



Revision of the EU ETS Directive

Joint position paper

8 November 2021

Energy-intensive industries (EIIs) provide direct employment to around 2.6 million people and represent the foundations of critical and strategic value chains for the EU economy and society. We support the objectives of the European Green Deal and the EU's climate neutrality goal. Timely action by 2030 needs to provide a balanced reduction pathway and redistribute in time efforts across the EU society.

Our sectors have collectively identified a range of technological pathways and companies invest in concrete projects to deliver deep emission reductions. As highlighted in the "Masterplan for a competitive transformation of EU EIIs enabling a climate neutral, circular economy by 2030", the successful deployment of breakthrough technologies requires three key enabling conditions, notably (1) access to abundant and competitive low-carbon energy and feedstock, (2) funding support for the upscale and roll-out of such technologies and (3) a supportive regulatory framework that creates lead markets for low-carbon solutions while preserving the competitiveness of industries highly exposed to global competition.

An effective and balanced "Fit for 55" package needs to include concrete measures to deliver these enabling conditions as soon as possible. In this context, the revision of the EU ETS Directive represents the core element of the overall regulatory framework for the transformation of EU EIIs towards climate neutrality. Taking into account both the environmental and economic implications of the legislation, the revision should pursue the following strategic priorities:

1. Achieving the higher 2030 ambition cost efficiently: while the legislation provides the legal certainty that the new 2030 target is accomplished, it needs to avoid undue additional direct and indirect carbon costs that would burden the EU society unnecessarily. Therefore, rebasing and tightening of the Market Stability Reserve should be avoided, since they increase costs for the same level of 2030 climate ambition, and measures should be investigated to address excessive carbon prices and financial speculation.
2. Strengthening carbon leakage protection: the carbon leakage risk is more pressing than ever, considering the recent evolution of the carbon price and the further increase expected in the

fourth trading period. Industry requires effective measures due to the lack of comparable efforts by the major competing countries. In particular, the following elements should be considered:

- Ensuring sufficient level of free allocation
 - Avoiding premature benchmark reduction
 - Avoiding the free allocation conditionality
 - Co-existence of a Carbon Border Adjustment Mechanism and free allocation
 - Effective carbon leakage protection from indirect carbon costs
 - Adjusting for the pandemic production levels
3. Accelerating the implementation of breakthrough technologies in industrial sectors: the regulatory framework should prioritise investments in technologies but also related low-carbon energy, fuels and infrastructure in hard to abate industrial sectors that will be essential for the transition towards climate neutrality. In addition to the Innovation Fund, all ETS revenues should provide financial support in this field, including via contracts for difference.
 4. Basing decision making on a comprehensive and realistic impact assessment: it is essential to present a proper assessment of the impact of the legislation on sectors exposed to carbon leakage to make well informed legislative decisions.

Against this background, we would like to share the following recommendations on the revision of the EU ETS Directive:

1. Achieving the 2030 target cost efficiently without rebasing nor Market Stability Reserve (MSR) strengthening

The climate ambition of the EU ETS will be defined by the stricter 2030 cap. This needs to be achieved in the most efficient way to reduce costs for compliance operators as well as the whole EU society through higher indirect costs passed on in the electricity price. Rebasing (i.e. one-off cancellation of allowances) and strengthening of the Market Stability Reserve (i.e. putting more allowances in the reserve) are not needed. They artificially increase the costs for the same level of climate ambition.

The sole increase of the Linear Reduction Factor (LRF) until 2030 represents a less disruptive measure that would deliver the 2030 target (i.e. the end point of the trajectory) with a significantly lower impact on the overall trading period. For instance, the closest option to the Commission proposal with rebasing described in the Impact Assessment (option AMB2c) entails an ETS cap with 355 million allowances below the corresponding option without rebasing (AMB2a). This has also an impact on the total free allocation, which is more than 160 million lower than without rebasing. This means it increases the magnitude of the cross sectoral correction factor.

Furthermore, tightening of the MSR until 2030 in the context of a much shorter trading period is unjustified. It should be noted that the introduction of the MSR as well as the doubled intake rate until 2023 were introduced to address the historical surplus from the previous trading period. This issue has been already addressed. The Phase 4 cap is being tightened due to the increased 2030 climate ambition.

Finally, in order to ensure the cost efficient and well-functioning of the carbon market, measures should be investigated to address excessive carbon prices and financial speculation, including the

functioning of the Market Stability Reserve. We have noted the ongoing analysis by the EU Commission on speculation and are keen to follow up with ESMA and EU Commission.

2. Strengthening carbon leakage protection

The “In depth analysis in support of the Communication A clean planet for all” acknowledged that *“the risk of carbon leakage depends on measures that allow EU industries to remain competitive and if there is a unified global decarbonisation ambition”*. Considering the unilateral increase in EU climate ambition and the steady increase of the EU carbon price by 2030, carbon leakage is a major threat both for EU industrial competitiveness and environmental integrity.

Therefore, it is essential that carbon leakage measures are strengthened in order to match the higher asymmetry. The predictability of the legal framework will also provide certainty for planning low-carbon investments and avoid market distortions.

