

# Consultation on revision of the EU Emission Trading System (EU ETS) Directive

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## Introduction

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On 24 October 2014, the European Council agreed on the 2030 framework for climate and energy [1], including a binding domestic target for reducing greenhouse gas (GHG) emissions of at least 40% in 2030 as compared to 1990. To meet this target, the European Council agreed that the emissions in the EU Emission Trading System should be reduced, compared to 2005, by 43%. A reformed EU ETS remains the main instrument to achieve the emission reduction target. The cap will decline based on an annual linear reduction factor of 2.2% (instead of the current 1.74%) from 2021 onwards, to achieve the necessary emission reductions in the EU ETS. The European Council furthermore gave strategic guidance on several issues regarding the implementation of the emission reduction target, namely free allocation to industry, the establishment of a modernisation and an innovation fund, optional free allocation of allowances to modernise electricity generation in some Member States.

The strategic guidance given by European leaders on these elements will be translated into a legislative proposal to revise the EU ETS for the period post-2020. This constitutes an important part of the work on the achievement of a resilient Energy Union with a forward looking climate change policy, which has been identified as a key policy area in President Juncker's political guidelines for the new Commission.

The purpose of the present stakeholder consultation is to gather stakeholders' views on these elements. This consultation focuses on issues not yet addressed in the consultations recently conducted for the 2030 Impact Assessment[2], the Impact Assessment for the carbon leakage list for 2015-2019[3] and the consultation conducted on post-2020 carbon leakage provisions[4].

In order to take stock of the EU ETS (established by Directive 2003/87/EC) as a policy measure, this consultation also contains questions concerning the general evaluation of this policy measure. The questionnaire consists of 7 chapters. You are invited to answer questions on the chapters which are relevant to you.

## 0. Registration

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0.1. What is your profile?\*

- Business
- A small and medium enterprise
- Trade association representing businesses
- SME business organisation
- Government institution/regulatory authority
- Academic/research institution
- Non-governmental organisation
- Citizen
- Other

0.2. Please enter the name of your business/organisation/association etc.:\*

EUROMETAUX, European association of metals

0.3. Please enter your contact details (address, telephone, email):\*

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Website: www.eurometaux.eu

0.4. If relevant, please state if the sector/industry you represent falls under the scope of the EU

ETS:\*

- yes
- no
- not relevant

0.5. If relevant, please state what sector your represent:\*

- Energy-intensive industry
- Energy sector
- Other

0.6. The results of this stakeholder consultation will be published unless stated otherwise. Can we include your replies in the publication?\*

- yes  
 no  
 partially

0.7. Register ID number (if you/your organisation is registered in the Transparency register):

6165079609348

## 1. Free allocation and addressing the risk of carbon leakage

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The European Council has concluded that free allocation to prevent the risk of carbon leakage should not expire as foreseen in the current legislation, but should continue also after 2020 as long as there are no comparable efforts to reduce emissions in other major economies.

Extensive stakeholder consultation was already carried out on the post-2020 carbon leakage provisions, as well as on aspects related to innovation support. The process included three full-day stakeholder meetings (June, July and September 2014) and a written consultation conducted for 12 weeks (8 May – 31 July, 2014). The written consultation covered 23 multiple choice questions with space for motivations, and a question allowing respondents to bring up any other issue they felt was important or insufficiently covered.

The documents and minutes of the meetings, as well as the submissions and the analysis thereof in the case of the written consultation, are available on the Commission website.

Information from the stakeholder meetings:

[http://ec.europa.eu/clima/events/articles/0090\\_en.htm](http://ec.europa.eu/clima/events/articles/0090_en.htm)

[http://ec.europa.eu/clima/events/articles/0095\\_en.htm](http://ec.europa.eu/clima/events/articles/0095_en.htm)

[http://ec.europa.eu/clima/events/articles/0097\\_en.htm](http://ec.europa.eu/clima/events/articles/0097_en.htm)

Replies and summary of the written consultation:

[http://ec.europa.eu/clima/consultations/articles/0023\\_en.htm](http://ec.europa.eu/clima/consultations/articles/0023_en.htm)

The results of the above mentioned public consultation are being taken into account in the preparation of the legislative proposal. In order to reduce the administrative burden for stakeholders and the Commission, the present consultation focuses on issues not already covered in this recently finalised public consultation. Respondents are nevertheless invited to add to the replies provided in the earlier consultations if deemed necessary in the light of the conclusions of the European Council in this area.

