



Confederation of Industry of the Czech Republic's comments on the proposal for the revision of transitional Union-wide rules for harmonised free allocation of emission allowances in EU ETS

The Commission presented on 5 December 2023 „COMMISSION DELEGATED REGULATION (EU) .../... of XXX amending Delegated Regulation (EU) 2019/331 as regards transitional Union-wide rules for harmonised free allocation of emission allowances” (“FAR revision”).

We welcome the opportunity to comment on this proposal.

1. General comment on deletion of fuel/electricity exchangeability principle

The proposal removes the fuel/electricity exchangeability and clarifies in recital 9 that indirect costs compensation is allowed for indirect costs that are not already covered by free allocation. It is essential that this provision is fully implemented when updating the EU ETS state aid guidelines.

2. Comment on Recital (21)

We suggest following change to the text: “To provide further incentives to reduce greenhouse gas emissions a provision on conditionality of free allocation on implementation of energy efficiency improvement measures was introduced in Article 10a, third subparagraph, of Directive 2003/87/EC, which needs to be supplemented. Recommendations included in energy audit reports or certified energy management systems, referred to in Article 10a(1), third subparagraph, of that Directive, which are at company-level, ***where applicable***, require a translation to installation level. To ensure legal certainty, the competent authority should only consider those recommendations as implemented when the implementation has been completed and the verifier has confirmed the completion. In order to safeguard the incentive given by the introduction of the conditionality, an installation should be granted the possibility to recover the reduced free allocation after having implemented the recommended measures as part of the annual activity level report and after the implementation of the recommended measures has been verified. An annual cycle for reviewing the conditionality of non-compliant installations that follows the reporting of the annual activity levels should be established. Operators of non-compliant installations facing the 20 % reduction of free allocation should provide verified evidence to the competent authority on the implementation of all recommended measures to ensure recovery of free allocation reduced due to conditionality.”

Justification:

It is important to underline that within the EnMS system (according to ISO 50 001), some recommendations or requirements might be set at the company level only (e.g. changes in the central documentation of the company). Therefore, those cannot be implemented to installation level. For this reason, the text should clarify that in such a case it is not necessary to translate all recommendations of the EnMS at the installation level.

In general, the text of the recital should distinguish further the different approaches of implementing recommendations from the energy audits and from EnMS.

3. Comment on Article 15 (the historical activity level)

Article 15 should be amended to avoid that unrepresentative production volumes due to covid and/or energy crisis are taken into account in the free allocation calculation, for instance by allowing operators to exclude two years from the 5-year baseline period 2019-2023 and using then the average of 3 years.

Justification:

The European industry has been facing in the latest years unprecedented and unforeseeable “force majeure” situations linked firstly to the covid pandemic and secondly to the ongoing energy crisis. According to the existing rules, this situation is affecting already the 2021-2025 sub-trading period as a result of the 2-year rolling average adjustments.

If no modification is introduced to the Free Allocation Regulation, such unprecedented crises would also unduly penalise companies in the 2026-2030 sub-trading period, when free allocation would be based on the median production volumes of the period 2019-2023.

4. Comment on Article 22a Conditionality of free allocation on implementation of energy efficiency improvement measures

FAR document should set less strict requirements towards the meeting of Article 10a(1) conditionality for derogation from the reduction of free allocation by 20%.

Justification:

In our opinion the strict requirement to cut expected allocation by 20% if not all of the energy audit recommendations are implemented is excessive and goes beyond what is needed to ensure the smooth implementation of the recommendations following from energy audits. In our opinion the 20% threshold following from the Article 10a(1) of the EU ETS Directive should be read as the maximum range of free allocation to be reduced if not all recommendations from audit will be met. The current wording of the draft FAR regulation leaves no flexibility with this respect and requires an absolute 20% reduction even if only one of the recommendations following from the energy audit is not fully implemented. This might mean severe economic loss, which could be disproportional to the cost of unimplemented recommendation. The better way of implementing the Article 10a(1) of the EU ETS Directive is to introduce a mechanism, which would reduce the free allocation proportionally to the cost of unimplemented energy audit recommendations – thus reducing the free allocation in proportion – one euro of the value of support measured on the basis of the average EUAs price reduced by one euro of the cost of unimplemented recommendations. This mechanism will incentivize operators to implement energy audit recommendations without too extensively punishing them for e.g. delays in implementing investments recommended by auditors.

