

Cefic comments on the EU ETS draft Allocation Rules and Benchmarks

Cefic urges the European Commission, the Member States and the European Parliament to use the current EC Interservice Consultation to bring rules for allocation and the benchmarks fully into line with the spirit and requirements of the EU ETS Directive Review.

Cefic proposes:

I. Encourage new investment; consistency between historical activity level (HAL), capacity and new entrants

A sustainable EU climate policy should not be built on the recent recession data. Therefore:

- The base period should exclude any unrepresentative year of each sub-installation by adopting the average of 2005-2008 minus the worst year. If the base period extends into the recession years, additional deletion of years is necessary: 2005-2009 minus 2 or 2005-2010 minus 3 years.

The following issues concern the investment in new installations or capacities. New capacities are urgently needed to reach lower GHG emissions without de-industrializing the EU. Therefore, it is of utmost importance that **new investment is not hampered but incentivised** as much as possible.

- For **extensions and new installations**, a default value for the standard utilization factor (SCUF) should be adopted – of **95% for the chemical sectors** – until subsector- specific SCUF values based on the 10% best installations can be derived from the actual data. Most recent expansions use up-to-date technologies and practices, and are built to run at highest utilization as the 10% best installations do. They cannot be compared with average performance or utilization of a sector.
- The **thresholds for access to the new entrants reserve (NER)** should be 10% extension above HAL or an increase of 10,000 allowances (EUAs) according to the applicable benchmark (product benchmark or fallback) for expansion after June 2011.
- **For expansions before June 2011, no minimum threshold** should be applied to avoid retro-active penalization of past expansion decisions. This is in line with the ETS Directive that requires a threshold of 10% only for real new entrants, i.e. expansions after June 2011.
- These rules should be the same for products not explicitly mentioned in Annex I of the Directive.
- “Allocations shall be adjusted by the linear factor referred to in Article 9” should be applied as meant, to **adjust the total cap**. Consequently, the same CSF should be applied to a new entrant (and for CHP) as to any incumbent, thus ensuring equal treatment.

II. Bring benchmarks into proper perspective

The EU must provide ambitious benchmarks for industry that are also workable for companies.

- The EU must give industry the needed lead-time to invest to reduce emissions instead of extracting needed financial resources to buy allowances. This can be done by **phasing in the benchmark** using as the starting point for 2013 the weighted average performance, and allowing for a transition to adopt the “top 10%” benchmark as the target for 2020.
- **Introduce a minimum reference for the “average best 10% installations”:** The benchmark should be based on the **average of the 10% best installations, at least of a minimum of 3 installations**. This is important in case the number of a given type of installations in the EU-27 is smaller than 30. Otherwise, the performance of e.g. a single installation and its (sometimes not replicable) technology would set the benchmark for the whole EU. Also, antitrust problems with the confidentiality of individual company data must be avoided.¹
- Allocations for installations under the regime of electricity /heat interchangeability should be treated as those without that regime to avoid lower allocation. **The final allocation should never be lower than according to the standard benchmark value on direct emissions only: limit the correction!**

III. Calculation of the maximum amount of allowances for free allocation

- The calculation of the maximum **amount of allowances for free allocation must be independent of permitting practices**.
- As a simple practical solution, **allowances for heat and for unavoidable waste gases emitted by “electricity generators” should be taken from the auctioning pot**, irrespective of whether the allocation will be to the electricity generator or to the consumer (for heat) or the producer (for unavoidable waste gases).

An in-depth argumentation for our proposals above is presented in [appendix 1](#). [Appendix 2](#): Cefic comments on UBA paper v. 3.0.

¹ For this reason, benchmark consultants limit information to a minimum grouping of 3-4 plants.
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Appendix 1: Cefic comments on the EU ETS draft Allocation Rules and Benchmarks of the interservice consultation version

Cefic gave detailed comments on the 3rd draft UBA discussion paper (by 12-8-2010) but understands that quite a few major issues are still unresolved in the draft paper of the allocation rules and benchmarks for interservice consultation, which started last 8 September. We urge the European Commission, the Member States and the European Parliament to adapt the rules for allocation and the benchmarks to bring these into line with the true aims and requirements of the Directive.

I. Encourage new investment; consistency between historical activity level (HAL), capacity and new entrants

Cefic has great concerns about the production volume to be used as multiplier to the benchmarks, the required determination of capacity of each sub-installation, the proposed severe rules for new entrants and, especially, the consistency between these important parameters.

