Cepi RENEWABLE RECYCLED RESPONSIBLE EUROPEAN PAPER

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EU ETS review: industry's competitiveness fit for 55

Cepi, the Confederation of European Paper Industry, believes that the review of the EU ETS Directive presents an opportunity to retain the regulatory stability and to improve several elements to trigger investments in low-carbon technologies. The core of the proposal is to protect the competitiveness of energy-intensive industries while reducing global carbon emissions.

The pulp and paper sector is in a key position to support the EU in becoming fit for 2050. Our sector has the potential to drive down greenhouse gas emissions with sustainable energy sources. From 2005, our industry has already made substantial reductions in carbon emissions by 29%, resulting in 24% carbon-intensity reduction. We have been early-movers in low-carbon investments, focusing on energy efficiency and renewable energy solutions. We plan to grow our business in Europe, which is a significant part of the circular economy and the bio-economy.

We call on the Commission to consider the following principles to achieve higher emission reduction by 2030, in line with our industry's competitiveness needs:

1) **Justly address the contribution of the current EU ETS and non-ETS sectors to emission reduction**
   All sectors must contribute to the more ambitious 2030 emission reduction target. The revision of the current policy framework must not lead to the current EU ETS sectors contributing disproportionally more than others. The efforts of sectors currently covered by the Effort Sharing need to be justly addressed so that they also deliver a fair share of emission reductions. Otherwise, the current functioning of the EU ETS and the competitiveness of industry are threatened.

2) **Grant all energy-intensive industries equal protection against present and future risks of carbon leakage**
   All sectors must be provided with the necessary framework conditions and support to accelerate reducing emissions. In this context, the Commission proposal needs to ensure that the overall carbon leakage protection does not considerably drop at a pace faster than our capacity to cope. Moreover, it is worth noticing that the rest of the world does not impose comparable costs on energy-intensive industries, with carbon leakage provisions appearing also in other non-EU countries.

   Should the European Commission consider additional tools to the existing carbon leakage protection measures such as the Carbon Border Adjustment Mechanism (CBAM), the most suitable sectors should be defined based on a set of clearly defined parameters, for example, trade balance, production processes, type of emissions, carbon intensity, number of installations, the share of small emitters, the complexity of value chain. A CBAM will not be a universal tool to protect all sectors under the EU ETS against carbon leakage. Industry sectors must be consulted.

3) **Avoid artificial shortage of free allowances to industry**
   The linear reduction factor can be expected to significantly increase to achieve higher emission reductions towards 2030. However, the amount of free credits needs to be defined in a way that not only prevents the risk of carbon leakage, but also allows for industrial production to recover from the ongoing economic crisis due to the Covid-19 outbreak. Creating an artificial shortage of free allowances needs to be avoided.

The application of the cross-sectoral correction factor (CSCF) in the revised EU ETS is detrimental to regulatory predictability. Its triggering endangers sufficient carbon leakage protection for the industry. In the revised EU ETS, the application of the CSCF can be avoided by increasing the share of free allowances. The CSCF is the most unfair among all instruments. It cuts allocation irrespectively of the industry's potential and punishes early movers in low-carbon solutions.

The EU ETS is the largest, most open and most liquid emissions trading scheme in the world. As such it attracts investors seeking not only to hedge their exposures to climate change, but also to follow other diverse interests. Therefore, the mechanisms of the Market Stability Reserve (MSR) originally based on the hedging requirements for compliance buyers need to be reassessed.

The Market Stability Reserve (MSR) is working as expected. With the post-pandemic economic recovery ahead and upcoming regulatory changes, a faster than expected absorption of the relatively small surplus might create more damage than good. This in fact takes away allowances from the market at the time the industry needs them the most.

Therefore, the European Commission should consider lowering the share of allowances to be put in the reserve from today's 24% back to 12% before 2023. In addition, allowances in the reserve could not be invalidated, but instead used to finance investments in low-carbon innovation.

All options to strengthen the ETS cap need to be carefully impact-assessed, including the possibility of a one-off emissions cap reduction (rebasing) and a tighter annual linear reduction factor for the period 2026-2030. There will be trade-offs between different measures and these should be assessed in a holistic approach. Any upcoming regulatory interventions need to minimise both the short and long-term impact of amending the ETS on the industry competitiveness.

4) **Keep the proposed approach to benchmarks review**
The recently agreed new rules on benchmarks have yet to be implemented. Before even assessing their effectiveness, it is unnecessary to reopen this discussion. It is worth stressing that data used for the new benchmark values (2014-2018) did not capture yet investment decisions based on new benchmark values.

The benchmark review needs to predictably promote and reward investments in low-carbon technologies, while finding the right balance between accuracy and administrative burden. Reducing benchmarks at achievable paces, with rules clearly stated upfront, will lower regulatory risks and reward the installations that will invest in low-carbon technologies.

5) **Stop penalising investments in industrial Combined Heat and Power (CHP)**
In the pulp and paper industry, CHP is considered as Best Available Technique. Installations are therefore expected to use this technology. Today however the EU ETS does not send the right investment signal to invest in industrial CHP. The EU ETS grants no free allocation for electricity produced. No consistent and adequate compensation for indirect carbon costs is given across Europe either. Given the relevant co-benefits CHP delivers in moving Europe towards a low-carbon economy, corrective measures to provide the right investment signal are urgently needed.

6) **Allow use of guarantees of origin (GOs) as purchase records under the EU ETS**
The industry should be rewarded for its individual decision to purchase or to produce renewable and low-carbon gases, even off the gas grid. By the introduction of an emission factor of zero for biogas,

the revision of the Monitoring and Reporting Regulation helps to increase the share of renewable gas used by the industry. However, the meaning of ‘purchase record’ could be further clarified.

Tradable Guarantees of Origin should continue to be recognised as proof of purchased and used biogas. In its current form, a GO and/or purchase agreement/receipt of the biomethane purchase combined with sustainability information/certificate should be sufficient as the required ‘purchase record’.

7) **Adopt binding EU rules for compensation of indirect carbon costs**
Indirect carbon costs affect industrial international competitiveness as much as direct carbon costs do. The principle of equal treatment in shielding industry from both carbon costs must effectively and consistently apply in all Member States.

8) **Earmark innovation and modernisation funding to energy-intensive industries**
It is of paramount importance to increase the financial support for the development and implementation of low-carbon technologies if the ETS sectors are now to reduce their emissions by 65% by 2030[1]. In needs to be ensured that the ETS revenues, whether national or European, are reinvested in industrial decarbonisation and protection of sectors competing globally.

The Innovation and Modernisation Funds should continue receiving a large share of ETS revenues to finance the transformation. The funds need to be made available to re-invest in new technologies for each of Annex I sectors.

9) **Avoid extending the EU ETS to new sectors**
Assuming a cap-and-trade system is the most appropriate way to tackle emissions from the building and transport sectors, it is premature to automatically extend the scope of the current ETS. Primarily because the impact of extending the current ETS to new sectors has not been thoroughly assessed and discussed. As long as it is unclear what the consequences of such inclusions would be for energy-intensive industries, they should remain separate from other sectors.

Each sector, such as building and transport, has quite different CO_2 abatement costs, elasticities and risks of carbon leakage. Their exposure to international competition varies from energy-intensive industries. There is a risk that their inclusion in the EU ETS would exacerbate carbon costs without a guarantee of reducing carbon emissions.

[1] "Stepping up Europe’s 2030 climate ambition. Investing in a climate-neutral future for the benefit of our people" (2020) European Commission