EUROMETAUX
EUROPEAN ASSOCIATION OF METALS

"Public consultation in preparation of an analytical report on the

impact of the international climate negotiations on the situation of energy intensive sectors"

Eurometaux response - April 2010

General comment: This process and assessment should be a continuation of the earlier cooperation on carbon leakage impacts done by DG Enterprise, built on their know-how on competitiveness and carbon leakage; the assessment should be continued at least jointly by DG Enterprise.

Question 1: In your opinion, how have key indicators of the risk of carbon leakage (such as exposure to international trade, carbon prices etc.) for the EU energy intensive industry changed since the adoption of the climate change and energy package implementing the EU's unilateral 20% emission reduction target at the end of 2008?

A. Failure at Copenhagen to reach an enforceable international agreement further underscores the deficiencies of the ETS provisions to prevent carbon leakage. The criteria in the carbon leakage exercise still need to be adjusted and, while well intentioned, are inadequate attempts to simplify the calculation of carbon leakage risks. They still do not reflect the real impact of direct and indirect carbon costs on industry:

-The criterion of trade intensity is a most imperfect approximation of (non) pass through potential. As non-ferrous metals cannot pass on any costs due to their global pricing system, the LME, a global pricing system, in itself, should be a sufficient criterion for listing, followed by trade intensity calculations;

-The cost of CO2 pass through in power prices is seriously under-estimated. In the carbon leakage exercise, these impacts are estimated as the average CO2 in the power generation mix, while the consequence of the current price-setting mechanisms is that the power producers pass through the marginal CO2 costs, which are much higher than the average CO2 content of the power generation mix.

Eurometaux believes that any changes in the key indicators used in the carbon leakage assessment since the adoption of the climate and energy prices have been triggered by the economic and financial crisis experienced around the world. These changes have not been triggered, nor influenced by the adoption of the package or the results of the climate conference in Copenhagen in December 2009.

B. Increasing risk of carbon leakage by EU policy for the remaining EU metals production:

EU policy increasingly disadvantages EU industry: failure to identify sectors at risk based on the real risk factors, as described above, will undermine the objective of eliminating (indirect) carbon leakage, jeopardizing the EU's internationally competitive metals industry. Border carbon adjustments would fail to address the deficiencies of the proposed compensation scheme for indirect emission costs, would compromise, further, the competitiveness of EU industry, throughout the product life cycle and would risk serious international trade conflicts. Therefore, there should be no further discussion of border carbon adjustments.

Increasing exposure of metals industry and manufacturing supply chain dependencies: Since 2008, the competitive position of the EU non-ferrous metals industry has continued to deteriorate, as is clearly evidenced by the dearth of new investment. Most of the EU's long-term power contracts are expiring/have expired and industries, elsewhere, generally, pay much lower power prices, as among other things, they bear no or much lower CO2 cost. This results from a combination of two EU policy experiments: the ETS and 'liberalisation' of power markets. **Another impact from the energy & climate change package arises from the increasing power transmission/renewables levies.** The situation is worsened by the crisis.

The global metals industry will develop sufficient capacity to supply the EU markets from non-ETS countries. Several new plants have already been announced/built outside and near the EU, while imports are already as large or larger than EU primary production. This would threaten the entire supply chain, as European manufacturing would not easily bear such a lengthening of its supply chains. Consequently, much manufacturing could be expected to follow primary production overseas, increasing the import of carbon in goods purchased from abroad.

EU policy leads to a situation where new investments are blocked, creating increased carbon leakage:

a) Because of the capital intensive nature of the non-ferrous metals industry, long-term investment (minimum of 20 to 25 years) is required. Due to the heavy fiduciary risk imposed by EU policy such as the ETS and (long-term) future policy uncertainty, it is extremely difficult for the primary metals industry to continue investing in Europe.

b) Uncertainty was further increased owing to the failure, in Copenhagen, to reach a binding global agreement. EU non-ferrous metals companies strongly supported the EU's objective to negotiate a global level playing field. Unfortunately, Copenhagen not only failed to obtain equivalent commitments from developed countries and sufficient ambition by developing countries but failed even to produce satisfactory language on monitoring & verification.