**1.1 The European Council called for a periodic revision of benchmarks in line with technological progress. How could this be best achieved in your view and, in particular, which data could be used to this end? How frequently should benchmarks be updated, keeping in mind administrative feasibility?**

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The electro-intensive industries are mostly exposed to the carbon cost passed through to the electricity prices (indirect effects). No other industries are more electricity intensive than non-ferrous metals industry, for which these costs can be up to 7 times higher than the direct ETS costs. Since commodity prices are set globally at the London Metal Exchange (LME), the European nonferrous metals and ferro-alloys and silicon producers cannot pass through the carbon costs incurred in Europe.

In this respect Eurometaux has consistently maintained that it is only by the application of realistic benchmarks, these will play a meaningful role within the ETS. This, together with components like full compensation for direct and indirect cost effects, "actual production" and due consideration of the interface between today's lack of an international playing field and the need to strengthen Europe's industrial competitiveness, will be key to ensure ETS as the tool for reducing global GHG emissions.

It is of importance that the benchmarks should be technically and economically achievable and not set in a manner penalizing the most efficient installations. Benchmarks must be set at a realistic level: an over-ambitious benchmark will increase costs and disincentive investments, thus increasing the risk of carbon leakage. They must be defined bottom-up, starting from the real performance levels and be based on the 10% best performing installations in the EU. The benchmarks should only be reviewed between trading periods as more frequent revisions will undermine predictability and constitute a disincentive to investments.

Technically and economically achievable benchmarks will not only ensure that the most efficient installations in Europe will not face undue carbon costs, as requested by the European Council (conclusions of October 2014), but will also duly incentivize the installations to be as close as possible to such benchmarks. Full compensation for best performing plants, when such benchmarks are met is absolutely necessary in order to preserve the competitive position of Europe as a location for energy intensive industries.

**1.2 The European Council has defined guiding principles for the development of post-2020 free allocation rules which provide inter alia that "both direct and indirect costs will be taken into account, in line with the EU state aid rules" and that "the most efficient installations in these sectors should not face undue carbon costs leading to carbon leakage" while "incentives for industry to innovate will be fully preserved and administrative complexity will not be increased" and while "ensuring affordable energy prices". Do you have views how these principles should be reflected in the future free allocation rules?**

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The underlying objective of the ETS revision process, should be securing a stable, competitive and predictable framework for industry, thus allowing for future investments and the eventual establishment of a global carbon price. Presently the lack of comparable efforts by major economies does however mean that there is no level playing field, resulting in a serious risk of carbon- and investment leakage. Compensation of indirect costs is currently not uniformly addressed, nor harmonised, throughout Europe. It is deemed to constitute State Aid which is unpredictable as it is exposed to budgetary constraints and annual decisions in the Member States. Furthermore, the amount compensated is insufficient. This is valid both for direct costs, based on historical output and reduction factors (free allowances are subject to an annual reduction of 5.73% in 2013 and 1.74% from 2014 onwards, and for indirect costs maximum allowed State Aid is capped, starting at 85% in 2013 and decreasing to 75% in 2020). This reduces incentives to operate and to invest, eventually increasing the risk of carbon leakage.

To Eurometaux undue costs mean that an installation operating at benchmark level shall not face any cost from EU ETS. To obtain that the most efficient installations do not face undue carbon costs leading to carbon leakage (The European Council October 2014), the compensation for indirect must be more predictable and the parameters deciding the compensation (direct and indirect) has to be amended:

1. Compensation for indirect emission costs must be more predictable: it should be granted through the EU ETS directive, as for direct emissions.
2. Level of compensation post 2020 should be based on the following principles:
  1. Realistic benchmarks: keeping the present system based on the 10% best performing installations in the EU is necessary for the preservation of the environmental and energy efficiency incentives to both new and old capacity.
  2. Actual output: in order to provide an incentive for growth and to allow optimal production flexibility through economic business cycles. This will not reduce the environmental incentive for the recipient. On the contrary, full compensation per unit of increased production is a precondition for investment in new technology and for increasing production at present capacity. According to economic theory, output-based allocation is socio-economically preferable in a carbon leakage situation and gives no loss of environmental optimality, provided that allocation is supported by a benchmark.

3. No further annual reduction; either through cross sectorial reduction factor (CSRF) or capping mechanisms. Insufficient compensation reduces the operational margins and will ultimately reduce the financial capability to keep the production equipment in good operational condition and to invest in new and more efficient technology. Investing in European capacity with new technology requires that the project financials match those of similar investments elsewhere.

