

**DRAFT COMMISSION DECISION ON
FREE ALLOCATION RULES FOR THE EMISSIONS TRADING SCHEME
('BENCHMARKING DECISION')**

Explanatory paper prepared by DG Climate Action for MEPs

1. SUBJECT MATTER

This paper aims at providing an overview of the draft Commission Decision determining transitional Union-wide rules for the harmonised free allocation of emission allowances pursuant to Article 10a of the 'ETS Directive'¹. The revised Directive was agreed by the European Parliament and the Council of Ministers in December 2008.

The draft Commission Decision contains the rules (including the benchmarks) to be used by the Member States to calculate the annual number of allowances to be allocated free of charge to ETS installations in their territories from 2013 onwards.

Stakeholders, such as industry (including all relevant EU-level sector associations directly affected by the ETS), NGOs, and Member States' representatives have been continuously consulted throughout the process of establishing these rules, which started as early as the beginning of 2009.

The benchmark decision was approved by a qualified majority of the Member States in the Climate Change Committee and, according to the "regulatory procedure with scrutiny", is now subject to scrutiny by the European Parliament and the Council before it can be formally adopted by the European Commission.

2. LEVEL OF THE BENCHMARKS

The benchmarks are in most cases based on the average of the 10% most efficient installations in a (sub)sector in the Union, as stipulated in the ETS Directive. Therefore, the benchmarks are derived from real-life industrial production in recent years (2007-08) and are achievable, by definition. The data used for setting the benchmarks was verified and has been provided by the concerned industry sectors. The achievability of the benchmarks in practice has been carefully evaluated by the Commission services.

The benchmarks are very important for the transition towards a low-carbon economy. They provide a strong signal for what is possible in terms of low-carbon production. They have been developed per product and without differentiating according to the technology, fuels or raw materials used, or by geographic location (principle of 'one product = one benchmark' as mandated by the ETS Directive). As the benchmarks are an implementation of the requirements of the ETS Directive, the room for Commission's discretion is strictly limited by these rules. The issue of fuel- or technology- specific allocation has been carefully analysed by the Commission's legal service, which has concluded that is not in line with the Directive.

¹ Directive 2003/87/EC, revised by Directive 2009/29/EC.

Before the draft benchmarks, as currently determined, received the support of the Member States in the Climate Change Committee, they were the subject of extensive dialogues between the Commission and industry stakeholders. The ETS Directive does not provide for benchmarks progressively approaching the level of the 10% best performers over the period. The Directive is clear that the starting point is the average of the 10% best installations in each sector, and only provides considerations to go below this value. Those considerations were assessed, but it was deemed not appropriate to reduce any benchmark further.

3. TRANSITION TO MORE GREENHOUSE GAS- AND FUEL-EFFICIENT PRODUCTION

Given that the benchmarks are based on EU-technology in 2007-08 and will remain in place until 2020, and since technology is expected to improve in the future, just as it has improved in the past, it will be easier year by year to reach the level of the benchmarks.

Being set at this level, the benchmarks may represent a challenge for some installations at the beginning and necessitate a transition to significantly more greenhouse gas- and fuel-efficient production. The main reason for potential significant differences in certain sectors between the best and worst performers is that emissions can be substantially reduced by applying technologies which are currently not yet used by all installations, e.g. end-of-pipe technologies for nitric acid (fertiliser) production.

Fertiliser industry is a particular sector with a large difference in emissions between most and least greenhouse gas efficient installation due to the existence of these end of pipe technologies. The Commission carefully listened to and studied material from the industry association. It took the information into account, by including methane emissions in setting the benchmark value, which led to a considerably higher benchmark.

Member States can and should use their revenues from auctioning emission allowances to support infrastructure providers, producers or consumers in making this transition. This can be done through a range of measures to modernise industry and energy systems, improve energy infrastructure, support the use of renewable energy and reduce any social impact on vulnerable citizens, for example. New state aid guidelines addressing possible financial compensation to electro-intensive industries for increased electricity prices, due to the ETS will be adopted by the Commission over the course of this year.

The free allocation rules are based solely on the requirements of the ETS Directive. However, in the overall context of economic aspects of the ETS it may be noted that most energy intensive sectors covered by the EU ETS has accumulated a surplus of free allowances, since allocation since 2008 often exceeds actual emissions. This accumulation of free allowances is likely to continue until the end of 2012. By then the surplus is estimated to amount to 500-800 million allowances with an economic value of around €7-12 billion.

4. CAPACITY CHANGES AND CESSATION OF OPERATIONS

Where an installation has had a significant capacity extension, additional allocation may be granted. It will be possible to accumulate capacity changes to reach the necessary threshold. Likewise, significant capacity reductions result in reduced allocation.

Where an installation has ceased operations, no allowances are to be allocated to this installation as of the year following the cessation of operations. Where an installation has partially ceased operations, the allocation to this installation is reduced as of the year following the partial cessation of operations.

