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### Position Paper on the EU consultation “Revised Delegated Regulation as regards transitional Union-wide rules for harmonised free allocation of emission allowances (FAR-Regulation)”

*The German association of industrial energy consumers (VIK e.V.) welcomes the opportunity to provide feedback on the Commission draft Delegated Regulation amending Delegated Regulation (EU) 2019/331 as regards transitional Union-wide rules for harmonised free allocation of emission allowances.*

As a result of the revision of the EU ETS Directive in 2023, the rules for the allocation of free allowances also need to be updated. The EU Commission plans to adopt a delegated act concerning the Union-wide harmonised rules for the allocation of free allowances. In this position paper we will focus on some critical points important for the energy-intensive industry in Germany.

#### **Climate neutrality plans**

When it comes to the content of climate neutrality plans, the Commission and national competent authorities should recognise that targets and investments in the future are highly dependent on a number of factors, some of them are not directly under the control of operators. It is important that the future policy framework provides a business case that attracts investment and enables competitiveness in global markets. Many milestones also depend on the availability of affordable low-carbon energy or access to specific infrastructure. As operators face uncertainties and may have different scenarios for the achievement of climate neutrality, it is important that there is a possibility to update the plans (Article 22d). In assessing the plans, authorities should also allow for this flexibility and recognise the inherent and unavoidable uncertainty.

The interpretation of the provisions on CNPs as being applied at installation level entails a disproportionate treatment: operators of installations covering multiple product benchmarks and fallback sub-installations would be subject to the obligation and penalty for their entire installation as soon as one sub-installation is in the worst 20% percentile of a given product benchmark in 2016-2017, regardless of the performance of all other sub-installations.

In our view, the obligation and penalty concerning CNPs for the least 20% efficient installations should be interpreted and applied at sub-installation level (Article 10a of the ETS Directive 2023/959). This would lead to a more consistent and proportionate treatment, where the obligation is applied only for the relevant product benchmark sub-installations belonging to the worst 20% percentile.

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Additionally, for installations that are already in the scope of the EU ETS, it is easy to find out, if they belong to CNP-installations, as the values can be derived from the applications for free allocation for 2021-2025 that were submitted in 2019 (in Germany).

A certain circle of companies that have received the relevant information from the Climate Expert Group will be able to prepare incumbent installations. However, in our opinion, all industry sectors should be informed by the EU Commission. The relevant values and benchmarks should be published in time and the national authorities should contact installations' operators beforehand. Additionally, the CNPs should be submitted by 30 May 2024: this time frame will be too short for companies to prepare themselves for CNPs.

### **Conditionality – recovery of free allocation in context of energy efficiency**

In our view, it is not possible to reclaim free allocated allowances for years in which the energy efficiency or alternative measures were not implemented in time for the relevant allocation year. This is not acceptable as there are several possible reasons why measures may not have been implemented in time. Most of these reasons are outside the control of EU ETS installations. Therefore, it must be possible for EU ETS installations to recover free allocations for earlier years in which the measures were not implemented but were implemented later and up to 2030. Such an adjustment of the FAR by the EU would result in a double incentive for installations and would be in line with the European climate and energy efficiency objective.

### **Definition of 'fuel benchmark sub-installation'**

The Commission proposes to change the definition of 'fuel benchmark sub-installation' to limit it to heat production only where it is "for the primary purpose of the generation of heat". This change will discriminate against efficient technologies where a low-carbon path to heat production has been established through process integration (e.g. exclude from free allocation all processes in which the energy included in the raw materials is not wasted but utilized to substitute CO<sub>2</sub>-emitting fuels). Such a change would significantly reduce free allocation for the copper smelters.

The EU Court case C-271/20 clearly ruled that for primary copper production facilities, the concept of a 'fuel benchmark sub-installation' includes the raw material copper concentrate used to be oxidized in flash smelting foundry and through this incineration generates the necessary heat in the furnace to melt the materials. It is good practice in the copper industry to recover the SO<sub>2</sub>-containing gases from the flash smelting process by producing sulphuric acid, a high value product. This is considered the best available technique to reduce SO<sub>2</sub> emissions within the framework of the BREFs for the non-ferrous metals industry. We therefore believe that the definition should remain unchanged. The possible change will result in a significant net cost burden that would

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impact the competitiveness of the copper sector and its ability to invest in decarbonisation solutions. It will also certainly undermine efforts to secure strategic commodities such as copper for the low carbon transition.

In addition, we would like to explicitly point out at this point that maintaining the fuel benchmark currently valid for the first phase of the trading period enables the utilisation of European support services and thus directly relieves the national budgets, as no funds have to be used for the comparable promotion of energy efficiency measures in this area. In short, free allocations at the current level ensure international competitiveness without the need to raise additional federal or state funds.

### **Inclusion of combined heat and power plants**

The inclusion of combined heat and power installations (CHP installations) in the scope of the EU ETS brings installations into focus regardless of their efficiency. Initial information from installations has shown that installations that operated their CHP during the base period are among the 20% worst performers, simply because the assessment does not differentiate between installations that only produce a benchmark product and those that also produce electricity and/or heat. The operating rate during the baseline period can unfairly distort the results and affect the evaluation of an installation's "efficiency" in this assessment. To ensure fairness and accuracy, CHP installations should be evaluated based on efficiency in the production of the benchmark product, rather than on external factors such as electricity production.

