ERCST

European Roundtable on Climate Change and Sustainable Transition

Public consultation on free allocation adjustments due to activity level changes in phase 4 of the EU ETS –ERCST answers

Questions

1. Which of the following option do you consider preferable for an adjustment to allocation due to activity level changes per sub-installation?
    a. For changes in activity level of more than 15%, the allocation should be adjusted proportionally to the actual change; i.e. an increase/decrease of activity by 19% would lead to an adjustment of 19% of allocation;
    b. A first allocation adjustment should be applied for a 15% increase or decrease in activity level. Subsequent allocation adjustments will be made within intervals of an amplitude of 10%; i.e. an increase/decrease of activity by 19% would lead to an adjustment of 15% of allocation; an increase/decrease in activity of 38% would lead to an adjustment of 35% of allocation; an increase of activity of 98% would lead to a 95% adjustment in allocation;
    c. A first allocation adjustment should be applied for a 15% increase or decrease in activity level. Subsequent allocation adjustments will be made within intervals of an amplitude of 15%; i.e. an increase/decrease of activity by 19% would lead to an adjustment of 15% of allocation, an increase/decrease of activity of 38% would lead to an adjustment of 30% of allocation; an increase of activity of 98% would lead to a 90% adjustment in allocation;
    d. A first allocation adjustment should be applied for a 15% increase or decrease in activity level. Subsequent allocation adjustments will be made within intervals of an amplitude of 30%; i.e. an increase/decrease of activity by 19% would lead to an adjustment of 15% of allocation, an increase/decrease of activity of 38% would lead to an adjustment of 15% of allocation; an increase of activity of 98% would lead to a 75% adjustment in allocation;
    e. No preference / Don't know

2. With the aim to reduce the administrative burden, do you consider that a minimum quantitative threshold should be introduced to determine whether the level of free allocation shall be adjusted? An adjustment would then take place only if the change would lead to an increase/decrease by a minimum of X EUAs.
    a. Yes, a minimum threshold of 100 allowances;
    b. Yes, a minimum threshold of 500 allowances;
    c. No quantitative minimum threshold shall be established;
    d. No preference / Don't know;
    e. Yes, a minimum threshold shall be established but another value shall be used.

If your answer to question 2 is e, please specify the value preferred below and give a justification:

3. In your opinion, when should activity level data start to be collected and when do you consider that allocation adjustments shall begin in the first allocation period 2021-2025:
    a. Allocation changes shall start in 2023 based on the activity level data collected from the years 2022 and 2021;
    b. Allocation changes shall start in 2022 based on the activity level data collected from the years 2021 and 2020;
    c. Allocation changes shall start in 2021 based on the activity level data collected from the years 2020 and 2019;
    d. No preference / Don't know.

4. In phase 4 of the EU ETS, activity level data will be collected for each installation at sub-installation level on an annual basis. This data will need to be verified and reported. In your opinion, how can the administrative burden be minimised while the robustness of collected data is ensured?

ERCST is of the opinion that aligning reporting verified activity level data with the deadline for reporting verified emissions should be considered as it would reduce the administrative burden.

However, as the deadline for reporting verified emissions is March 31st, and the issuance of allowances has to takes place before February 28th, aligning both reporting deadlines would mean that the verified activity level data from year x-1 will only be known after the free allocation for year x has been issued, creating a time-lag of more than one year.

As either pushing back the February 28th deadline or pushing forward the March 31st deadline would entail revisiting legislation, this option seems unlikely.

Alternatively, one could imagine a true-up mechanism being developed, as is done by the Californian emission trading system, which corrects the level of free allocation issued to operators by February 28th based on the verified activity levels later in the year.

5. If, in your opinion, there are other aspects which should be considered when developing detailed rules on free allocation adjustments due to production level changes, please describe them:

An absolute threshold as an alternative to the relative threshold

Both the recitals to Directive 2003/87/EC as well as the Commission's roadmap recognise the possibility of adopting absolute thresholds.

Based on this, an absolute threshold as an alternative to the relative threshold could be adopted, which would trigger an adjustment even if the relative threshold of 15% is not reached, making the system more dynamic. During Phase 3, an absolute threshold of 50.000 EUAs already exists in the context of assessing 'significant capacity extension', which can lead to additional free allocation for an installation.

In Phase 3, in accordance with decision 2011/278/EU, this threshold of 50.000 has to represent at least 5% of the sub-installation's free allowances. Given these requirements, it can theoretically only apply to a limited number of installations. Moreover, this number is declining over Phase 3 as the amount of free allowances allocated is steadily decreasing in line with the LRF and the benchmarks.

For Phase 4, we support adopting an additional absolute threshold to make free allocation adjustments more dynamic, both for increasing and decreasing activity levels. Ideally, the absolute threshold would be set as low as possible: the lower the threshold, the more dynamic the system will be, as more installations can theoretically reach the absolute threshold before the 15% relative threshold. For example, based on 2017 data, a 50.000 threshold would only be relevant for about 400 installations, while a 25.000 threshold can theoretically apply to 800 installations, and a 10.000 threshold to 1600 installations.

The absolute threshold itself should ideally also be made dynamic and decline over Phase 4, as a static one will gradually apply to fewer installations as benchmarks decline and industry continues to decarbonise. This threshold could be pegged to a variety of indicators, the most obvious one being the LRF.

Fall-back benchmarks

We want to highlight that issues could arise for installations making use of a fall-back benchmark if their free allocation is directly aligned with changes in their activity level.

Free allocation for such installations is calculated by multiplying their historical fuel/heat consumption with the fuel/heat benchmark. This means that any reduction in consumption is

automatically treated as a decrease in activity levels, and translated in a decrease in the amount of free allocation received.

This means that consumption reductions thanks to efficiency gains will also lead to lower levels of free allocation, even if actual production does not decrease. Likewise, installations that become less efficient (consume more) would receive additional free allocation. For installations with product benchmarks, a comparable efficiency gain or loss does not result in free allocation changes.

This creates both perverse incentives and discourages investments in efficiency improvements. The implementing act should take this issue into account.

6. Do you see a need for further safeguards to prevent manipulation or abuse of the system?

As a general comment, ERCST wants to highlight that operators should not make decisions on production volumes based on the rules of the EU ETS. Unfortunately, the use of minimum thresholds, both relative or absolute, to determine whether or not adjustments to free allocation should take place always has the potential to create such perverse incentives.

If, as implied by question 2 above, an absolute minimum threshold might be considered, this would contribute to the risk for perverse incentives that already exists due to the use of the 15% relative threshold.

However, by considering an absolute threshold, that would trigger an adjustment regardless whether the relative threshold has been reached, this risk could be decreased.