

**INOVYN response to the public consultation on the draft “Guidelines on certain State Aid measures in the context of the system for greenhouse gas emission allowance trading post 2021” – the draft guidelines.**

**Reference HT.582**

**Introduction**

INOVYN welcomes the European Commission’s public consultation on the draft guidelines regarding the compensation of indirect costs of the EU ETS for the period 2021-2030

Directive 2003/87/EC established a system for greenhouse gas emissions allowance trading within the Union, in order to promote reductions of greenhouse gas emissions in a cost-effective and economically efficient manner. According to Article 10a(6) of the ETS Directive 2018/410, significant indirect ETS costs should be compensated by Member States in order to prevent the risk of carbon leakage.

As a highly electro-intensive industrial consumer, the CO<sub>2</sub> emissions costs passed on in electricity prices severely impact the competitiveness of INOVYN, thus increasing the risk of carbon leakage and exposing Europe to an increase of imported products manufactured with a higher carbon intensity.

During EU ETS Phase III, Guidelines were put in place that allowed, but did not oblige, Member States to provide partial compensation against the additional costs of indirect emissions thus helping industrial consumers to maintain a competitive position. The published draft guidelines propose a number of key changes which significantly lower the level of compensation that may be provided. It is essential, in our view, that the provisions should not be weakened in Phase IV as the competitiveness threats we face today remain exactly as they did ahead of Phase III. Our views and recommendations are summarised below. We subsequently provide more detailed views on these points:

- We acknowledge the Guidelines propose that Member States now **should** provide financial compensation. We believe there should be an **obligation** on Member States to do this otherwise there is risk of continuing distortions within the internal market
- We acknowledge the equal treatment of “***sources of electricity supply***” (para 14 (10)) apparently bringing clarification to the treatment of electricity supplied, for example under renewable PPAs
- **All electro-intensive sectors exposed to a high risk of carbon leakage** (direct + indirect) and/or whose transition towards a low carbon model involves high level of electrification should be eligible to compensation. This includes **all** sectors that were eligible during EU ETS phase III
- **The emission factors should continue to be set at regional level:** compensation should reflect the actual cost of the EU ETS passed on in electricity market prices, without creating distortions of competition between Member States. In particular we note the Compass Lexecon study on behalf of UNIDEN justifying that France should remain part of the CWE Region and we provide clear supporting evidence to demonstrate that Norway should remain part of the Nordic region to properly capture the CO<sub>2</sub> impact on electricity price in these countries
- Although the **proposals maintain the aid intensity at the same level** as at the end of the current phase, this only provides for compensation of 75% of costs. We believe aid intensity should be allowed up to 100% of costs. Inclusion of the ability to limit exposure to a function of Gross Value Added is welcomed
- **Efficiency benchmarks for the chlor-alkali sector should be maintained at current levels** as Best Available Technology has not changed since they were established for Phase III
- We **welcome the proposal to move to provision of compensation** based on actual production
- As in Phase III, the conditions for receiving compensation **should not include** any requirement for energy audits and/or management systems.

## Provision of State Aid

We acknowledge that the proposals now state that Member States **should** provide financial compensation to exposed sectors, which is slightly strengthened from the current guidelines. However, this still does not **require** Member States to provide any or all compensation allowed.

In Phase III a number of Member States have chosen not to, or only partially to, provide compensation. This has created internal market distortions and without an obligation on Member States this will continue into Phase IV.

We also note (para 31) that Member States would have the ability to limit the amount of aid to specific sectors. This additional provision further increases the risk of internal market distortions as operators in different countries are compensated at different levels.

## Equal treatment of sources of electricity

We welcome the inclusion of “equal treatment of all sources of electricity” within the definition of CO2 emission factor (para 14(10)). We assume that this is also intended to include, in addition to those sources quoted, renewables PPAs. Explicit inclusion of these would be helpful in further developing the nascent market for renewable PPAs.

## Eligibility

All electro-intensive sectors exposed to a high risk of carbon leakage (direct + indirect) and/or whose transition towards a low carbon model involves high level of electrification should be eligible to compensation. This includes all sectors that were eligible during EU ETS Phase III.

