BUSINESSEUROPE

POSITION PAPER

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COMMUNITY-WIDE BENCHMARKS AND IMPLEMENTING RULES FOR ALLOCATION OF ALLOWANCES UNDER THE REVISED EU EMISSION TRADING SCHEME (ETS)

DELIVERING THE 21% REDUCTION TARGET

The aim of the revised ETS Directive is to ensure that EU industry reduces its emissions by 21% by 2020 compared to 2005, which will be by far the major contribution to the EU's overall 20% target across society. A gradually tightening cap from 2013 to 2020 will ensure that this target is met but also allows time for cost effective emission reductions across industry.

In recognition of the significant risk of carbon leakage, many ETS sectors will be granted free allowances up to the level of a benchmark in order to mitigate the cost of buying allowances in a world of unequal carbon costs. Yet there will be additional ETS-induced cost burdens on the overwhelming majority of companies because carbon leakage and benchmarking are interlinked issues: too stringent benchmarks will result in the leakage which the directive tries to prevent.

The Commission is currently discussing benchmarking and other allocation rules[1], which are designed to reduce the amount of free allowances considerably below the emissions of the current best performance and thus below the achievable.

Against this background, BUSINESSEUROPE urgently calls for the following issues to be taken into account in the calculation and application of these benchmarks, in line with the provisions, the spirit and the objectives of the Directive.

A. Benchmarks must be set at a level realistically achievable by installations in a sector

The Directive states that "in defining ***the principles*** for setting the ex ante benchmark …***the starting point*** is the average performance of the 10% most efficient installations in a sector…" BUSINESSEUROPE acknowledges the work done on benchmarks by Ecofys and Fraunhofer, but a first analysis of the proposed benchmarks in a number of sectors suggests that on average these benchmarks would result in considerably reduced allocations compared to the current average performance within the sectors (almost 30% difference). This would translate into an overall reduction obligation far more stringent than the -21% of the Directive and thus expose large parts of the EU economy to unsustainable and unilateral carbon costs. Excessively low allocations to sectors will take investment funds away from companies at the very time they are trying to make improvements. The principles to identify the installations that define the final benchmark must therefore create a realistic challenge for others in the sector by excluding outliers, i.e. exceptional installations that are not representative in a sector. In addition, the products grouped together under a specific benchmark must be truly comparable.

1 Unless stated otherwise, the word "benchmark" in this paper refers to all proposed rules for free allocation.

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B. Allocation rules other than product benchmarks
Where benchmarking proves infeasible, a different fair allocation method has to be found.

The allocation for the use of heat which is not included in product-specific benchmarks needs special attention, as heat is used across all industries. Heat which is needed for industrial processes should be considered an integral part of production activity and thus receive the same quota of free allocation as the respective sector. For example, heat needed for a process in a sector at risk of carbon leakage must receive 100% free allowances, based on a simple heat production benchmark. This must hold for all these sectors, irrespective of the many different installation permitting schemes across the Member States and irrespective of the ownership of the heat producer.

Where allocation takes place on the basis of fuel mix benchmarks, a genuine fuel mix benchmark should be used if natural gas cannot be used due to technical limitations or due to lacking availability.

If allocations need to be grandfathered the application of the improvement factor should in principle not be used.

C. A proper use of the linear reduction factor
The linear reduction factor (-1.74% per year) mentioned in the directive prescribes the reduction path of the overall cap in order to achieve the -21% of total ETS emissions by 2020 and must not be applied to benchmarks for individual installations.

D. Role of the cross-sectoral correction factor
All sectors must contribute their fair share towards the EU wide reduction target. The cross-sectoral reduction factor, as mentioned under article 10a5 of the Directive, can then be used if absolutely needed to ensure the declining cap is met. BUSINESSEUROPE believes this factor should be used to achieve no more and no less than the industrial reduction target of -21% by 2020 according to the proportionality principle. Hence, if the benchmarks overshoot the -21% target – which would be the case if the benchmarks proposed by the consultants were applied - the correction factor should be higher than 1.

E. Determining historical production
In order to determine the number of allowances for each installation the benchmarks will be multiplied with a level of historical production. The proper reference production period to determine this level of production should be the 2005-2007 period. This is in line with the period to calculate the share of industry emissions in the total cap as stipulated by the directive. Including 2008 as a base year would set different bases for the cap and for the allocation calculation. Furthermore 2008 already includes the emerging effects of the economic crisis. Within the reference period long-term impairment of production must be excluded when justified (such as long-term maintenance stops or revamps, labour disputes, or non-representative market conditions).

F. Specific problem for capacity increases 2007-2011
Since the New Entrants Reserve is designed to begin to account for new capacities only as from 2011, BUSINESSEUROPE suggests to base the allocation on the year with the highest production from the base period, plus a correction for capacity increases in the following years until the New Entrants Reserve can be accessed. There should be no minimum threshold for capacity increases 2007-2011 because the

investment decisions for these have already been made. The new entrants reserve should be refilled by unused quota from significant production reduction or closure to enable growth of industry.