***Copenhagen failure will accelerate technology drain*:** As the EU loses its non-ferrous metals production, it also will lose its leading technological R&D base in this sector aimed at, inter alia, further reducing process emissions. In turn, Europe will become increasingly irrelevant as an intervener in international discussions on technology development and transfer for this sector.

Question 2: Do you think that the outcome of Copenhagen, including the Copenhagen Accord and its pledges by relevant competitors of European energy-intensive industry, will translate into additional greenhouse gas emission reductions sufficient to review the list of sectors deemed to be exposed to a significant risk of carbon leakage? If so, how and why?

This consultation exercise should only be conducted, based on binding and enforceable commitments, which were not obtained in 'Copenhagen'. Every other parameter should be deemed as a constant factor – 'ceterus paribus'.

Article 10b cannot change the carbon leakage list but deals with possible support measures applied to the sectors on this list. There is a considerable need for support against (indirect) carbon leakage.

Copenhagen failed to persuade developing economies with a high growth to take on enforceable carbon emission reduction targets. Therefore, the only result of a review of post-Copenhagen impacts must be to improve the provisions for the sectors at risk.

Eurometaux believes that the Copenhagen agreement and the subsequent pledges announced are not sufficient to allow a proper assessment of the future GHG reductions by the major competitors of our industry (China, Brazil, India, South Africa, Chile, etc). In addition, a pledge is not sufficient to ensure that our competitors will face comparable CO2 constraints, in accordance with Art. 10a18 of the ETS Directive. To ensure that real GHG emission reductions are achieved globally, we require national emission reduction legislation being implemented in the key countries our sectors compete with.

Failure to reach a legally binding international agreement setting comparable commitments to reduce emissions will continue to perpetuate a non level playing field for industry potentially leading to higher emissions.

Question 3: In your view, what would be a compelling new general economic or other factor which would require a change of the level of free allocation to sectors deemed to be exposed to a significant risk of carbon leakage?

Free allocation currently only addresses carbon leakage due to costs related to direct emissions, not indirect impacts. It is critical, however, that the EU also addresses adequately the impact of CO2 costs in power prices. These latter costs are included in the carbon leakage process and compensation is promised in the ETS Directive to help to address the continuing global unlevel playing field. Failure specifically to address indirect carbon leakage in this questionnaire appears to deny the vital importance of this source of carbon leakage. For non-ferrous metals indirect CO2 costs can be as much as 50 times as expensive as the costs of direct CO2 emissions. Real financial compensation for this impact is essential, as long as the risk of indirect carbon leakage exists.

The level of free allocation for direct emissions is linked to the risk of carbon leakage. As long as Europe's competitors have not adopted similar CO2 constraints, Europe must provide free allocation adequate to prevent carbon leakage. Any international agreement must be judged against its creation of a true level playing field with the EU's main global competitors. It must include benchmarks to track effectively both direct and indirect CO2 costs impacts. It must compensate the seriously impacted sectors for the real costs of CO2 in power prices.

Question 4: Do you consider free allocation of allowances as sufficient measure to address the risk of carbon leakage, or do you see a need for alternative or additional measures?

Indirect Impacts not seriously addressed: Free allocation only addresses carbon leakage due to costs related to direct emissions. It is critical that the EU also analyses impacts and measures with regards to the impacts of CO2 costs in power prices. These latter costs and a process for their compensation are included in the ETS Directive. It is urgent that these be given effect through the promised revision of the Environmental State Aid Guidelines, and their immediate application.

Relief from transmission/renewable levies required: Another impact of the energy & climate change package are the increasing costs from power transmission/renewable levies. Until competitors elsewhere in the world pay similar burden, European sectors that cannot pass on these costs should be relieved from these increasing levies.