New capacities are urgently needed to reach lower GHG emissions without de-industrializing the EU. Therefore, it is of utmost importance that new investment is not hampered but incentivised as much as possible. However, some of the parameters actually proposed in the allocation formulae do just that: discourage new investment! A great concern are the severe rules for access to the new entrants' reserve (NER): an extension of [10%-20%] of the whole "installation" (permit site) and {[10%-20%] capacity increase of the relevant sub-installation or an allocation of more than [50,000] EUAs according to the benchmark}. This would be a clear "no growth" signal due to the severe thresholds so that large chemical installations would have very difficult access to the NER. . Other concerns are that the default for the SCUF (standard capacity utilisation factor) is set at 80% and that the latest rules for access to the NER for products not explicitly mentioned in Annex I are still vague (most chemical products and e.g. the complete food industry are part of the EU ETS through the "installation" definition). It is also not fair to apply the Linear Factor (LF) on new entrants, and for that matter CHP, while a cross-sectoral correction factor (CCF) is applied to incumbents if needed.

Determining the capacity of each sub-installation would require a detailed protocol for each type of sub-installation, which is presently not available. ² Therefore, submitting all capacities in a proper objective and transparent manner is simply not doable in the present timeframe. Member States (e.g. the Netherlands) have already rejected this idea, also because of the huge administrative burden.

The period 2005 to 2009 and 2010 is extraordinary: 2008, 2009 and at least part of 2010 are not representative (financial crisis), while many sub-installations had a maintenance shut- down in one of the better years 2005-2007. Therefore the median production of 2005-2009 or 2010 is most often not representative for the future 2013-2020, and will cause competitive distortions. For many plants this would cause an additional shortage of allowances of around 10% on top of the shortages due to the tough benchmarks.

Using an unrealistic and ex-ante fixed activity base period without consistency with the

² Different types of sub-installations have specific characteristics, such as periodic de-coking, feedstock dependency (e.g. crackers, refineries), the inherent annual capacity loss of (glass) furnaces before a major overhaul after 10 years or campaign production for products like sugar. Capacity information from the permit may be too high, causing an undue hurdle for access to the NER, and nameplate capacity is not objective.

new entrants' rules is not in line with the Directive and will weaken the EU ETS:

- By undermining the trust in the system as is illustrated by the current discussion about “over-allocation” and the CO₂ price decrease due to the economic crisis.
- By harming the EU's efforts to boost growth (Europe 2020), because any industrial growth not meeting the severe thresholds for access to the NER would be subject to full auctioning.
- Because allocation based on static production levels provides the wrong incentive, namely to lower production levels and export emissions (carbon leakage).

To resolve these problems, Cefic has consistently proposed a rolling average production to fulfil the aims of the Directive. The choice for any historical activity level (HAL) has no mandatory legal basis in the Directive.³ It would be inconsistent if the allowances for existing activities were granted according to an undue low HAL while allowances for extensions would only be given for extra capacity. Cefic is convinced that an installation meeting the benchmark should have no shortage of allowances.

If, nevertheless, a more direct link to actual production like rolling average is rejected, Cefic proposes at least to achieve a logical consistency between HAL, capacity and realistic rules for new entrants:

- For extensions and new installations, a default value for the SCUF should be adopted – of 95% for the chemical sectors – until subsector specific SCUF values based on the 10% best installations can be derived from the actual data. Most recent expansions use up-to-date technologies and practises and are built to run at highest utilization as the 10% best installations do. They cannot be compared with average performance or utilization of a sector.
- The thresholds for access to the NER should be 10% extension above HAL or an increase of 10,000 EUAs according to the applicable benchmark (product benchmark or fallback) for expansion after June 2011.
- For expansions before June 2011, no minimum threshold should be applied to avoid retro-active penalization of past expansion decisions. This is in line with the ETS directive that requires a threshold of 10% only for real new entrants, i.e. expansions after June 2011.
- These rules should be the same for products not explicitly mentioned in Annex I of the Directive.
- “Allocations shall be adjusted by the linear factor referred to in Article 9” should be applied as meant, to adjust the total cap. By consequence the same CSF should be applied to a new entrant (and for CHP) as to any incumbent, thus ensuring equal treatment.

II. Bring benchmarks in proper perspective

The application of the very ambitious average of the 10% best installations benchmark immediately as from 2013 would introduce substantial auctioning for industry, contrary to

³ This was confirmed by the Commission at the ECCP stakeholder meeting of 17 March 2010.

the aims of the Directive to prevent carbon leakage and to preserve the competitiveness⁴ of European industry as best as possible within the constraint of the total cap.