G. A fair approach in setting the industry share of the reduction

New installations and sectors will come into the enlarged scope, and some installations like heat and electricity generators may change from electricity to industry sectors. The industry share of the overall cap in 2005-2007 for the calculation of any correction factor must be adjusted for these and any other changes in emissions reporting to avoid further burdening industry.

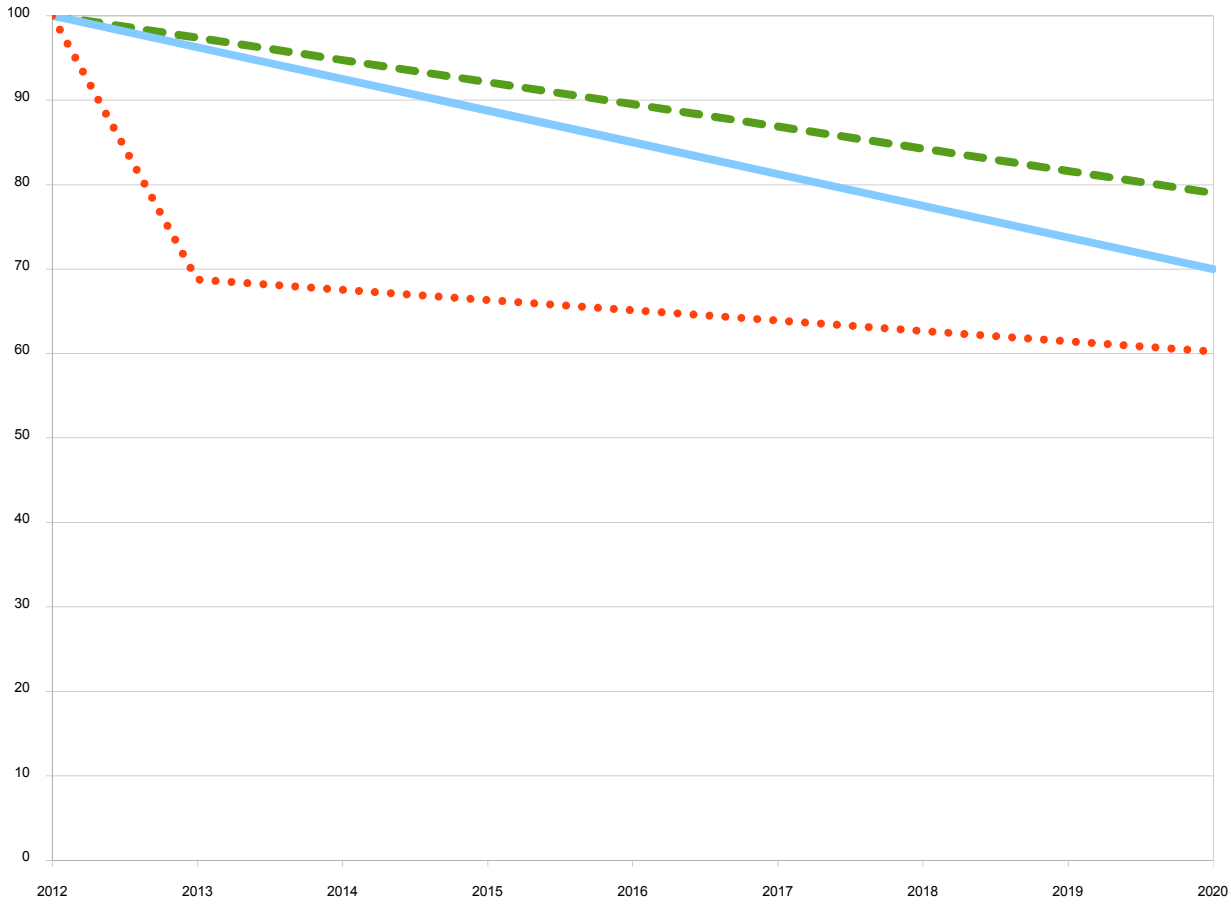
H. BUSINESSEUROPE's proposed solution: benchmarks for 2020

To meet the objectives described above:

- the benchmark should be the performance to be achieved in 2020;
- in 2013, allocations should be based on average product-specific emissions multiplied by 2005-2007 productions ;
- the cross-sectoral correction factor should be used to guarantee the overall -21% target;
- a trendline can then be calculated per benchmark to set the yearly benchmark values between 2013 and 2020.

Graph illustrating BUSINESSEUROPE's proposal:

This graph shows various paths for a representative benchmarking value between 2012 and 2020. The green interrupted line represents the BUSINESSEUROPE proposal



Benchmark to be achieved in 2020 AFTER correction factor ensres a 21% reduction in 2020 (proposed BUSINESSEUROPE formula)

Benchmark to be achieved in 2020 BEFORE correction factor ensures a 21% reduction by 2020

Proposed Commission formula

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