Harmful border adjustments: The discussion on border adjustments will only undermine the development of effective policy to prevent carbon leakage for the vast majority of industry sectors with downstream applications and would threaten serious international trade conflicts. The issue should be deleted from EU policy discussions as soon as possible.

Long-term policy proposal needed to allow new investments: (Indirect) Carbon leakage includes also the loss of potential new investments, which is unfortunately taking place. New investments can only take place when the policy driven uncertainty is taken away and a long-term risk management is possible, including post 2020. The EC needs to address; e.g. grandfather existing conditions for new investments for a longer period of time.

Free allocation plans need some serious improvements:

The Commission is developing allocation rules for ETS allowances. These free allocation rules to prevent carbon leakage and should consider, among other concerns, the interests of economic activity/employment in remote/disadvantaged EU regions. This should have been considered in the setting of the emissions CAP. Free allocation of allowances for direct emissions, while essential, will be insufficient unless indirect emissions are appropriately compensated and if allocation fails to take into

consideration the following concerns:

- Huge potential impact on non-ferrous metals: Current proposals will put an unequal burden on different sectors, particularly, owing to large differences in the spread of their product benchmark curves. The non-ferrous sector will be much more heavily burdened than other sectors, with a burden considerably in excess of the overall EU reduction target. This will be particularly damaging to a sector, such as ours, which is unable to pass on any of the costs, due to the global pricing system, the LME.

- Fallback approach, fuel-mix benchmark, exemption justified and needed: the current draft plans will allocate free allowances based on natural gas, as the fuel mix. They foresee no specific fuel mix benchmark (exemption) where gas grids are not located near to the company or were the industrial process is recognized to function better on another fuel. Consequently, installations that use coal/oil in areas with no gas - or where gas is not the best fuel to use - will have to buy substantial amount of allowances. Particularly, in remote areas and for complex metals recycling, this will impose unbearable costs, leading to carbon leakage. Therefore, in these circumstances, allocation must be based on the specific fuel used.

- Fallback approach, grandfathering: reduction factor is not justified: the EC plans a reduction ('effort-sharing') factor on grandfathered process emissions. The process emissions in the major product benchmark sectors have no reduction factor (recognized by Ecofys), as such a factor would have no link to how the product benchmarks are set. It would be highly inequitable to impose a reduction factor on the process emissions of heterogeneous small emitting sectors where there is no effort sharing at all. These process emissions (e.g. due to organic in feed or carbon in feed, or due to fuel oil or coke used (as reducing agent) to melt and reduce scrap or other recycling materials) are unavoidable. Moreover in the metals industry these process emissions have a recognized low reduction potential, which means that any artificial reduction factor would just be a tax on the industry and no incentive to improve. The EC justifies this plan by the fact that it found a link in one tiny product benchmarked sector (Tiles) between the benchmark and the process emissions. This can not justify the imposition of such a factor on other sectors, such as metals recycling.

- Fallback approach, grandfathering, should encourage recycling, not harm it: the above measures negatively impact metals recycling and contradict the EU Recycling policy for which specific support for recycling activity should be expected. In order to encourage metals recycling within the EU, recycling (processing and treatment of scrap or other metal containing materials) must receive full free allocation of allowances, without any reduction factor. Failing this, strategic European scrap and other secondary raw materials will be increasingly lost to non-EU27 countries which are already eagerly purchasing the materials, where often they are treated in a less-environmentally-protective way.

In this context, the definition of process emissions is unclear. Process emissions should be defined as all emissions that arise during the process and occur due to all the fuels which come in contact with the raw materials.

-The issue of the Alumina outlier must be solved in such as way as to prevent the closure of the remaining plants in this small subsector.

Eurometaux expects these concerns to be carefully considered and taken into account in the report. We see no significant change since the adoption of the Climate and Energy Package and the conclusion of the Copenhagen Climate Conference, which would justify the revision of the carbon leakage assessment. At best, the criteria used should be revisited, to ensure a better reflection of the market situation (i.e. effect of CO2 prices in power prices, global pricing mechanism).

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