4. Use of marginal producer's electricity emission pass through factor (for compensation of indirect costs):

The European electricity market prices are decided by the marginal producer. Even though a higher share with renewable production is being introduced there will, in most cases, be pass-through of the marginal producer's emission allowance cost into the electricity price. By using electricity market models, the marginal price setter technology can be determined ex post.

**1.3 Should free allocation be given from 2021 to 2030 to compensate those carbon costs which sectors pass through to customers? How could free allocation be best determined in order to avoid windfall profits?**

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However, as long as the European ETS remains geographically isolated and non-ferrous metals and ferro-alloys and silicon prices use global pricing mechanism, the Eurometaux members cannot pass through any European carbon costs to its customers, without losing market shares. Thus, the non-ferrous metals and ferro-alloys and silicon industry does not make any windfall profit from any compensation system

To avoid windfall profits the carbon leakage list should be based on the industries' level of exposure to global competition (ability to pass-through cost to customers) and on the total direct and indirect carbon costs exposure. Installations meeting both criteria at significant levels would fall in the most exposed category of the carbon leakage list and therefore must be treated especially due to their degree of global competitive risk exposure.

Using actual production instead of historical output as the basis for allocation/compensation would also eliminate the risk of windfall profits, and would allow the right matching with an installation's needs to avoid carbon leakage. This would also be in line with the European Council's conclusions asking that "Future allocation will ensure better alignment with changing production levels in different sectors".

Analysis verifies that there are sufficient allowances available to finance compensation of both direct and indirect effects of the EU ETS for industry exposed to global competition. Especially this will be the case if the compensation structure (level) differentiates between those most at risk and those less vulnerable. By using the surplus of allowances not auctioned (e.g. backloaded volume and other unused allowances as NERs) the ETS could create a compensation mechanism that both incentivize industrial growth and provide carbon leakage protection in a transparent, harmonized and predictable way. However if there is not sufficient amount of allowances available in a EU harmonized scheme the possibility of supplementary national measures embedded in the state aid guidelines should be kept.

#### 1.4 Are there any complementary aspects you would like to add to the replies given to the previous written consultation in the light of the European Council conclusions?

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Present compensation system for indirect emissions opens up for only 75% in 2020 if required benchmark standard is met. The non-ferrous metals and ferro-alloys and silicon industry is amongst most carbon leakage exposed industries in Europe. An insufficient level of compensation after 2020 and the threat of a further reduction, combined with a large expected price increase due to the likely introduction of MSR, will dramatically reduce the competitiveness of the European non-ferrous metals industry. Without predictable and sufficient compensation the uncertainty will prevent investments and lead to carbon leakage. A binding international agreement leading to global pricing of emissions and more equal CO2 cost situation, with no further distorting of global international competition for different sectors, is further away than previously expected. In this situation, compensation for direct and indirect effects should be maintained until a global level playing field, meaning until a critical mass of industry competing with European industry is exposed to a similar climate cost level.

## 2. Innovation fund

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The European Council has concluded that 400 million allowances in 2021 to 2030 should be dedicated for setting up an innovation fund to support demonstration projects of innovative renewable energy technologies, carbon capture and storage (CCS) as well as low carbon innovation in industrial sectors. To make this fund operational, a legal basis has to be created in the EU ETS Directive while further implementation modalities can be set out in secondary legislation. The work can build on the experience with the existing "NER300" programme which made available 300 million allowances for CCS and innovative renewable energy technologies[1].

With regard to establishing a legal basis for the innovation fund as part of the revision of the EU ETS Directive, the Commission seeks feedback on the following questions:



**2.1 Do you see reasons to modify the existing modalities applied in the first two calls of the NER300? Are there any modalities governing the NER 300 programme which could be simplified in the design of the innovation fund? If you see the need for changes, please be specific what aspects you would like to see changed and why.**

*4,500 character(s) maximum*

**2.2 Do you consider that for the extended scope of supporting low-carbon innovation in industrial sectors the modalities should be the same as for CCS and innovative renewable energy technologies or is certain tailoring needed, e.g. pre-defined amounts, specific selection criteria? If possible, please provide specific examples of tailored modalities.**

*4,500 character(s) maximum*

**2.3 Are there any complementary aspects regarding innovation funding you would like to add to the replies given to the previous written consultation in the light of the European Council conclusions?**

*4,500 character(s) maximum*

### 3. Modernisation fund

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The European Council has concluded that 2% of the total EU ETS allowances in 2021 to 2030 should be dedicated to address the particularly high investment needs for Member States with GDP per capita below 60% of the EU average. The aim is to improve energy efficiency and to modernise the energy systems of the benefitting Member States. The fund should be managed by the beneficiary Member States, with the involvement of the European Investment Bank (EIB) in the selection of projects. To make this fund operational, a legal basis has to be created (in the EU ETS Directive), while further implementation modalities can be set out in secondary legislation.