### **Recognition of Carbon Capture and Storage (CCUS)**

CCUS technologies are not mentioned in the updated version of the FAR-Regulation. In our view, it is not possible to achieve climate neutrality without recognition of these decarbonisation technologies. Carbon dioxide is used as an important raw material in industrial processes. So-called "green" CO<sub>2</sub>-production exclusively from biomethane will not work due to the limited biomethane capacities in Europe. In order to ensure planning certainty for European industry, the use of CCUS technologies should be taken into account for free allocations in the current version of the FAR Regulation.

### **Best performers and cross-sectoral correction factor (CSCF)**

The CSCF exemption test, which determines whether a benchmark is in the top 10%, is carried out at the sub-installation level, but the consequences would always apply to the ETS installation as a whole. In this case, the Commission has introduced an additional threshold that the sub-installation must receive at least 60% of the provisional annual number of allowances allocated free of charge for the CSCF exemption to be valid. There are significant inconsistencies in these approaches, particularly for larger ETS

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installations with multiple sub-installations. At least a consistent interpretation of 'installation' with the same threshold for both conditionalities must be used.

To address these concerns, we propose the following options:

1. Carry out conditionality and CSCF tests at the sub-institutional level and apply the consequences at the sub-institutional level accordingly, without the need for an additional criterion.
2. If the 60% criterion is maintained in the CSCF exemption, the same interpretation must be applied in the conditionality test. For example, CNPs should be submitted by ETS installations that have a sub-installation with more than 60% free allowances and that is among the worst 20% in the benchmark.

### **De-minimis rule**

The draft of FAR-Regulation removes the de-minimis rule (e.g. the 95% rule) by replacing Article 10.3. To limit administrative burdens the de-minimis rule need to be maintained.

### **Implementation deadline of FAR-Regulation is too short**

The regulation should apply retroactively from January 2024. At present, the German Emissions Trading Authority (DEHSt) has not yet published the national requirements for the preparation of climate neutrality plans, and a specific electronic tool for the preparation of plans is not available yet. We therefore consider the deadline of 30 May 2024 to be too short, especially as companies affected by CBAM will also have to apply for allocations for the second half of the fourth trading period in the same period.

### **Exchangeability of fuel and electricity**

The draft Delegated Act deletes Article 22 on exchangeability. This raises many questions, particularly regarding its potential impact. This decision may have an impact on the amount of free allocation and on the CSCF. In our opinion, the EU Commission should firstly make an impact assessment and only after that decide if the cap on free allocation should be increased to reflect the shift from offsetting indirect emissions to free allocation.

Secondly, the legal text remains rather unclear on the inclusion of electricity consumption in the benchmarks. If exchangeability is abolished, the current practice of converting electricity into CO<sub>2</sub>-emissions for the calculation of benchmark curves should be maintained in order to keep the benchmarks representative.

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Thirdly, Recital 9 states that free allocation of indirect emissions from electrified processes should not prejudge the possibility of receiving compensation for indirect costs. Since free allocation is not given for indirect emissions but for production, VIK asks, how this combination is to be interpreted in the light of the ETS Directive. Important parts of the chemical industry have been excluded from indirect cost compensation under the 2021 State Aid Guidelines. As economic pressures and carbon and investment leakage risks have changed drastically in recent years, these parts of the chemical industry should be reassessed in 2025.

### **Free allocation for ammonia and hydrogen production**

1. In the EU, the installations for ammonia production from methane receive free certificates for ammonia production within the EU ETS. The ammonia, produced as a hydrogen carrier, is to be converted into hydrogen at another location using a cracker. The hydrogen cracker normally receives free allowances for hydrogen production. This practically results in double free allocations, even though hydrogen is produced directly from methane which means that there would only be one free allocation. In our view, this double allocation represents a distortion of competition, but is a likely scenario in view of the hydrogen ramp-up with ammonia as a global hydrogen carrier. In our opinion, this case should be explained in detail within the new FAR-Regulation.
2. It is not clear how a company operating a hydrogen electrolysis and ammonia plant (both ETS plants) should behave if the hydrogen is sold and at the same time used directly for green ammonia production. Hydrogen is produced within an electrolysis installation. This electrolysis installation is an independent EU ETS installation. The produced hydrogen is further transferred in whole or in part to an ammonia plant for ammonia production. According to the FAR-Annex, the ammonia benchmark is to be used for ammonia production via hydrogen. However, it is not clear what happens if the electrolysis and ammonia plants are two independent EU ETS installations. The hydrogen could also be sold to third parties. There is a need for further clarification here.

*VIK is the association of industrial energy consumers in Germany. For more than 70 years VIK represents in his role as an industry-wide association the interests of companies from e.g., aluminium, chemicals, glass, paper, steel and cement. VIK advises its members on all energy and energy-related environmental issues.*