16 March 2015

Consultation on revision of the EU Emission Trading System (EU ETS) Directive

French Association of Large Companies (AFEP) and Cercle de l'Industrie's joint position

Executive summary

French companies are committed to combating climate change. A reinforced and structurally reformed ETS must be the cornerstone of the EU energy and climate policy, in order to reach -40 % greenhouse gas emission reduction in 2030 compared to 1990 while preserving the competitiveness of energy-intensive companies exposed to international competition. This document is the executive summary of Afep and Cercle de l'Industrie's joint reply to the consultation of the Commission consultation.

1) Free allocation and addressing the risk of carbon leakage

In order to better stimulate investments in low carbon technologies, member companies are in favour of introducing a **dynamic allocation of allowances**. The aim is to adjust the allocation of allowances year X on the basis of their real activity level of year X-1 (instead of rigid activity forecasts). This will ultimately reduce the risk of over/under-allocations. Such adjustment should rely on the **Market Stability Reserve.** Therefore, the **cross-sectoral correction factor**, which is applied to calculate final allocations, should be suppressed.

Benchmarks should be revised on the request of each sector, at European level, one year before the end of each period, in view of being applied throughout the whole period to come, to ensure stability. The revised benchmarks should be based upon a significant sample of installations in Europe using a transparent methodology.

To avoid the strong distortions of competition throughout Europe created by the current national **compensation system for indirect CO_2 costs**, companies recommend:

- allocating to electro-intensive companies **free allowances at EU level** instead of national financial support, mostly to ensure transparency and equal treatment across the EU;
- enabling 100 % compensation for indirect costs;
- sourcing those free allowances either from the Market Stability Reserve, or unallocated allowances from phase 2013-2020, or back-loaded allowances;
- defining the allocation of free allowances on a common performance ratio (e.g. in terms of CO_2/MWh), in order to avoid windfall profits and to create a level playing field.

2) The Innovation Fund

Companies support the decision of the European Council to renew **NER300**, to extend its scope to low carbon innovation in industrial sectors, and to increase its endowment to 400 million allowances. However, its operating framework must be reformed.

They recommend that the current EU framework supporting low carbon innovation in industrial sectors be improved, in particular as regards the **selection criteria of projects**, in order to promote projects showing the best cost/efficiency ratio and replicable projects. Non-cooperative projects should also be supported. Furthermore, the EU should also finance the pre-commercial phase of projects.

3) The Modernisation Fund (2% of the allowances in 2021 to 2030 for the poorest Member States)

The projects financed should meet **selection criteria** expressed inter alia in terms of performance (GHG emission reduction/euro invested), replicability, and impact on investments in plants presenting high production and environmental standards. Rigorous and reliable **monitoring** should be put in place in order to ensure that the investments planned have really been implemented. The fund should foster as a priority the construction of new plants.

If, as recommended by companies, a system of dynamic allocation of allowances were combined with the deletion of the cross-sectoral correction factor, the best solution to tackle the issue of GHG emission reductions of the electricity generation sector is to **dedicate a special Fund** to that purpose, apart from the Modernisation fund.

4) Free allocation to promote investments for modernising the energy sector (Article 10 c)

Investments should have an **added value in terms of GHG emissions per kWh** that would put Member States on track to catch up with those that are the most advanced in terms of GHG emission reductions. Allowances should be distributed to projects selected on a technology-neutral basis, stage by stage depending on the completion of the projects, and on a transparent way. Such source of funding should not be used for interconnection projects.

5) Small installations, Registry, use of auctioning revenues

Member States' possibility to exclude **small emitting installations** from the ETS should be maintained after 2020. Exclusion criteria must be harmonised at EU level.

Companies call for a highly secured and user-friendly **Union Registry**, whose fixed costs should be financed by Member State's auction revenues. Registry operating fees should be made more convergent at EU level, and calculation rules should be more transparent and fairer.

100% of **auctioning revenues** should be earmarked to climate-related projects selected at EU level and mainly benefitting to ETS sectors.

6) Assessment of the ETS Directive

The ETS Directive's objective to reduce emissions has been met.

However, the allowance's price has not been the main driver for this reduction. Furthermore, the ETS Directive has failed to provide long term visibility required to stimulate investments in low carbon technologies and processes, and the "3x20" package for 2020 proved to lack internal consistency. **Its main weaknesses** are: the benchmarks definition which is often too tight to reflect actual performance levels, the existence of the cross-sectoral correction factor which is redundant and counterproductive, and the fact that the ETS Directive does not solve the problem of indirect costs, but gives a mere possibility to Member States to compensate for it, which opens the way to distortions of competition among Member States.

Yet, the ETS Directive remains **a relevant instrument** to tackle climate change. It enables harmonisation throughout the 28 Member States, and therefore creates a level-playing field. It has inspired other countries, and enables linking between different regions of the world in view of a progressive global coverage. But it needs to be adapted to changing economic conditions, in order to restore all key actors' confidence.

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About AFEP (French Association of Large Companies)

The purpose of AFEP is to present the views of large French companies to the European Institutions and the French authorities, mainly with regard to the drafting of non-sectoral legislation (on the economy, finance, taxation, company law, financial information and markets, competition, intellectual property rights, consumer affairs, social protection, employment legislation, environment and energy, corporate social responsibility, etc.).

In 2015, AFEP represents more than 110 of the top private sector companies operating in France. The companies which belong to AFEP have 8.5 million employees and a combined turnover of 2 600 billion euros.

As a major force for analysis and proposals, AFEP is also a prime forum for contacts between member firms and public authorities, which consult the Association when considering plans for reforms or regulations. Senior officials in the European Union and French administrations regularly take part in meetings organised at the head office of the Association, enabling direct and constructive dialogue to take place.

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About Cercle de l’Industrie

Based in Paris and Brussels, Cercle de l’Industrie is a forum for dialogue and exchange. It brings together the Chairmen of large businesses in all industrial sectors and polic-makers. In 2015, member companies of Cercle de l’Industrie had a turnover of around 865 billion euros; they employed 2.7 million people.

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