With regard to establishing a legal basis for the modernisation fund as part of the revision of the EU ETS Directive, the Commission seeks feedback on the following questions:

**3.1 Implementation of the modernization fund requires a governance structure: What is the right balance between the responsibilities of eligible Member States, the EIB and other institutions to ensure an effective and transparent management?**

*4,500 character(s) maximum*

**3.2 Regarding the investments, what types of projects should be financed by the modernisation fund to ensure the attainment of its goals? Should certain types of projects be ineligible for support?**

*4,500 character(s) maximum*

**3.3 Should there be concrete criteria [e.g. cost-per-unit performance, clean energy produced, energy saved, etc.] guiding the selection of projects?**

*4,500 character(s) maximum*

**3.4 How do you see the interaction of the modernisation fund with other sources of funding available for the same type of projects, in particular under the optional free allocation for modernisation of electricity generation (see section 4 below)? Would accumulation rules be appropriate?**

*4,500 character(s) maximum*

**3.5 Do you have views how the assessment of the projects should be reflected in the forthcoming 2030 governance process (e.g. national climate programmes, and plans for renewable energy and energy efficiency)?**

*4,500 character(s) maximum*



### 3.6 Should the level of funding be contingent on concrete performance criteria?

*4,500 character(s) maximum*

## 4. Free allocation to promote investments for modernising the energy sector

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The conclusions of the European Council provide for the continuation after 2020 of the mechanism foreseen in Article 10c of the EU ETS Directive, which allows some Member States to opt to hand out free allowances to power plants in order to promote investments for modernising the energy sector. The current Article 10c modalities, including transparency, should be improved to promote investments modernising the energy sector, while avoiding distortions of the internal energy market.

With a view to reviewing and improving the current modalities as part of the revisions to the EU ETS Directive, the Commission seeks feedback on the following questions:

**4.1 How can it be ensured that investments have an added value in terms of modernising the energy sector? Should there be common criteria for the selection of projects?**

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**4.2 How do you see the interaction of the free allocation to energy sector with other sources of funding available for the same type of projects, e.g. EU co-financing that should be made available for the projects of common interest under the 2030 climate and energy framework? Would accumulation rules be appropriate?**

*4,500 character(s) maximum*

**4.3 Do you have any views how the assessment of the projects should be reflected in the forthcoming 2030 governance process (e.g. as regards improving transparency)?**

*4,500 character(s) maximum*

**4.4 The maximum amount of allowances handed out for free under this option is limited. Do you think eligible Member States should use the allowances for a period of time specified in advance (e.g. per year), or freely distribute them over the 2021-2030 period? (Please explain your motivation.)**

*4,500 character(s) maximum*

**4.5 Should there be priorities guiding the Member States in the selection of areas to be supported?**

- yes
- no

**4.6 How can improved transparency be ensured with regard to the selection and implementation of investments related to free allocation for modernisation of energy? In particular regarding the implementation of investments, should allowances be added to auctioning volumes after a certain time period has lapsed in case the investment is not carried out within the agreed timeframe?**

*4,500 character(s) maximum*

## 5. SMEs / regulatory fees / other

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In order to allow taking stock of the EU ETS aspects beyond those examined by the European Council, respondents are also invited to provide feedback on certain other questions.

The Commission ensures that better regulation principles govern all of the policy work, including that the specificities of small and medium sized enterprise (SMEs) are taken into due consideration. Member States can exclude certain small installations from the EU ETS in the current trading period (2013-2020) if taxation or other equivalent measures are in place that will cut their emissions. If such a possibility was to be reviewed, a legal basis would have to be created in the EU ETS Directive.

The accurate accounting of all emission allowances issued is assured by a single Union Registry with strong security measures. The operations were centralised in a single Registry operated by the Commission, following a revision of the ETS Directive in 2009. This has replaced Member States' national Registries. Despite the considerable resources from the EU budget required for maintaining the EU Registry, as does supporting work on auctioning, the Commission does not have the possibility to charge any fees. However, Member States administrators may still charge Registry fees to account holders administered by them. There are discrepancies in fees across different Member States.