INOVYN operates processes manufacturing products covered by NACE Codes 20.13, 20.14 and 20.16. We welcome that NACE Code 20.13 is included in ANNEX 1 however we are concerned that 20.14 and 20.16 products are no longer included (although they were included in Phase III).

The products we manufacture covered by codes 20.14 and 20.16 are also highly electro-intensive. Our manufacturing processes are part of highly integrated and dependent supply chains. Loss of any link in the chain seriously impacts the whole chain so it is vital that these NACE Codes are also included within ANNEX 1.

**In addition to the risk of carbon leakage, exclusion of these sectors sends a very negative signal to the promotion of electrification of our processes.** In the case of our Norwegian operations, we consume ethylene from an “ethylene cracker” (operated by a sister company) which is already more highly electrified than is typical across the European cracker fleet. It is entirely illogical that this operation would be eligible for less compensation than an equivalent cracker making direct CO2 emissions through the combustion of hydrocarbons.

It is essential (and logical) that indirect compensation is provided for the same NACE codes that are on the current list and are entitled to free allocation of EU ETS certificates. At the very least, all sectors on the current list should have the opportunity to undergo qualitative assessment.

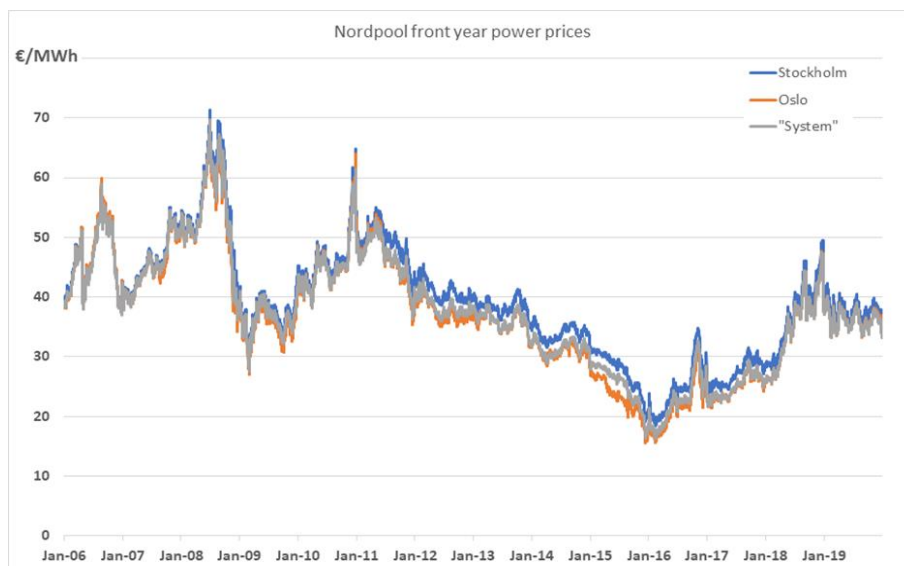
For the reasons above, we recommend that the list of sectors in ANNEX 1 is expanded to include NACE Codes 20.14 and 20.16 as was the case in Phase III.

## Emission Factors should continue to be set at regional level

Emission factors should continue to be set at regional level such that compensation reflects the actual cost of the EU ETS passed on in electricity market prices, without creating distortions of competition between Member States. While it is likely that the mix of no and low CO<sub>2</sub> generation has increased in the generation across Europe, this does **not** proportionately reduce the embedded cost of carbon in market prices. This must be recognised and properly assessed in the development of updated Carbon Emissions Factors which have not been set down in ANNEX III.

We can see no logic to the proposed changes being made to the zones identified in Annex III. Europe is pushing for greater electricity market integration through increased physical interconnection (for example through Projects of Common Interest). It is very apparent this is happening and that markets are converging – France, Germany and Belgium are now coupled formally through the Flow Based Market Coupling mechanism. Recognising this, we would expect an expansion of zones rather than disaggregation. We note two specific examples: -

- The break-up of the CWE zone is entirely illogical. We note the Compass Lexecon study on behalf of UNIDEN1 clearly justifying that France should remain part of the CWE zone. The study can be found at: -  
<https://www.fticonsulting.com/fti-intelligence/energy/research/carbon/analysis-co2-power-emission-factor-indirect-compensation-related-eu-ets>
- Norway has been omitted from the Nordic zone and indeed Norway hasn't been included on the ANNEX III list – we assume this is a mistake. It is clear that Norwegian wholesale prices are entirely correlated and near fully converged with the rest of the Nordic market. We have shown this correlation in the chart below showing examples zones in Sweden and Norway against the “Nordic System” price – which all zones trade against.