Confederation of Industry would also like to point out that the operators of installations should be able to demonstrate realistic costs of implementing the recommendations based on their own and most current evaluations. When submitting applications for the free allocation of emission allowances for the period of 2026-2030, the recommendations issued so far will apply, in some cases even from 2021. In these

recommendations, the costs of individual recommendations were often underestimated due to ongoing inflation and overall energy crisis.

5. Comment on Article 22a (1), point d)

We suggest following changes to the text:

“d) the recommendations would not lead to energy savings within the system boundaries of the industrial process carried out at the installation **or the recommendations in its nature cannot be implemented at the installation level;**”

Justification:

In relation to the justification of the recital 21, we are of the opinion that FAR document should elaborate in more details different approaches with regard to implementation of recommendations as set in energy audits and EnMS systems (according to ISO 50 001). The text of this article should therefore also ensure that conditionality for reduction of free allocation by 20% is not applied if recommendations of the EnMS are relevant for the company level only.

6. Comment on Article 22a (3) and (4) point b)

We suggest deleting the following:

~~“3. The verifier shall check as part of the verification of the baseline data report referred to in Article 4(2) whether the recommendations referred to in paragraph 1, first subparagraph, are implemented and whether the conditions set out in paragraph 1, second subparagraph, are met, where applicable.~~

~~Where relevant, the verifier shall check, as part of the verification of the annual activity level report in accordance with Article 7 of Implementing Regulation (EU) 2018/2067**, whether the recommendations referred to in paragraph 1, first subparagraph, are implemented and whether the conditions set out in paragraph 1, second subparagraph, are met, where applicable.~~

~~4. point (b) the verifier has confirmed the completion referred to in point (a) in accordance with paragraph 3.”~~

Justification:

In our opinion these provisions go beyond the wording of the Article 10a, third subparagraph of the Directive 2003/87/EC, which does not specify at all that recommendations of the audit report or of the certified energy management system has to checked by the verifiers. For this reason those provisions should be deleted.

7. In Article 22b (3), 1st subparagraph, point b):

We suggest following changes to the text:

„(b) the installation or district heating company invested a volume at least equivalent to the economic value of the additional number of free allowances for the period from 2026 to 2030, in accordance with the intermediate targets and milestones as set out in the climate-neutrality plan to measure, by 31 December 2025 and by 31 December of each fifth year thereafter, progress made towards reaching climate-neutrality,

all investments implemented or subsidised from 1 January 2021 are eligible under this point. Furthermore, any investments contributing to CO2 savings in a given installation initiated in 2021 or later and fully financed or co-financed from revenues stemming out of the Directive 2003/87/EC, Cohesions Funds or national funding shall be eligible and accountable for the propose of meeting the targets and milestones of the Climate Neutrality Plan.

Justification:

The installation or district heating company is implementing within climate-neutrality plan overall strategical investments leading towards climate neutrality objective by 2050 (in accordance with Article 2(1) Regulation (EU) 2021/1119). Additional free allocation for district heating installations under Article 10b(4) of the Directive represents only a part of these overall expenditures to reaching climate neutrality objectives. Thus all investments implemented leading to the ultimate goal irrelevant of their nature and method of financing (subsidised or not) should be eligible towards meeting this requirement. Furthermore, we would like to note that the costs of the required emission reductions from a given installation is multiply higher than the value of the additional 30pct free allocation of allowances. For the sake of transparency, it is also necessary to set the staring date for the eligibility of investments. Therefore, any investment initiated in 2021 that contributes to a given decarbonisation target, including the overall transition towards climate neutrality goal by 2050, needs to be accounted for. Without this measure, installations will not use this extra 30pct of free allocation of allowances for economic reasons.