**5.1 Are there any EU ETS administrative requirements which you consider can be simplified? Do you see scope to reduce transaction costs, in particular for SMEs? If yes, please explain in detail.**

*4,500 character(s) maximum*

**5.2 Member States had the possibility to exclude small emitting installations from the EU ETS until 2020. Should this possibility be continued? If so, what should be the modalities for opt-out installations to contribute to emission reductions in a cost-effective and economically efficient manner? Should these be harmonised at EU level?**

*4,500 character(s) maximum*



**5.3 How do you rate the importance of a high level of security and user-friendliness of the Union Registry? Do you think the costs for providing these services should be covered via Registry fees?**

*4,500 character(s) maximum*

**5.4 Do you consider discrepancies in Registry fees in different Member States justified?  
Should Registry fees be aligned at EU level?**

*4,500 character(s) maximum*

**5.5 Under the current EU ETS Directive, at least 50% of the revenues generated from the auctioning of allowances should be used by Member States for climate-related purposes. For the calendar year 2013 Member States have reported to have used or to plan to use 87 % on average to support domestic investments in climate and energy. Do you consider the current provisions regarding the use of the revenues adequate for financing climate action? If not, please explain why?**

*4,500 character(s) maximum*

## 6. General evaluation

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## **6.1 How well do the objectives of the EU ETS Directive correspond to the EU climate policy objectives?**

### **How well is the EU ETS Directive adapted to subsequent technological or scientific changes?**

*4,500 character(s) maximum*

Europe is the first region in the world to implement carbon constraints policies in such a comprehensive way. We support such a political move on the condition that the ETS Directive includes sufficient mechanisms to prevent carbon leakage until a critical mass of industry competing with European industry is exposed to a similar climate cost level. Reinforcing the international competitiveness of European industry is of paramount importance. To this end, establishing predictable framework conditions and promoting industrial investments should be the main focus of the EU ETS directive. Its unintended direct and indirect effects corresponds neither to industrial growth nor climate targets the EU has set itself and could lead to global emission growth. Compensation for both direct and indirect emissions should thus be integrated in ETS Directive and be based on actual industrial output and realistic benchmarks. This is essential at a time where Europe is witnessing a serious reduction in industrial production and truly needs growth. European demand for non-ferrous metals and ferro-alloys and silicon is expected to increase considerably due to both the substantial benefits with its properties, compared to other metals, as its climate benefits when used in cars, packaging, building and engineering. Based on all these climate advantages, it is therefore a paradox that Europe's import of non-ferrous metals is increasing substantially from countries without carbon regulations.

**6.2 What are the strengths and weaknesses of the EU ETS Directive? To what extent has the EU ETS Directive been successful in achieving its objectives to promote emission reductions in a cost-effective manner compared to alternatives, e.g. regulatory standards, taxation?**

*4,500 character(s) maximum*

**Weakness:**

Current compensation of direct and indirect effects on manufacturing industry is inadequate (keeping benchmark exposed to costs and not relating to actual production) and unpredictable for indirect costs. It therefore hinders new investments, leading to carbon leakage. Today's carbon leakage list, setting one size of compensation for all sectors, should be better structured and focused, to differentiate the level of compensation based upon the different level of exposure to the carbon leakage risk.

**Strength:**

A market based system (in principle), establishing uniform rules within the EU/EEA area (except for indirect cost compensation left at national level) and has delivered according to its principal objective of reducing emissions.

The potential to be linked with ETS developed in other regions and build over the long term a common ETS regime if rules and principles can be aligned.

**6.3 To what extent are the costs resulting from the implementation of the EU ETS Directive proportionate to the results/benefits that have been achieved, including secondary impacts on financing/support mechanisms for low carbon technologies, administrative cost, employment impacts etc.? If there are significant differences in costs (or benefits) between Member States, what is causing them?**

*4,500 character(s) maximum*

#### **6.4 How well does the EU ETS Directive fit with other relevant EU legislation?**

*4,500 character(s) maximum*

Lack of adequate and predictable compensation does not correspond to European targets for industrial growth. Further, it could have a reverse effect and worsen Europe's total carbon footprint due to increased imports of goods from countries with substantially higher carbon footprint.

#### **6.5 What is the EU value-added of the EU ETS Directive? To what extent could the changes brought by the EU ETS Directive have been achieved by national measures only?**

*4,500 character(s) maximum*

Energy intensive industry has an innate incentive to become more energy efficient due to high energy cost, independently of the extra cost arising from an ETS. Improvements however require investments, either in upgrading existing capacity or in developing new plants. Because of insufficient compensation of additional climate policy costs the EU ETS actually reduce the margins of the industry, thereby reducing its ability to invest and eventually to become more energy efficient.

**6.6 Do you have any other comment on the revision of the EU ETS Directive that you would like to share?**

*4,500 character(s) maximum*

**Contact**

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