Joint feedback by energy intensive industries to the Expert Group on Climate Change Policy

Meeting on free allocation and carbon leakage list: 15 June 2023

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1. Climate neutrality plans, exemption from the cross-sectoral correction factor and energy efficiency conditionality: application at sub-installation instead of installation level

The interpretation of the provisions on climate neutrality plans (on the exemption from the cross sectoral correction factor and on the energy efficiency conditionality) as being applied at "installation level" entails a disproportionate and inconsistent treatment. In the case of climate neutrality plans, operators of installations covering several product benchmarks and fall-back sub-installations would be subject to the obligation and penalty for their entire installations as soon as one sub-installation belonged to the worst 20% percentile of a given product benchmark in the years 2016-2017, regardless of the performance in all other sub-installations. Similarly, in the case of the energy efficiency conditionality, operators of installations may be subject to the obligation and penalty for their entire installations as soon as one sub-installation does not complete on time all the recommended energy efficiency measures, regardless of the performance of the other sub-installations.

Solution: As explained below, the wording and spirit of article 10a paragraph 1 as well as the previous jurisprudence indicate that the obligation and penalty concerning climate neutrality plans for the least 20% efficient installations should be interpreted and **applied at sub-installation level**. This would lead to a more consistent and proportionate treatment, where the obligation and penalty are applied only for the relevant product benchmark sub-installations belonging to the worst 20% percentile. In order to ensure consistency throughout the Directive, also the conditionality on energy efficiency measures and the exemption from the cross sectoral correction factor should be interpreted at sub-installation level.

a) The precedent of the activity level changes interpreted at sub-installation level

Article 10a (20) of the ETS Directive (EU) 2018/410 on the activity level changes referred to the concept of "installation", even though the concept of "sub-installation" was already known to the co-legislators since it was part of the 2013-2020 Commission Decision 2011/278/EU. Yet, in the subsequent Commission Implementing Regulation (EU) 2019/1842 on activity level changes, the COM interpreted the "installation" of the ETS Directive as a 'sub-installation'. The relevant references are provided below:

Article 10a (20), Directive (EU) 2018/410:
The level of free allocations given to installations whose operations have increased or decreased, as assessed on the basis of a rolling average of two years, by more than 15 % compared to the level initially used to determine the free allocation for the relevant period referred to in Article 11(1) shall, as appropriate, be adjusted. Such adjustments shall be carried out with allowances from, or by adding allowances to, the amount of allowances set aside in accordance with paragraph 7 of this Article.

Recital 3, Commission Implementing Regulation (EU) 2019/1842
In accordance with Article 10a(20) of Directive 2003/87/EC, the allocation of emission allowances free of charge to installations whose operations have increased or decreased, as assessed on the basis of a rolling average of two years, by more than 15 % compared to the historical activity levels is to be adjusted in a symmetrical manner. To implement the adjustments of allocation of emission allowances due to changes in activity, since the installations are divided in sub-installations in accordance with Article 10 of Delegated Regulation (EU) 2019/331, it is appropriate to compare these changes against the historical activity levels at sub-installation level.

b) The reference to "product benchmarks" in article 10a paragraph 1

The new article 10a paragraph 1 refers to "*operators of installations whose greenhouse gas emission levels are higher than the 80 percentile of emission levels for the **relevant** product benchmarks".* The reference to "product benchmarks" clearly entails an interpretation at sub-installation level, since product benchmarks are defined only at sub-installation level in the secondary legislation, including the Free Allocation Rules to be amended at this stage. As an extreme example, even when an installation produces only a product benchmark, its treatment under the FAR is defined as a sub-installation) .

c) Only article 10b(4) shall be read as to referring to installation level

The new ETS Directive clearly states that only article 10b(4) *"shall be read as only referring to installation level".* Article 10b(4) is primarily developed for district heating, where the application at installation level may be indeed more justifiable and appropriate. Yet, no similar provision is mentioned for article 10a paragraph 1. Hence, this article is not subject to the obligation of interpreting it "at installation level". Therefore, the concept of *"operators of installations whose greenhouse gas emission levels are higher than the 80 percentile of emission levels for the relevant product benchmarks*" should be interpreted as applying at sub-installation level.

