

Report of the ad-hoc stakeholders meeting of the ECCP Working Group on ETS on carbon leakage and benchmarking

**30 March 2009
Brussels**

Welcome, introduction and general remarks

Ms Yvon Slingenberg (Head of Unit, DG Environment) and Mr Didier Herbert (Head of Unit, DG Enterprise) welcomed the participants to the meeting on behalf of the Commission. They explained that the aim of the meeting was twofold: to discuss the state of play on the assessment of energy intensive industries possibly at a significant risk of carbon leakage, and to provide more clarity on the benchmarking exercise. The preliminary results of the quantitative part of the carbon leakage analysis will be presented at the next stakeholder meeting on 27 April.

State of play on the carbon leakage assessment

Quantitative assessment

Mr Barreiro-Hurle (DG Enterprise) gave an overview of data sources used for the quantitative criteria in the analysis to determine sectors at significant risk of carbon leakage. He clarified that the objective is to do an analysis for all sectors both at NACE-3 and NACE-4 levels of disaggregation. With respect to the reference years, coherence is ensured for all variables within a criterion and sector. However, slightly different reference years across the criteria and sectors are possible.

WWF asked why the Commission is not doing the qualitative analysis in parallel with the quantitative analysis, as criteria such as market characteristics could demonstrate a sector's ability to pass on the cost. The Commission explained that the legal text of the revised EU Emissions Trading Scheme (ETS) Directive states that following the quantitative analysis the list of sectors can only be supplemented, meaning that any sector that passes the thresholds cannot be taken off the list based on the qualitative analysis.

There were some questions on how the Commission will take into account that only part of a certain sector is covered by the ETS and different coverage of NACE codes and the ETS activities. The Commission replied that it is aware of the issue and is trying to address it. The legal text requires the Commission to do the analysis at sectoral level, according to NACE codes.

Denmark pointed out that even at the higher level of disaggregation, NACE-4, there are some energy- and trade-intensive sub-sectors that may distort the picture of a sector as a whole. The Commission explained that in principle, where one can distinguish subsectors that are systematically different, there may be a case for going beyond the NACE-4 level of disaggregation in the qualitative stage of the assessment.

There were some questions on the matching of the Community Independent Transaction Log (CITL) and NACE codes. The Commission explained that this was done based on the name of the company to which an installation in the CITL belongs to and identifying the company's corresponding NACE codes found in databases such as Amadeus. A residual share of

emissions that will not be covered this way is expected and the Commission is doing further work to address the issue. The matching is done at the NACE-4 level, which can then be simply aggregated to the NACE-3 level.

The ceramics sector (Ceramunie) pointed out that for the installations that will be included in 2013 due to the change of activity definition in Annex I of the Directive, there is no data available in the CITL. They were particularly interested in how the process emissions will be calculated. The Commission replied that it is aware of the issue and has therefore asked the Member States also for data on process emissions, in addition to fuel emissions.

A number of participants made the point that using 100% auctioning as the basis for the carbon leakage analysis does not adequately reflect the text of the Directive, which refers to the cost of its implementation, i.e. the default level of free allocation to industry declining from 80-30% over 2013-2020 rather than being 100% from 2013. However, Business Europe argued that the carbon leakage assessment was put in the Directive with explicit aim to avoid the risk of carbon leakage and that only using full auctioning reflects this idea.

The Commission replied that it is very difficult to define the exact cost of the implementation of the Directive until the benchmarks, which will be the basis for free allocation, are adopted. There is no alternative other than taking account of all costs and therefore a worst case scenario is being used for the assessment.

Climate Strategies wondered how the Commission will deal with cases where industry associations may question the official data, and asked for a confirmation that, given the conservative thresholds, the analysis is going to be done for the whole EU with aggregated data. The Commission clarified that it wants to rely as much as possible on official data. If these are contested with legitimate arguments, some of the more important observations will be communicated to Eurostat and other verifiable sources may be used. Where there are no data available, the sectoral units in DG Enterprise will contact industry associations. The data used in the calculations will be aggregated for the EU27.

