

ETS PHASE IV REVIEW AMENDMENTS OPTIONS

CEMENT INDUSTRY'S VIEWS

The European institutions are intensively debating the EU ETS Phase IV options. The present paper aims at outlining what the cement industry preferred amendments are.

Article 9, Subparagraph II – Linear Reduction Factor

LRF = 2.2%

- No further burden should be imposed on EU-ETS sectors and the LRF should be maintained at 2.2%.

⇒ No need to amend the European Commission's proposal

Article 10 Paragraph 1, Subparagraph II – Auction Share

Auction share
= 52.5%

- The October 2014 European Council conclusions intend to give priority to the need for free allowances to ensure that the best performers are not penalised by undue carbon costs for both direct and indirect emissions.
- By assuming a 57% auctioning share, 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 Historic Activity Level (HAL). This approach creates legal uncertainty for EU industries as it is contradicting the European Council's request that the best performer should not bear undue carbon costs.
- The October 2014 European Council conclusions states that "the rest of allowances will be distributed among all Member States on the basis of verified emissions, without reducing the share of allowances to be auctioned" but does not provide guidance on how to calculate the actual "share of allowances" to be auctioned.
- The correct calculating of the actual auction share in the EU ETS phase III should consider that allowances originally dedicated to free allocation to industry should not be accounted in the auctioning share:

Auction Share 52,5% of the cap, consisting of:

- *allowances designated for auctioning by Member States including the back loaded allowances and other allowances to be placed in the Market Stability Reserve in 2019 and 2020: 48% of the cap*
- *allowances provided for free to the power sector pursuant to Article 10c of the Directive: 4.5% of the cap*

Free allocation share (allowances originally dedicated to free allocation to industry) 47,5% of the cap, consisting of

- *allowances allocated for free over phase 3: 43% of the cap*
- *allowances that were not handed out because they carry out activities which were not in the carbon leakage list : 1% of the cap*
- *allowances remaining unused in the New entrants reserve : 1.5% of the cap*
- *allowances that were not handed out to installations because they stopped production (closures) or reduced their production (partial cessations): 2% of the cap*

- Thus, the actual share of allowances (for Phase III and also for Phase IV) is determined as 52.5% for auctioning and 47.5% available for free allocation as required for carbon leakage protection according to the benchmark principle.

Therefore, we support:

- ⇒ ITRE 201 & ENVI 241: “From 2021 onwards, the share of allowances to be auctioned by Member States shall be 52%, which includes the 400 million allowances for the innovation fund.”
- ⇒ ITRE 195 & ENVI 240: “From 2021 onwards, the share of allowances to be auctioned by Member States shall be 52%, and that share shall decrease by up to two percentage points up to 2030 pursuant to Article 10a(5). Such an adjustment shall take place solely in the form of a reduction of allowances auctioned pursuant to point (a) of the first subparagraph of Article 10(2). “

Article 10a Paragraph 1, Subparagraph II – Dynamic allocation in case of increases or decreases in production

- A more dynamic allocation is at best implemented based on verified data from the previous year
- The first baseline period should be as close to 2020 as possible and provisions to ensure exchange of free allowances for plant rationalisations should be in place. Although details should be established by comitology, direction should be provided by the Directive itself.
- Dynamic allocation, should include benchmark update based on real data

Preferably full dynamic allocation (N-2) or $\leq 10\%$ cumulative increase or decrease if a threshold is set

Therefore, we support:

Preferably

- ⇒ ITRE 264: “The Commission shall be empowered to adopt a delegated act in order to revise the rules referred to in this paragraph in accordance with Article 23. This act shall also provide for additional allocation from the new entrants reserve for production changes. Any increase or decrease in production reported through verified production data from two years before in accordance with Article 11 should on an annual basis result in a corresponding adjustment of the amount of free allowances granted to each installation by placing allowances into or releasing allowances from the reserve referred to in paragraph 7.”
- ⇒ ITRE 270: “The Commission shall be empowered to adopt a delegated act in accordance with Article 23. This act shall also provide for additional allocation from the new entrants reserve for significant production increases by applying the same thresholds and allocation adjustments as apply in respect of partial cessations of operation. The act shall also provide for measures for the transfer of allowances in the event of plant rationalisation. Thresholds and reference years should allow for the use of recent (year N-2) production data.”

Alternatively

- ⇒ ITRE 392, ENVI 302 and 395: “Allowances from the maximum amount referred to Article 10a(5) of this Directive which were not allocated for free up to 2020 shall be set aside for new entrants and significant production increases of more than 10% expressed as the rolling average of verified production data for the two preceding years compared to the production activity reported in accordance with Article 11. In addition, 250 million allowances placed in the market stability reserve pursuant to Article 1(3) of Decision (EU) 2015/...of the European Parliament and of the Council(*) shall be set aside for this purpose.

Article 10a Paragraph 2, Subparagraph III – Benchmarks

- The fundamentals of the benchmark principles of article 10a(1) and 10a(2) should be maintained as endorsed in the Council conclusions of October 2014. Benchmarks shall be based on recent and real data of installations. For that purpose; benchmarks shall be set and updated on the basis of verified emission data of the best performers and shall not be arbitrarily reduced.