In particular, the following elements should be considered:

a) Ensuring sufficient level of free allocation

The revision needs to ensure sufficient level of free allocation at the level of realistic benchmarks without the application of the cross sectoral correction factor, considering also the possible extension of free allocation rules to additional installations. To this purpose, the 3% flexibility between auctioning and free allocation shares needs to be increased. This is largely possible, since the impact assessment on the 2030 targets acknowledged that the abatement potential of the power sector (which is the historical reference of the auctioning share) is much larger than energy intensive industries (i.e. 70% vs. 22%). Similarly, allowances in the Market Stability Reserve could be used as well to avoid the application of the cross sectoral correction factor.

b) Avoiding premature benchmark reduction

Effective carbon leakage protection requires representative, technically feasible and realistic benchmarks. If the maximum reduction rate is increased from 1.6% to 2.5% and additional technologies and installations are included in update of existing benchmarks in 2025 as proposed by the Commission, benchmarks and free allocation could decrease sharply (50%) for entire sectors already in 2026-2030, when such technologies and/or underlying energy sources are very limited.

Therefore, existing definitions and system boundaries need to remain in place until 2030 in order to provide legal predictability for investment planning. If any modification of the rules is nonetheless introduced to reward low-carbon technologies, it should not prematurely reduce benchmark levels.

Furthermore, the update of product and fall-back benchmarks should take into account EU-wide availability of affordable resources (e.g. biomass, electricity and hydrogen), infrastructure (e.g. CO₂, electricity and hydrogen) and technologies without distorting competition between member states.

c) Avoiding the free allocation conditionality

The new provision introducing conditionality of free allocation undermines the carbon leakage protection measure. Furthermore, it creates an unnecessary overlap in the

regulatory framework, increases administrative burden and risks being inconsistent with the pathway towards climate neutrality. Such an approach will require in some cases the time- and resource-intensive conversion of industrial sites to breakthrough technologies rather than incremental efficiency gains of existing ones.

d) Co-existence of a Carbon Border Adjustment Mechanism and free allocation

Free allocation and, where granted, indirect costs compensation have proven to be effective measures to a large extent, although in the context of much lower carbon prices. Should a Carbon Border Adjustment Mechanism (CBAM) be introduced, it should include a solution for exports and co-exist with the current system of full benchmark-based free allocation at least until 2030, to provide certainty for low-carbon investments and avoid market distortions. Any subsequent modification of the rules needs to be conditional to a monitoring system assessing and ensuring the effectiveness of the CBAM both for imports and exports.

e) Effective carbon leakage protection from indirect carbon costs

Direct and indirect electrification represents one of the key solutions for transforming EU industry towards the climate neutrality target. However, high electricity prices resulting from the carbon cost component and other elements are a major barrier for such process. At present, carbon leakage protection for electricity consumption is insufficient and fragmented across EU member states. Therefore, it is essential to ensure effective carbon leakage provisions against indirect carbon costs in all EU member states.

f) Adjusting for the pandemic production levels

The revision of the Directive offers also the opportunity to adjust specific provisions of the secondary legislation that risk having unintended effects. According to the current rules, free allocation for the period 2026-2030 will be based on the average production levels in the period 2019-2023. This will penalise EU companies which had unrepresentatively low production in 2020 due to covid pandemic. A targeted clause should be introduced so that 2020 production does not impact the calculation.

3. Accelerating the implementation of breakthrough technologies in industrial sectors

Following the development and implementation on large scale of renewables in the power sector in the last decade, it is clear that the upcoming decade need to focus on accelerating low-carbon technologies in hard to abate industrial sectors. The proposals to increase funding including via carbon contracts for difference which will rate up to 100% of the eligible costs is a welcomed step.

Yet, the increased size of the Fund should be financed fully from the auctioning share rather than free allocation in order to avoid undermining the effectiveness of carbon leakage measures. Since the Innovation Fund is also extended to the transport and buildings sectors, it should be ensured that auctioning revenues from traditional ETS sectors such as industry are allocated to them rather than being diverted to new sectors.

The first call of the Innovation Fund for large scale projects registered applications that required financial support which was 22 times higher than the available budget. This shows clearly that much more financial resources should be mobilised to support low-carbon technologies in ETS

sectors, and industry in particular. Therefore, in addition to the Innovation Fund, all revenues raised from the EU ETS should be reinvested in industrial sectors under the EU ETS sectors, including on indirect costs compensation.

4. A comprehensive and realistic impact assessment is essential for well informed decision making

The EU ETS Impact Assessment does not provide a comprehensive analysis of the impact of the final Commission proposal, since elements of the Directive (e.g. ambition, carbon leakage provisions, Innovation Fund, Market Stability Reserve) have been assessed only in isolation. In particular, it does not present a proper assessment of the impact of the legislation on sectors exposed to carbon leakage. Notably, indirect costs have not been assessed at all and direct costs have been largely underestimated due the following four key reasons:

- The carbon price used in the assumption (see table 45, Annex 4, page 90) starts at 42€ in 2021 and increases to 60€ only in 2030 (while it is above 60€ already now).
- Direct emissions have been underestimated, because the model assumes high reduction rates between 1% and 2% per year for all energy intensive sectors, which do not match the actual trend of the last years (see table 43, Annex 4, page 87). Moreover, investment costs for achieving such high abatement rates have not been estimated.
- Free allocation was overestimated because it was assumed taking into account the existing benchmark rates within the range 0.2%-1.6% (see Annex 4, section 9.2.1 page 82), while the Commission proposal increases the higher range from 1.6% to 2.5%.
- Free allocation was overestimated because it did not take into account the shift of 40 million free allowances to the Innovation Fund that is included in the Commission proposal.

A comprehensive, transparent and realistic analysis of the combined effect of all provisions on carbon leakage sectors is needed for a well-informed decision-making process.