5. RELEVANCE OF THE CARBON LEAKAGE LIST

When the production takes place in sectors not deemed to be exposed to a significant risk of carbon leakage², the free allocation of allowances will be reduced. The free allocation will in that case be 80% of the preliminary amount to be allocated in 2013 and will gradually decrease to 30% of this amount in 2020 with a view to reaching no free allocation in 2027. Annex VI contains the factors to be applied in each year of the third trading period.

Where a sector or sub-sector has been put on the carbon leakage list, these factors do not apply and consequently, free allocation for those sectors is not reduced throughout the period 2013-20. The carbon leakage list may be amended during 2011, adding a few more sectors.

6. SPECIAL RULE FOR DISTRICT HEATING

A special provision on district heating delivered to households has been included in the draft (Article 10 (3)). It will provide district heating installations that have high emissions with a temporary and declining extra allocation. This is to smoothen the transition to a significantly reduced allocation compared to the current situation.

² Cf. Commission Decision 2010/2/EU of 24 December 2009 determining, pursuant to Directive 2003/87/EC of the European Parliament and of the Council, a list of sectors and subsectors which are deemed to be exposed to a significant risk of carbon leakage.

ANNEX – ADDITIONAL TECHNICAL EXPLANATIONS OF THE DECISION

1. GENERAL METHODOLOGY

The allocation rules include, 52 product benchmarks, which are listed and defined in Annex I of the draft Commission Decision, a heat benchmark, a fuel benchmark, and a methodology for free allocation for process emissions.

The proposed product benchmarks are expected to cover some 75% of industry emissions under the ETS. The choice of which product benchmarks to develop was based on objective criteria and made in close cooperation with the concerned industry sectors, in view of having a maximum amount of emissions covered by a manageable number of product benchmarks. For several benchmarks specific technical characteristics were taken into account, in order to ensure feasibility and to provide a fair representation of the respective sectors.

Production of products not covered by a product benchmark will be allocated free allowances based on a heat benchmark for heat consumption (estimated to cover around 20% of eligible emissions), and a fuel benchmark for fuel consumption (estimated to cover around 5% of eligible emissions) if there is no measurable heat. For process emissions, which are not related to energy (estimated to cover less than 1% of eligible emissions) the allocation will be based on historical emissions.³

2. FREE ALLOWANCES PER INSTALLATION

In simplified terms, the number of allowances to be given to an existing installation (Article 10) is calculated by multiplying the relevant benchmark by the installation's historic production expressed as the median of the years 2005-08 or 2009-10, whichever is higher (Article 9).⁴ The use of the median ensures that the impact of special circumstances, such as temporary closure of installations and periods of economic contraction, is reduced.

As the total number of free allowances is limited, a so-called cross-sectoral correction factor is foreseen in the ETS Directive to ensure that the total amount of free allowances does not exceed the maximum available.⁵

The allocation of allowances for new installations (Article 19) is calculated, in short, by multiplying a relevant benchmark by the installation's estimated capacity increase and a standard capacity utilisation factor (Article 18). Subsequently, an annual linear reduction

³ To facilitate the calculation of allowances to be allocated per installation, the concept of sub-installations is introduced allowing installations may to be divided into parts covered by product benchmarks, the heat benchmark, the fuel benchmark, and process emissions (Article 6).

⁴ The median of the years 2005-08 implies excluding the highest and the lowest year, and calculating the mean of the remaining two middle years. The median of the years 2009-10 is equivalent to the mean of 2009-10.

⁵ The maximum amount is defined in Article 10a(5) of the ETS Directive. It is linked to industry's share of total average verified emissions in the period from 2005-07.

factor of 1.74% is applied, as required by the ETS Directive. The total number of allowances for new entrants is also limited.

3. ARRIVING AT FREE ALLOCATION

To calculate the amount of allowances to be allocated per installation, a baseline data collection (Article 7) is to be carried out by the Member States, collecting from operators all relevant information (listed in Annex IV). The collected data needs to be verified (Article 8) and is to be used by the Member States to calculate the preliminary amount of free allowances for each installation. This shall be submitted to the Commission by 30 September 2011 (Article 15).

The Commission will assess the information submitted by the Member States and use it to calculate whether the cross-sectoral correction factor is needed and, if so, from which year on it will apply.⁶ In case the Commission does not reject the calculated preliminary amounts, the Member States have to apply the possible cross-sectoral correction factor to the preliminary amounts and notify the Commission of the resulting final annual amount of free allowances per installation. The number of allowances to be allocated per installation for each year, from 2013 up to 2020, will be known in advance (before 2013), except for capacity changes.

⁶ The determination of the cross-sectoral correction factor is set out in Article 15(3). In case the total preliminary amount of free allowances for all installations exceeds the maximum available, this factor will reduce each installation's number of free allowances in a uniform manner so as to meet that maximum (cf. previous footnote).