**Update based on real data
No ratchet**

Therefore, we support:

⇒ ITRE 313: “(i) Before the start of the trading period benchmarks in individual sectors and subsectors, shall be updated based on the average of the verified emissions of the 10% most efficient installations in a sector or subsector in the Union in the years 2017 and 2018. Benchmarks shall be set on the basis of information submitted pursuant to Article 11. The Commission shall consult the relevant stakeholders, including the sectors and subsectors concerned.”

- If a ratchet is applied, rather than updating the benchmarks based on real data, non-combustion source stream emissions (process emissions), must be excluded from such a ratchet. A linear reduction trend is unachievable and principally inappropriate for unavoidable process emissions and the chemical, physical and technical limits for emission reduction of non-combustion source streams and process emissions from raw materials must be taken into account. This is a key prerequisite for preventing their Carbon Leakage out of the ETS.

Therefore, we support:

⇒ ITRE 328 “Sectors with a share of more than xx% of verified emissions considered as unavoidable process emissions, shall not be faced with a reduction of the benchmark value, at least for the part of those emissions. For every subsequent period, the latest benchmark value shall be used as a reference point for calculating the new reduction value.”

Article 10a Paragraph 5 – Cross Sectoral Correction Factor (CSCF)

- No CSCF. Its application goes against the Council conclusion that best performers must get full free allocation and this can only be obtained with a guaranteed 100% benchmarked free allocation.
- Should the CSCF nevertheless apply, up to 7% of allowances shall first be taken from the auction share
- This would maintain the overall environmental ambition and the cap. At the same time it is ensuring the required carbon leakage protection for the most vulnerable sectors.
- The benefits of this approach are twofold. Firstly it ensures that the cost of meeting the climate change targets is spread as widely as possible via electrical energy consumption, which ensures that all areas of the economy make a contribution. Some flexibility in the proportion of auctioning is provided which will be in line with the targeted decarbonisation of the power sector. Secondly it allows the EU to meet its growth objectives by encouraging all manufacturing industries at the risk of carbon leakage to remain in the EU rather than relocating investments and production to lower carbon constrained economies. Best performers can benefit by making investments in Europe that achieve additional emission reduction below the levels of the updated and verified benchmarks.

No CSCF, should the CSCF apply up to 7% of allowances shall be taken from the auction share

Therefore, we support:

- ⇒ ITRE 347 (similar to 372 in ENVI): “In order to respect the auctioning share set out in Article 10, the sum of free allocations in every year where the sum of free allocations does not reach the maximum level that respects the Member State auctioning share, the remaining allowances up to that level shall be used to prevent or limit reduction of free allocations to respect the Member State auctioning share in later years. Where, nonetheless, the maximum level is reached, free allocations shall be adjusted accordingly. Any such adjustment shall be targeted in accordance with the carbon leakage risk and shall in any case guarantee that 100% free allocation up to the level of the benchmarks is maintained”
- ⇒ ITRE 353, ENVI 375 (374) exclude process emissions from the CSCF: “In order to respect the auctioning share set out in Article 10, the sum of free allocations in every year where the sum of free allocations does not reach the maximum level that respects the Member State auctioning share, the remaining allowances up to that level shall be used to prevent or limit reduction of free allocations to respect the Member State auctioning share in later years. Where, nonetheless, the maximum level is reached and the allocations from the reserve referred to in paragraph 7 are used up, free allocations shall be adjusted accordingly. Any such adjustment shall be done in a uniform manner, excluding unavoidable process-related emissions, which are not subject to adjustment.”

Article 10a Paragraph 6 – Indirect Costs

- Strengthening the provision for the compensation of increasingly important indirect costs of EU ETS in electricity prices
- Member States shall adopt financial measures in favour of sectors or subsectors which are exposed to a genuine risk of carbon leakage
- The same procedure as the proposed new design for the evaluation of sectors at risk of carbon leakage from direct costs must be put in place for the definition of sectors eligible for compensation for indirect costs, using the cumulative combination of a direct plus indirect emission intensity criteria in a fair and predictable way avoiding an unlevel playing field within the EU.
- Alternatively, a fair and realistic procedure could be put in place for the definition of sectors eligible for compensation for indirect costs, using as for the direct emissions calculation, ex-ante benchmarks of the indirect emissions of CO₂ per unit of production

**Harmonized
compensation based on
same carbon leakage list
as for direct costs**

Therefore, we support:

- ⇒ ENVI 389: “Member States shall adopt financial measures in favour of sectors or subsectors or individual installations which are exposed to a genuine risk of carbon leakage due to significant greenhouse gas emission costs passed through to electricity prices, in a technology-neutral manner. State aid rules and the Stability and Growth Pact shall not apply to such financial measures to compensate 100% of those costs.”
- ⇒ ITRE 361: “Sectors or sub-sectors which are exposed to a significant risk of carbon leakage due to indirect costs that are incurred from greenhouse gas emission costs passed on in electricity prices shall receive financial compensation as set out in Article 10. Such financial measures shall compensate indirect costs up to the level of ex-ante benchmarks of the indirect emissions of CO₂ per unit of production as laid out in Annex III (new). Where the amount of compensation is not sufficient to compensate for all eligible costs, the remaining share may be compensated by Member States. Financial compensation shall be based on ex-ante benchmarks of the indirect emissions of CO₂ per unit of production. These benchmarks shall be calculated for a given sector as the product of the electricity

consumption per unit of production corresponding to the most efficient available technologies and of the CO₂ emissions of the relevant price-setting electricity production mix. By [6 months after entry into force], the Commission shall adopt the implementing acts in accordance with article 22a to establish the common compensation rules for the use of X% of the auctioned allowances in line with Article 10, to set ex-ante benchmarks and to define the list of eligible sectors and the regional CO₂ emission factors, as per the criteria laid out in Annex III (new) “

Article 10a Paragraph 7 – New Entrants Reserve

- Take 250 million allowances from the auction share instead of from the MSR as to help avoid the CSCF

Take 250 millions allowances from auction share

Therefore, we support

- ⇒ ITRE 351: “In order to respect the auctioning share set out in Article 10, the sum of free allocations in every year where the sum of free allocations does not reach the maximum level that respects the Member State auctioning share, the remaining allowances up to that level shall be used to prevent or limit reduction of free allocations to respect the Member State auctioning share in later years. Where, nonetheless, the maximum level is exceeded, a free allocation shall be made **from the reserve in accordance with paragraph 7**. Any such adjustment shall be done in a uniform manner”
- ⇒ ITRE 393: Allowances from the maximum amount referred to Article 10a(5) of this Directive which were not allocated for free up to 2020 shall be set aside for new entrants and significant production increases, **and for adjusting the maximum level of free allocation laid down in paragraph 5 together with** allowances placed in the market stability reserve pursuant to Article 1(3) of Decision (EU) 2015/... of the European Parliament and of the Council(*).

Article 10a Paragraph 8 – Innovation Fund

- There is lack of clarity on how the NER and Innovation and Growth funds will be fed and how many allowances are available for these purposes in total.
- The NER and Innovation and Growth Funds should be primed using excess Phase III or MSR allowances only so that the level of benchmarked free allocation is not reduced further.
- Support for innovation should not be restricted to carbon capture and storage. It should be extended to cover the use of CO₂ from industrial carbon capture and use. In addition, support mechanisms need to be available for switching to unconventional/technologically challenging fuel use in industrial processes particularly as more expensive fuel sources (driven by tighter benchmarks and other limiting factors in the Directive) add to production costs and therefore increase the carbon leakage threat at high levels of fuel switching.

400 millions from auction share plus 50 millions from MSR

Support both CCS & CCU

Therefore, we support

- ⇒ ITRE 408 : “400 million allowances, taken from the share of allowances to be auctioned, shall be available to support and leverage investments, using different instruments managed by the European Investment Bank, in innovation in low-carbon technologies and processes in industrial sectors listed in Annex I, and to help stimulate the construction and operation of commercial demonstration projects that aim at environmentally safe CCS and CCU as well as demonstration projects of innovative renewable energy technologies,

energy conversion and storage, as well as electric battery development in the territory of the Union “

⇒ ITRE 734: “An obligation to surrender allowances shall not arise in respect of emissions verified as captured and transported for permanent storage to a facility for which a permit is in force in accordance with Directive 2009/31/EC of the European Parliament and of the Council of 23 April 2009 on the geological storage of carbon dioxide (1), nor in respect of emissions verified as captured and/or re-used in an application ensuring a permanent bound of the CO₂, for the purpose of carbon capture and re-use.’.”

Article 10b – Carbon Leakage

- Tiering does not remove the risk of carbon leakage for all sectors and exacerbate the risk of investment leakage.
- A differentiated treatment of sectors under a differentiated approach is open to legal challenge as it discriminates sectors on the basis of unclear and unverifiable criteria.
- Tiering will introduce distortion of competition on downstream markets
- For sectors with a significant share of non-combustion source stream emissions (process emissions), a linear reduction trend is unachievable and principally inappropriate. The chemical, physical and technical limits for emission reduction of non-combustion source streams and process emissions from raw materials must be taken into account. This is a key prerequisite for preventing their Carbon Leakage out of the ETS.
- A better way forward exists and must be given priority i.e. securing a sufficient number of free allowances, adjusting better the allocations to real production data and realistic benchmarks based on bottom-up real installation data
- Carbon leakage assessment should be carried out at the relevant ETS product level
- If, against our wishes, tiering is progressed the following text should be included:
 - “Sectors and sub-sectors with emissions resulting directly from physical or chemical process necessary to produce the product in question (process emissions), with a total emission intensity, >12kgCO₂ divided by their gross value added (in €), shall also be deemed to be at risk of carbon leakage. Such sectors and sub-sectors shall be allocated free allowances for the period up to 2030 at 100% of the quantity determined in accordance with the measures adopted pursuant to Article 10a”.

No tiering, tiering is especially inappropriate for industries with a high share of process emissions