d) Inconsistency with the legal wording of the Directive (penalty also to fall back benchmarks sub-installations)

The interpretation of new article 10a paragraph 1 at installation level is not consistent with the reference to "product benchmarks" in the same article. In fact, with such interpretation, all the fall back benchmarks sub-installations that have also product benchmark sub-installations within the boundaries of the ETS permit would be covered by the obligation and penalty on climate neutrality plans, regardless of their performance within the curve of the relevant fall back benchmark. This would make the reference to "product benchmarks" of the article legally irrelevant.

e) Distortion of competition among installations

The interpretation at installation level would also cause undue distortion of competition among installations, since those that have also product benchmark sub-installations above the 80th percentile within the ETS permit would be subject to the climate neutrality plan obligation and penalty for their entire installation (including for product benchmark sub-installations that are below the 80th percentile and fall back benchmark sub-installations) while those installations that do not have product benchmark sub-installations above the 80th percentile would be automatically exempted.

Furthermore the size of installations depends on the environmental permit framework in Member States. This entails a wide range going from installations with boundaries at the level of sub-installations to installations with multiple sub-installations, unified under 1 environmental permit. This diverse aspect of interpretation in each member state would lead to undue distortions of the level playing field in the application of installation-level for the conditionality.

Such undue impacts on competition would be inconsistent with the new wording of recital 20 of the ETS Directive, which prescribes that "*the Commission should ensure that the application of the conditionality does not jeopardise a level playing field, environmental integrity and equal treatment between installations across the Union*".

f) Consistency with the exemption from the cross sectoral correction factor

As explained above, provisions of the EU ETS Directive concerning climate neutrality plans and exemption from the cross sectoral correction factor should be interpreted as applicable at sub-installation level in the

Free Allocation Regulation. More generally, both provisions should be implemented consistently, since the ETS Directive refers to "installations" in both cases.
Yet, the latest Commission text proposes to interpret and implement the provisions on climate neutrality plans at installation level, while the exemption from the cross sectoral factor would be implemented only for very large sub-installations that represent more than [60%] of the total free allocation of an installation. This creates a manifest different treatment: on one side, even if a product benchmark sub-installation represents a small share of the total emissions of an installation, the operator would be required to develop a climate neutrality plan for the entire installation and potentially be subject to the 20% free allocation penalty for the total installation's free allocation; on the other side, if the same sub-installation is below the average of the best 10% in the relevant product benchmark, the exemption from the cross sectoral correction factor would not be granted at all because it represents less than 60% of the total free allocation of the installation.
Such inconsistency on the interpretation of installation would create legal uncertainty and should be avoided in the final text by harmonising the provisions on climate neutrality plans and exemption from the cross sectoral correction factor in the Free Allocation Regulation

2. Climate neutrality plans: targets and milestones should refer to measures and investments instead of emissions reductions

The draft concept note links targets and milestones of climate neutrality plans to (absolute or relative) emission reductions. However, as explained below, the revised ETS Directive clearly relates such targets and milestones only to measures and investments described in the plans.

Article 10b(4) provides a clear sequence of elements, notably:

- Point (a): measures and investments to reach climate-neutrality by 2050 at installation or company-level, excluding the use of carbon offset credits;
- Point (b): intermediate targets and milestones to measure, by 31 December 2025 and by 31 December of each fifth year thereafter, progress made towards reaching climate -neutrality as set out in point (a);
- Point (c): an estimate of the impact of each of the measures and investments referred to in point (a) as regards the reduction of greenhouse gas emissions.

The subsequent subparagraph clarifies that the scope of the verification shall be "*the attainment of the targets and milestones referred to the third subparagraph of point (b)*".

Solution: Therefore, the format and design of **climate neutrality plans should focus on** the attainment of intermediate targets and milestones of point (b) against **measures and investments** of point (a) instead of emissions reductions of point (c), which is not mentioned in the final sub-paragraph.