Some participants argued that the legal requirement for derogations in certain Member States to exclude the power sector from full auctioning will have an impact on electricity prices due to a lower rate of pass through of the cost of allowances, and that the analysis should take this into account. The Commission explained that there is an option for these Member States to apply for such derogations, rather than a legal requirement for them to give free allocation in the power sector. In any case, as the carbon leakage analysis is done at the EU27 level, even with such derogations and assuming the power generators do not pass on the opportunity costs, the impact on industry would probably be too small to affect the overall outcome.

WWF suggested to improve and broaden the monitoring, reporting and verification process for stationary installations along the line of the monitoring and reporting guidelines for the aviation sector. They also asked the Commission to share with the participants the questionnaire for the emissions data that was sent to the Member States. The Commission took note of the point on monitoring, reporting and verification. It is trying to address the issue of verifying the data used for the assessment as best as possible given the limited resources and time. It is willing to share the questionnaire sent to the Member States also with other stakeholders.

The representative of the aviation sector (CEFA) asked for clarification about their status and whether the sector is covered by the carbon leakage provision. The Commission replied that it is checking the issue with its legal service. However, according to its interpretation it is likely that the articles on carbon leakage apply only to stationary installations.

The representative of the fertilisers sector (EFMA) suggested to clear and disclose the sectors that obviously meet the criteria as soon as possible. Furthermore, he was interested in how the stakeholder consultation process will continue. The Commission explained that it aims to deliver a robust assessment and accommodate requests from the associations for bilateral consultations, both of which require time. With respect to stakeholder involvement, the Commission also intends to conduct regular broader consultations, with the next meeting on 27 April where the first results of the quantitative assessment will be presented.

Business Europe expressed the opinion that consultations should include a sectoral dimension and asked for interaction not only between industry associations and the Commission, but also with the Climate Change Committee. The Commission excluded the possibility as simply not being part of the comitology process. Nevertheless, the stakeholders would continue to be fully involved and have the opportunity to present their positions to the Member States in the broader consultations meetings such as this one and on 27 April.

CAN-Europe asked how will the extent to which third countries commit to reducing greenhouse gas emissions have an impact on the quantitative analysis. For example, will the exports to the USA be subtracted, if they put in place an emissions trading system of their own. The Commission replied that at the moment, the analysis can only be done based on available data and existing policies.

Qualitative assessment

Following Mr Juergens' (DG ENTR) presentation on possible indicators used for the three main criteria in the qualitative assessment (technological assessment, market characteristics and profit margins), some further questions were raised concerning the detailed methodology.

The Italian representative asked whether there was a way to aggregate the qualitative analysis into a systematic one and proposed to also look at the foreign direct investment (FDI) flows. The Commission answered that the objective is to have a set of indicators reflecting the requirements of the Directive, for which data may be available for all the sectors. The analysis should focus on "ceteris paribus" effects, isolating the effects of the ETS with all other things being equal. The FDI flows may, in the context of the carbon leakage, not be so important.

A number of stakeholders noted that the potential to reduce emissions is important also for the benchmarking and wondered why the carbon leakage and benchmarking exercises are not merged. The Commission explained that there is one important difference in scope, the benchmarks namely refer more to products, while the carbon leakage exercise to sectors and sub-sectors. Moreover, it would be impossible to determine the benchmarks within the deadline given for the list of exposed sectors.

The representative of Climate Strategies pointed out that the profit margins can be very volatile and therefore the assessment for this criterion must be very carefully done. Furthermore, the Commission must be aware that other countries are observing the exercise.

The Commission reminded that the qualitative assessment must be seen as relevant only in exceptional cases, considering that the quantitative thresholds are rather generous. It is also aware of the huge interest in other regions, notably the USA, about what the EU decides. Therefore, it is particularly important to do a credible evidence-based exercise.

The representative of the glass industry voiced the concern that the level of disaggregation may not be enough for certain (sub-)sectors, and was therefore interested whether the Commission would consider a more in-depth analysis. The Commission took note of the concern, but stated that the Directive foresees scrutiny at NACE-3 and NACE-4 levels.