Furthermore, if the number of sub-installations in EU-27 is relatively small, less than 30 like 8 or 12, applying the 10% rule without any regard for the shape of the performance curve – in these examples 0.8 (so the best plant) or 1.2 (with 20% of the second best plant) – is unduly stringent and raises concerns about the confidentiality of submitted performance data.

The Commission (DG Climate Action) has often asserted that more stringent benchmarks are environmentally better. However, the stringency (level) of benchmarks does not affect the incentive for an investment to reduce emissions. But it does affect the cash position of European industry severely.

The incentive to reduce emissions is contained in the benchmark concept; it consists of the benefits of avoided purchases of CO₂ allowances plus (as apparently often overlooked) the revenues from sales of CO₂ allowances.⁵

The ambitious “top 10%” benchmark is not prescribed by the Directive for immediate use in 2013 but the Directive refers to the “top 10%” as starting point for setting benchmarks. The year 2013 is long before industry can have embarked on the needed abatement investments to achieve the -21% target (versus 2005) in 2020. The “top 10%” in 2013 means that 95% of all factories are buyers of allowances. It is reasonable and according to the spirit and aims of the Directive that industry is granted the lead-time to invest, and substantial resources are not taken away to achieve this ambitious target.

Cefic therefore proposes:

- To base the average of the 10% best installations in EU-27 on a minimum of 3 sub-installations (manufacturing plants) in order to avoid a most stringent benchmark in case the number of sub-installations in EU-27 is smaller than 30, and to avoid antitrust problems with the confidentiality of individual company data.⁶
- To adopt the “top 10%” benchmark as the target for 2020 to give industry the needed lead-time to invest to reduce emissions and not to extract needed substantial financial resources to achieve this ambitious target. A more realistic starting point for 2013 is the weighted average performance.

III. Calculation of the maximum amount of allowances for free allocation

Since the definition of an “installation” provided in the EU ETS Directive is not implemented in EU Member States, it depends on the permitting practice whether

⁴ See recital 25 of the EU ETS Directive.

⁵ Example: an investment project can reduce emissions from 900 to 600 kg CO₂/unit of product.

If benchmark = 800 kg CO₂/unit: incentive = (900 – 800) + (800 – 600) = 300 CO₂/unit of product.

If benchmark = 650 kg CO₂/unit: incentive = (900 – 650) + (650 – 600) = 300 CO₂/unit of product.

⁶ For this reason, benchmark consultants limit information to a minimum grouping of 3-4 plants.

certain emissions are calculated towards the maximum amount for free allocation for industry or towards the amount for auctioning. This has led to diverse and inconsistent data collection as permitting practices differ widely.

While in some Member States an installation may indeed be equivalent to an industrial site (wide definition), in other cases and other Member States, each plant on an industrial site is considered a separate installation (narrow definition). As the narrow definition prevails for most and especially large combined heat and power plants and for electricity produced from unavoidable waste gases, these “installations” are regarded as “electricity generators” (even though the activities are directly associated with an industrial activity) and, therefore, according to the guidance of the Commission (which does not take account of the wide “installation” definition of the ETS Directive) their emissions are calculated towards the auctioning pot.

As a result, the maximum amount for free allocation of allowances will be too low as there will be free allocation according to Art. 10a (1) and 10a (4). The undue distortions may add up to 50-100 Mton for CHP, and around 50 Mton/year for unavoidable waste gases, in total $\geq 10\%$ of the “industry cap”. This will lead to an unjustified early application of the uniform cross-sectoral correction factor, which does not take into account the realistic CO₂ abatement potential and thereby weakens the effectiveness of benchmarking in preventing carbon leakage and to protect industrial competitiveness.

The latest move of the Commission to take the allocation for heat from CHP assigned as “electricity generator” from the auctioning pot is hardly a relief because this would only be valid for allocation to such electricity generators. In practice, most CHP units (except district heating) are connected to an industrial activity, which will receive the allowances for heat (according to “method 1”).

Cefic therefore asks:

- That the calculation of the maximum amount of allowances for free allocation be independent of permitting practices and in line with the principles of free allocation.
- To ensure this, the ETS Directive’s definition of an “installation” must be respected throughout the EU and applied for EU ETS purposes, without adaptation of the non-legally binding “Guidance Paper to identify electricity generators”.
- As a simple practical solution, allowances for heat and for unavoidable waste gases emitted by “electricity generators” should be taken from the auctioning pot, irrespective of whether the allocation will be to the electricity generator or to the consumer (for heat) or to the producer (for unavoidable waste gases).