3. Energy efficiency conditionality: sufficient time for implementing audits' recommendations

According to the revised ETS Directive, operators applying for free allocation in May 2024 will need to provide evidence that they have implemented all the recommended energy efficiency measures with proportionate costs and with a payback of three years or less in order to avoid the 20% free allocation penalty. With the latest Commission proposal, installations with energy audits issued by the end of 2023 would have very limited time to implement all the recommendations in order to avoid the free allocation penalty.

Solution: Since energy audits have a four-year calendar in line with the provisions of the Energy Efficiency Directive, the timeline of the energy efficiency conditionality should allow sufficient time to operators for implementing such recommendations by considering only implementation of measures resulting from audits issued by 31 May 2021 .
Furthermore, companies that have implemented a certified energy or environmental management system which recommends the planning of the implementation of energy efficiency measures according to a specific calendar, with some measures to be implemented chronologically after others, should be considered fulfilling the ETS energy efficiency conditionality.

4. Historical activity level

The European industry has been facing in the latest years unprecedented and unforeseeable situations linked firstly to the covid pandemic and secondly to the ongoing energy crisis. According to the existing rules, this situation is affecting already the 2021-2025 sub-trading period as a result of the 2-year rolling average adjustments.

If no modification is introduced to the Free Allocation, such unprecedented crises would also unduly penalise companies in the 2026-2030 sub-trading period, when free allocation would be based on the average production volumes of the period 2019-2023.

Solution: Against this background, we urge the Commission to amend the provisions on historical activity level in order to avoid that unrepresentative production volumes due to covid and/or energy crisis are taking into account in the free allocation calculation, for instance by allowing operators to exclude two years from the baseline period 2019-2023.

ANNEX

New paragraph in article 10a paragraph 1 *: In addition to the requirements set out in the third subparagraph of this paragraph the reduction by 20 % referred to in that subparagraph shall be applied where, by 1 May 2024, operators of installations whose greenhouse gas emission levels are higher than the 80 percentile of emission levels for the* ***relevant*** *product benchmarks have not established a climate neutrality plan for each of their installations for its activities covered by this Directive. That plan shall contain the elements specified in Article 10b(4) and be established in accordance with the implementing act provided for in Article 10b(4). Article 10b(4) shall be read as only referring to installation level.*

Article 10b(4): *In Member States where, on average in the years 2014-2018, the share of emissions from district heating of the EU total of such emissions divided by the Member States' share of GDP of the EU total GDP is greater than 5 for district heating for the period from 2026 to 2030, additional free allocation of 30 % of the quantity determined pursuant to Article 10a shall be given to district heating provided that an investment volume equivalent to the value of that additional free allocation received is invested to significantly reduce emissions before 2030 in accordance with climate-neutrality plans in accordance with sub-paragraph 3 and that the attainment of the targets and milestones referred to in point (b) of the third subparagraph are confirmed by the verification carried out in accordance with sub-paragraph 4. By 1 May 2024, operators of district heating shall establish a climate-neutrality plan for the installations for which they apply for additional free allocation in accordance with the second subparagraph. That plan shall be consistent with the climate-neutrality objective set out in Article 2(1) of Regulation (EU) 2021/1119 and shall set out:*

(a) measures and investments to reach climate-neutrality by 2050 at installation or company-level, excluding the use of carbon offset credits;
(b) intermediate targets and milestones to measure, by 31 December 2025 and by 31 December of each fifth year thereafter, progress made towards reaching climate -neutrality as set out in point (a);
(c) an estimate of the impact of each of the measures and investments referred to in point (a) as regards the reduction of greenhouse gas emissions.

The attainment of the targets and milestones referred to the third subparagraph of point (b) shall be verified with respect to the period until 31 December 2025 and with respect to each period ending 31 December of each fifth year thereafter, in accordance with the verification and accreditation procedures provided for in Article 15. No free allowances beyond what is referred to in the first sub-paragraph shall be allocated if achievement of the intermediate targets and milestones has not been verified with respect to the period up to the end of 2025 or with respect to the period 2026 to 2030.