The representative of the mineral wool sector (Eurima) inquired about the degree of involvement of DG Competition in the data collection regarding confidentiality. The Commission assured the participants that all the Commission services have to deal with confidential data. In cases where any such concerns exist, the Member States can send the data directly to Eurostat. In any case, confidential information will not be revealed to third parties.

The representative of the wood-based panels sector (Europanels) asked if the qualitative assessment is going to be done only for the sectors that are close to thresholds, and why other current and future policies are not taken into account. The Commission clarified that proximity to thresholds is not the decisive factor whether to analyse the sectors in the qualitative analysis. The analysis will focus only on impact related to the ETS and not other current and possible future policies.

Eurochambres inquired how the Commission would go about claims from industry that certain installations would have been assessed within the "wrong" sector. The Commission's reply was that it ultimately is the Member States who decide on the classification of an installation in a certain (sub)sector, and that the Commission would verify these decisions.

The representative of WWF asked whether, considering the concept of carbon leakage refers to the relocation of production to more greenhouse gas (GHG) emission intensive facilities in third countries, the Commission is collecting data from other regions. The Commission replied that it is doing a study on GHG-efficiency of industrial activities in the EU and third countries. However, given the cap, any relocation of emissions outside the EU could lead to an increase in global emissions and therefore could constitute carbon leakage. Notwithstanding the different views on the definition of carbon leakage, clear criteria to determine the sectors exposed are given in the Directive and the analysis focuses on those.

Indirect emissions

Ms Tranholm-Schwarz (DG Competition) gave a presentation on reducing the risk of carbon leakage due to indirect emissions and on the relevant state aid rules. She emphasised that at this stage the Commission was still reflecting internally and hence, it was not possible to provide very detailed information. However, in general any financial compensation will be governed by two guiding principles, the necessity and proportionality of aid.

The representative of the paper industry (CEPI) asked about the relationship between the overall list of sectors exposed to a significant risk of carbon leakage and the list of sectors exposed due to costs relating to greenhouse gas emissions passed on in electricity prices. The representative of IFIEC argued that it would be illogical to have different criteria for the direct

and indirect effects. The Commission explained that as stated in the non-paper presented in COREPER, the list for indirect emissions will be established along the same lines as the general list but appropriately adapted. At this stage, it is not possible to say more. The issue is not straightforward and the Commission takes note of the comments in order to come to the best conclusions.

The representative of WWF noted that according to the environmental state aid guidelines, aid can only be given for higher environmental performance, and that the aid for indirect emissions cannot proceed under the block exemption, as this would undermine the purpose of the carbon market. Moreover, he questioned the environmental benefit and effects on competition if many sectors are being subsidised. The representative of the non-ferrous metals industry (Eurometaux) argued that there are environmental benefits attached, as the aid will help avoid indirect carbon leakage. They also questioned the usefulness of the non-paper presented in COREPER, which originates from before the different final political agreement on the revised ETS, particularly with respect to the link with the international agreement.

The Commission explained that it is already allowed to give state aid to big polluters, if it is necessary for achieving overall a higher level of environmental protection. In the context of the ETS it could be argued that if state aid had not been allowed, the revision and improvement of the ETS would have failed. In any case, aid will only be granted where necessary. With respect to the rules, it appears unlikely that these provisions would be put under the block exemption. Regarding the link with the international agreement, the Commission noted that in the statement the Commission has undertaken to amend the Environmental state aid guidelines in the case there will be no agreement. It does not refer to a situation, where there will be an agreement.

The representative of the fertilisers industry (EFMA) pointed out that there may be a risk of distortions of the competition due to the short-run capture of emissions (e.g. there two kinds of substituting fertilisers, one emitting while manufactured and the other after put into the soil). The Commission reminded that in the third phase of the ETS such life-cycle issues will be addressed, since all sectors of the economy, including agriculture will be subject to emission reduction targets and measures.

