

Cefic response to draft Delegated Act on Free Allocation Rules in the context of the revised ETS Directive

Performance-driven free allocation and financial compensation for indirect costs (where granted) have proven to be effective means to mitigate carbon leakage risks. With increased climate ambitions, only a robust framework for carbon leakage provisions covering direct and indirect emissions costs can help safeguard industry's competitiveness and help remove barriers for investment in new technologies in Europe. Cefic takes note of the European Commission's draft Delegated Act on Free Allocation Rules to implement the recent revision of the ETS Directive and would like to make some recommendations.

Conditionality – climate-neutrality plans

The conditionality of free allocation, requiring operators of the 20% worst performing installations to develop and implement a climate-neutrality plan, is being applied to installations. The conditionality is, however, calculated on the basis of benchmarks, which apply at a sub-installation level. As such, any potential reduction of free allocation should rather be restricted to the share of allowances allocated to the sub-installation. In practice, this can otherwise result in a low-performing small sub-installation triggering the CNP requirement and a potential disproportionate reduction of free allocation for a site with large highly efficient sub-installations. Next to this, as Member States have varying ways of greenhouse gas permitting, this can create an unlevel playing field within the European Union.

As such, Cefic reiterates its concern about the foreseen application of the CNP conditionality at installation level. As this conditionality is calculated on the basis of product benchmarks, it should apply to the sub-installation level.

In the absence of applying this conditionality to sub-installation level, Cefic welcomes the introduction of a de-minimis rule in the new Article 22b (2). As the draft also introduces a threshold for the exemption from the cross-sectoral correction factor in Article 16 (8), Cefic would recommend putting these on par. Concretely, the CNP conditionality should apply where the relevant product benchmark sub-installation contributes more than 60% of the entire installation's free allocation.

When it comes to the content of climate-neutrality plans, the Commission and national competent authorities should acknowledge that targets, milestones, and investments in the future are highly dependent on many factors, many of which not directly under the operators' control. Importantly, the policy framework should deliver a business case that attracts investments and allows for competitiveness on global markets. Many milestones also depend on the availability of affordable and abundant low-carbon energy, access to certain infrastructure, or the availability and readiness of certain technologies. As operators deal with uncertainties and may have different scenarios towards climate neutrality, it is important there is a possibility for updating the plans, as per the new Article 22d. In assessing the plans'

compliance, the authorities should also allow for this flexibility and acknowledge the inherent and unavoidable uncertainty.

Another important omission, related to the operators' uncertainty, is that the ETS Directive and the CNP Implementing Act do not yet recognise the potential of carbon removals. With a view to reaching net-zero by 2050 and considering that industrial processes – as long as they do not cease operation – are likely to emit some residual greenhouse gases¹, the integration of carbon removals is an important element. This should be allowed in CNPs and addressed in upcoming reviews of the relevant legislation.

There may be cases where operators do not meet the targets before the start of the allocation period, but that they achieve them soon after. As such, it is important that this is annually reviewed and that operators can receive the full allocation as soon as they comply. It should also be clarified that free allocation should not be reduced in case important enabling conditions outside of the operator's control are not in place in time.

The draft introduces a new article, Article 22e, referring to the publication of the climate-neutrality plans. Its contents are, however, likely to include company-specific strategies, investments, future emission forecasts, and other commercially sensitive, confidential information. Before this Delegated Act is adopted, this should be better clarified. These climate neutrality plans should also not lead to any legal consequences beyond the conditionality of free allocation in the ETS.

Conditionality – energy efficiency

For the conditionality related to the implementation of the audit recommendations on energy efficiency, Cefic would recommend due consideration of already existing national schemes. As such, in those Member States where voluntary arrangements already exist that meet the payback criteria, compliance with such national schemes should qualify as compliance for this conditionality.

Similarly to the CNP conditionality, it is important that this is annually reviewed and that operators can receive the full allocation as soon as they comply. Further to this, the amount of free allocation that is withheld while measures were not implemented, should be able to be recovered by the operator once the measures are in place, where the measures could not be realised in time because of reasons outside of the operator's control.

Exchangeability of fuel and electricity

The draft Delegated Act deletes Article 22 on exchangeability. This gives rise to many questions, especially with regard to its potential implications. First, there will be an impact on the total amount of free allocation due to this decision, which can impact the cross-sectoral correction factor (CSCF). As such, it would be important to have a more thorough analysis of the impacts of this measure. Based on this, the Commission should postpone the deletion of exchangeability until it is evaluated whether to increase the cap for free allocation, reflecting the shift from compensation of indirect emission to free allocation.

¹ Cf. Communication from the European Commission COM(2018) 773 final: A Clean Planet for all - A European strategic long-term vision for a prosperous, modern, competitive and climate neutral economy, 'Figure 6: GHG emissions trajectory in a 1.5C scenario' (page 23)

Second, the legal text remains unclear about the consideration of electricity consumption in the benchmarks. In case exchangeability is deleted, Cefic asks for maintaining the current practice of conversion of electricity into CO₂ emissions for the calculation of the benchmark curves in order to keep the benchmarks representative. Deleting the concept of exchangeability for the benchmark curves without maintaining the conversion of electricity to CO₂ emissions will lead to distorted annual improvement rates, which will unduly reduce free allocation and thus the protection against carbon leakage for the sectors previously covered by exchangeability.

Third, recital 9 points out that free allocation granted to indirect emissions of electrified processes should not prejudice the possibility to receive compensation for indirect costs. It would be good if the Commission could provide more clarity on how free allocation and indirect cost compensation can work together following the removal of exchangeability. Important parts of the chemical industry have been excluded from indirect cost compensation according to the State Aid Guidelines of 2021. As the economic pressures and carbon and investment leakage risks have changed drastically during the past years, these parts of the chemical industry should be reassessed in 2025.

Fallback benchmarks

The draft Delegated Act updates the definitions of the fallback benchmarks. In the fuel benchmark, in Article 2 (6), new language has been added to restrict it to fuel combusted for the primary purpose of the generation of heat. This change would exclude the eligibility for free allocation for low-carbon energy resulting from chemical energy in raw materials under the fuel benchmark. This deletes an important incentive to use and recover all forms of low-carbon energy and does not follow the principle of technology neutrality. Therefore, we recommend deleting the restriction of the fuel benchmark to fuel combusted for the primary purpose of the generation of heat.

In addition, it would be important that the Commission provides a clarification that for the fuels benchmark remains inclusive of fuels used for critical safety systems such as flaring equipment. These systems are indispensable as they are needed to ensure safety and to minimise environmental pollution during unplanned and transitional events.

De-Minimis Rule

The draft Delegated Act removes the de-minimis rule by replacing Article 10 (3), that exempted operators from providing data on the distinction of carbon leakage exposure in case at least 95% of the activity level of the fallback benchmark sub-installation serves sectors or subsectors exposed to carbon leakage risk. To limit administrative burden, the de-minimis rule should be maintained.

For more information please contact:

Dr Peter Botschek, Director Industrial Policy and Competitiveness, Cefic

pbo@cefic.be

+32 478 380 153

Justin van Schepen, Manager Climate Change Policy, Cefic

jva@cefic.be

+32 499 58 59 01

About

Cefic:

Cefic, the European Chemical Industry Council, founded in 1972, is the voice of large, medium and small chemical companies across Europe, which provide 1.2 million jobs and account for 14% of world chemicals production.