap, sufficient free allowances should be made available from reserves to support the production, investment and growth of EU manufacturing industries.

3. The benchmarks should be reviewed and updated by reference to proven technological progress **based on actual data.** The benchmarks should be fixed for the fourth trading period to encourage undertakings that meet benchmark standards to reduce their emissions through further innovations; whilst requiring less efficient undertakings to purchase allowances unless and until they invest in reaching the benchmark level. Unavoidable process emissions cannot be reduced other than through reduction of EU production and should be recognized in the benchmarks.

4. The ETS reform should introduce dynamic allocation, based on output (e.g. output in year N-1 or N-2). This output-based allocation should work both ways, ensuring that carbon-efficient growth is matched by increased free allocation, while reductions in output would lead to reduced allocation. There should be no threshold changes in production that would set limits on the dynamic allocation of allowances.

5. The criteria in the current ETS Directive for identifying industrial sectors at risk of carbon leakage should be retained. The proposed changes to these criteria arbitrarily reclassify over two thirds of these sectors as being less exposed and therefore only deserving of free allowances up to

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30%: and arbitrarily limit the use of qualitative criteria in the risk assessment. This reclassification is unjustified and would mean that important chemical industry sectors are at risk of dropping off the CL list.

6. We welcome the creation of an Innovation Fund of about 400 million allowances, with accessibility for industrial projects. The setting up of this fund should not lead to a reduction in the number of allowances available for free allocation, which would reduce the innovation capacity of those companies it is intended to benefit.

2 Cefic comments on the Commission's proposal

Cefic has called for a substantive reform of the EU ETS in line with the October 2014 European Council Conclusions[1], ranking carbon leakage risk prevention as the first priority of the ETS revision. The COM proposal is an important step in the right direction but needs significant upgrade.

The most important outcome of the ETS reform should be that most efficient installations will not face additional, undue direct or indirect carbon costs. Less efficient companies will be encouraged to improve their ghg emission performance since they will in comparison be undersupplied with, and will have to buy the necessary emission rights on the carbon market.

We welcome that the Commission proposal recognises:

- An industry reserve is needed for new entrants and production growth….
- Exposed sectors should receive free allocation based on benchmarks to prevent the risk of carbon leakage
- Updated benchmarks need to better reflect progress made…
- Allocation to companies needs to be oriented to recent production output…
- Innovation needs support…
- The issue of indirect carbon costs needs to be addressed…

However, concrete COM proposals are insufficient and fall short of providing desired results and may only increase carbon costs and carbon and investment leakage risks for EU companies.

The current EU ETS reform proposal needs a significant upgrade to ensure reconciling EU's growth and climate agendas so that energy intensive industries including the EU chemical industry have a future in Europe.

[1] Quote from 23 October 2014 Council Conclusions: "The benchmarks for free allocations will be periodically reviewed in line with technological progress in the respective industry sectors. Both direct and indirect carbon costs will be taken into account, in line with the EU state aid rules so as to ensure a level-playing field. In order to maintain international competitiveness, the most efficient installations in these sectors should not face undue carbon costs leading to carbon leakage. Future allocations will ensure better alignment with changing production levels in different sectors. At the same time, incentives for industry to innovate will be fully preserved and administrative complexity will not be increased."

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3 Issues with Commission's proposal

3.1 Limited access to reserve for manufacturing and industrial growth

We welcome that a reserve allowances for manufacturing and industrial growth is proposed. While the reserve can be replenished (=flexibility) i.e. from plant closures, the suggested amount of allowances is limited, might be insufficient and will only be made available for allocation to new entrants and/or "significant production increases" at unrealistically high thresholds.

3.2 Commission proposal puts even best performers at risk of carbon investment leakage

According to the COM proposal, free allocation to industry will shrink every year, given a declining industry cap. In order to align the shrinking allowances amount with what can be given to industry the COM proposes more and more stringent benchmark levels (flat-rate decline of 1%/a; +/- 0.5%), retains the correction factors[2] (e.g. CSCF) eventually reducing free allocation and further reducing the number of sectors on the carbon leakage list. These measures of allocation elimination will mean increasing carbon costs for industry, even for the best performers. Such costs will increase by 70% for sectors falling off the list. These additional costs may reduce EU industrial competitiveness even of the best performers and discourage investments, in contradiction to the EU's growth and employment agenda.

3.3 Recent production based free allocation – in-built delay

The October 2014 Council Conclusions request a better alignment of free allocation with changing production levels. The Commission proposal envisages an alignment with changing production levels only once every 5 years that would still be depending on thresholds,.

The time gap between allocation and the considered production is still significant and will not reflect the real dynamics of economic development. The COM proposal suggests setting of important allocation rules such as thresholds outside of the Directive by separate regulatory decisions.

3.4 Carbon leakage criteria off-purpose

The thresholds for both quantitative (0.2) and qualitative assessment (0.18) could be seen as arbitrary and unjustified. Documentation is missing that would demonstrate convincingly a relation to alleged cost pass-through capacities and an improved carbon leakage risk prevention. In fact, the new criteria seem to remove numerous sectors currently considered at risk of carbon leakage from the list. In turn, 70% of their current carbon leakage protection would be taken away increasing risk of losing international competitiveness. For the qualitative assessment, in particular, there should be NO threshold.

The effect of these measures on total ETS sector emissions volume is negligible (a few percent of the total free allocation) : just for reducing administrative burden seems not a good enough reason for kicking sectors off the list and exposing them and entire value chains to the risk of carbon leakage. Other options such as removing minor emitters from the ETS scope should be considered.

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[2] Pending EU Court cases re. ETS III Cross sectoral correction factor, C191/14, C192/14, C295/14, C389/14, C391/14, C392/14, C393/14, http://curia.europa.eu/jcms/jcms/Jo1_6581/?dateDebut=03%2F09%2F2015&dateFin=03%2F09%2F2015&typeU=U&typeP=P&numAffaire=&langueProc=&nomPartie=&juridictionC=C&opSearch=recherche"

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3.5 Indirect carbon costs addressed, but not solved

The COM proposal seems to strengthen compensation but does not provide a clear solution.

3.6 Innovation funding

The extension of the NER400 to industrial projects is welcome but COM proposes to take away allowances for this purpose from the free allowances volume. Impact assessment does not match proposal

Other than declared as ‘better regulation’ objective of the Commission, the COM’s impact assessment does not cover the impacts of the combined set of parameters that are put forward in the proposal. Next to that, the impact of the agreed MSR is not being taken into account.

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