WWF voiced their concern that if state aid will be granted to some operators, trade distortions will occur because of these state aid measures themselves, unless all installations receive subsidies. This, in turn, would undermine the purpose of the carbon market. The Commission replied that indeed state aid per definition distorts trade, which is why it is only granted very carefully and to the extent necessary, and any such measures have to be authorised by the Commission.

Results of benchmarking study made for the Commission and update on going work

Mr Neelis (Ecofys), representing a consortium of consultants contracted by the Commission, presented the findings of the study made for the Commission on the principles for benchmarking and the relation to the ongoing study assisting the Commission in designing allocation rules for all relevant sectors.

There were a number of clarification questions regarding the setting of benchmarks. The Commission explained that according to the Directive, the average performance of the 10% most efficient would apply to the number of installations, and that the base years for

determining the benchmarks would be 2007-2008. With respect to the base years for the production figures, to which the benchmark will apply, it would be a historic figure, e.g. average of 2005-2007, in any case before the adoption of the revised Directive. Given the limited resources and time, the consultant will determine the benchmarks based on all the information readily available in the next couple of months, i.e. sector experts' advice, literature studies, existing benchmarking curves etc.

In this respect, the representative of the cement industry (Cembureau) pointed out that an independent database reporting all necessary data on CO₂ and energy performance is available for the cement industry and accessible to the Commission, consultants and the Member States.

The consultant also clarified that in principle the benchmarks would be determined both for sectors covered by activities explicitly mentioned in the Annex I, as well as sectors covered solely by the combustion activity, if feasible. This remains work in progress.

The representative of the paper sector (CEPI) asked for clarity on what constitutes equivalent measures for small installations, which could influence the number of benchmarks, and on how the Commission intends to assess whether sectors share equal burden. The consultant clarified that the central concern is consistent application of benchmarking principles. The Commission added that the legal text gives an indication of how the benchmarks should be determined but there is no requirement on equal distribution of burden across the sectors. With respect to small installations, the issue of equivalent measures was extensively discussed in the co-decision process and ultimately remains up to the Member States.

Norway expressed support for determining benchmarks for products, and asked for a clarification whether that means that the fuel mix will not be taken into account. The consultant explained that, as more efficient fuels will produce less emissions, the fuel mix is automatically a part of the benchmarking curve based on which the average performance of the 10% most efficient installations will be determined. Fuel mix will not be taken into account individually.

For sectors with a limited number of installations, the representative of CAN-Europe suggested to use the best practice technology. Moreover, he proposed to use benchmarks that evolve over time along with the technology, rather than static benchmarks. The Commission replied that this is something it has been considering and is already the case for the N₂O opt-in. However, since this is about free allowances, their amount will already be decreasing in line with the cap. As for the best practice technology, it is indeed one of the possible fall back approaches under consideration.

Some questions were raised with respect to the treatment of district heating and cogeneration. The consultant confirmed that it is in the scope of the exercise to look at possible approaches for the two sectors and that they will contact heat producers for consultation. In any case, all heat should be treated equally, however it is also clear that not all output can be benchmarked easily. The Commission also assured the participants that determining allocation rules for these sectors is equally important as for other sectors. At the end, some products will get an individual benchmark, some will be grouped together and some will be dealt with by means of an alternative generic approach. Once the products for which the benchmarks are needed are known, it will be the Member States which will collect the corresponding production data which will already be a few years old, so confidentiality concerns should be limited.

The assistant of Ms Avril Doyle, MEP, asked whether, regardless of the outcome of the agreement in Copenhagen, the Commission is taking into account the linking aspects when determining the benchmarks. The Commission replied that its first concern at the moment is to implement the Directive in a fact-based manner and according the requirements in the legal text. Generally speaking, however, reasonable benchmarks are a good starting point for any linkage exercise.

The representative of the ferrous metals industry (EUROFER) expressed concerns about one of the principles mentioned in the consultants' study, namely basing the benchmarks on energy efficiency. They believe that they should rather be based on GHG-efficiency. The consultant agreed (their study was namely based on the original Commission proposal and further work would have to be adapted to reflect accurately the final text) and clarified that they nevertheless try to look at all the different elements separately (energy efficiency, process emissions) in order to get the full picture.