In addition, over recent years and due to interconnection, Nordic prices have been converging with prices in Germany and indeed in 2019, Norwegian prices actually traded at a premium to Germany with Norway being a net importer in 2019.

## **Aid Intensity**

Although the proposals maintain the aid intensity at the same level as at the end of the current phase and with no degressivity, this only provides for compensation of 75% of indirect costs.

However, we believe State Aid should not be cut or limited to 75% of incurred indirect costs as suggested but should be set at 100% of costs. Such under-compensation will systematically disadvantage domestic electro-intensive chlor-alkali manufacturing in Europe.

Inclusion of the ability to limit exposure to a function of Gross Value Added is welcomed.

We do recognise the developing proposals for a Border Adjustment Mechanism (BAM) – although it is very far from clear what the impact of this may be. Provision could be made that in the event of further significant developments with a BAM then indirect cost compensation could be adjusted accordingly.

## **Efficiency Benchmarks**

Efficiency benchmarks for the chlor-alkali sector should be maintained at current levels as Best Available Technology has not changed since they were established for Phase III.

We stress the reality of the Chlor-Alkali sector and its thermodynamic limits therefore meaning further improvements are limited by the Best Available Technology. It is inappropriate to apply an annual “improvement” to *efficiency* benchmarks as it wouldn’t represent a realistic achievable improvement target. The benchmark should simply be what is observed as best practice at the beginning of each half of the phase.

## **Compensation based on actual output**

We welcome the proposal to move to providing compensation based on actual production. This will provide a much more rational basis for compensation properly reflecting real costs.

## **Energy Audits and Management Systems**

As in Phase III, the conditions for receiving compensation should not include any requirement for energy audits and/or management systems.

## About INOVYN

INOVYN is the largest manufacturer in the European chlor-alkali sector with 15 production sites spread across 8 countries in Europe. It is the market leader in Europe for supplies of chlorine, caustic soda, caustic potash, vinyls, epichlorohydrin, allyl chloride and chlorinated alkanes. Some of these chemicals are used as raw materials in almost every industrial process, producing products which find use in almost every aspect of modern society - keeping people housed, healthy and connected.

With an annual turnover in excess of €3.5 billion, INOVYN has more than 4,300 employees.

INOVYN has been registered on the EU Transparency Register since July 2015 (when INOVYN was formed). Our registration number is 618735118061-79.

[www.inovyn.com](http://www.inovyn.com)

The production of chlorine and caustic soda is one of the most electro-intensive industrial processes – carried out by the electrolysis of common salt (sodium chloride). This transformation produces foundation chemicals which are the building blocks for the downstream products that we produce and indeed for the wider chemical industry.

Electricity is a **raw material** in the process with minimum consumption which is determined by the laws of thermodynamics. Electricity typically represents 60% of the variable cost of production. As the major production cost, efficiency of electricity use and electricity price are critical for maintaining competitiveness.

The chlor-alkali sector in Europe has collectively invested over €3 billion implementing the 'cleanest', most energy efficient technology (INOVYN alone has invested more than €1 billion), but the reduced total capacity combined with advantageous electricity prices in competitor regions, such as the US, is leading to increased imports of caustic soda into Europe – so carbon leakage for our sector is already a reality. Similarly, increased European production costs for chlorine and chlorine derivative products, such as vinyl, is already leading to a significant increase in vinyl imports into Europe. In fact, European vinyl production volumes are still well below the pre-recession peak in 2007. It is regrettable that whilst the European chlor-alkali and vinyls sector has invested in the most energy efficient technology available (in accordance with the requirements of the Industrial Emissions Directive) we are still not able to match the production costs in rival regions owing to the significant disadvantage that we have on electricity price. In this market environment it is not possible for us to pass on the indirect emissions costs. If carbon prices increase further, and if we are not fully compensated for the increase, then European chlor-alkali producers will inevitably continue to lose market share to imports and will find it increasingly difficult to compete in world markets.