8. In Article 22b (3), 3rd subparagraph:

We suggest following changes to the text:

„For the purposes of point (c), emission reductions are significant where the specific emissions, expressed as tonnes of CO2 per terajoules of district heating supplied, of the installation or district heating company are reduced below the average specific emissions during the relevant baseline period with an emission reduction rate equivalent to the application of the linear reduction factors referred to in Article 9 of Directive 2003/87/EC, starting from the mid-point of the relevant baseline period. **Installations, where emission reductions took place before the relevant baseline period, may use the respective emissions period, when this reduction occurred, instead of average specific emissions during the relevant baseline. The competent authority should take into account also the nature of the installation concerned and fuels used for district heating.**”

Justification:

Current setting of the definition of “significant emission reductions” take into account only emission reduction realized during the period 2021-2030. This approach disadvantages installation where early actions for emission reductions took place before the year 2021. Thus the definition of “significant emission reduction” should take into account the measures and investments put into place before the relevant baseline period in order not to disadvantage the installations where early actions were implemented.

Also, current setting of the definition does not leave the space for competent authorities to take into account the nature of the production of heat in district heating installation and fuels used for the heat production. The way how the heat is produced (for example utilisation of emergency fuels during the energy crisis and different production regimes which could have different emissions as standard fuels) or abatement potential of various fuels (difference in emission reduction potential for natural gas fired installation and coal fired installation) need to be taken into account by competent authority to define significant emission reductions.

9. Article 22d (1):

We suggest following changes to the text:

„1. The operators shall, at periods specified in the climate-neutrality plan referred to in Article 22b and whenever necessary, evaluate the effectiveness of the climate-neutrality plan regarding greenhouse gas emissions reductions and implement corrective actions where appropriate to ensure that the milestones and targets are met. Any update shall only affect **current and** future milestones and targets.”

Justification:

Given the nature of climate and energy crisis and time frames for the administration connected to update of the climate-neutrality plans, the process of updating of climate-neutrality plans should also allow for changing current milestones and targets.

10. Article 22.e - energy efficiency conditionality

The energy efficiency conditionality should allow sufficient time for operators for implementing audits' recommendations. Consistently with the 4-year calendar of the Energy Efficiency Directive, the conditionality should allow consideration of recommendations issued by 2021.

Justification:

The Commission proposal requires installations to implement all the relevant energy efficiency recommendations issued during the first 4 years of the baseline period 2019-2023 in order to avoid the 20% free allocation penalty. Due to that, installations with energy audits issued by the end of 2022 would have very limited time to implement all the recommendations. In order to avoid such situation, the proposed rule should apply.

11. Article 22e (1) and (2):

Furthermore, we suggest following changes to the text:

„1. Competent authorities shall publish **only information that is important for the environment and climate, such as emissions reduction targets or historical emissions, which are contained within** the climate-neutrality plan submitted pursuant to Article 22b.”

“(2) If an operator considers that the climate-neutrality plan contains commercially sensitive elements which, if disclosed, would harm its commercial interests, the operator may request the competent authority not to publish those elements. **Upon the request of the operator,** ~~Where the request is justified~~ the competent authority shall publish the climate-neutrality plan without those elements.’;”

Justification:

We are convinced that CNP will, in many cases, constitute important and very sensitive data for companies such as estimated costs related to investments as well as milestones. Therefore, Confederation of Industry believes that CNPs should publish only information that is important for the environment and climate, such as emissions reduction targets or historical emissions. Any commercially sensitive information contained in climate neutrality plans should not be published. Where relevant, this may concern also the installations' identity.

It is up to operator to identify the commercially sensitive data, which shall not be published. Therefore, upon the request of the operator, the Competent Authority shall not publish the commercial sensitive data identified in the operators' request. Limiting the scope of making plans public will further make administrative matters easier for authorities and will reduce the risk associated with different interpretations by authorities regarding the reservation of sensitive data.

12. Annex I and recital 31 - Hot metal/iron benchmark

While we understand the intention to allocate free allowances to installations using alternative steelmaking technologies according to hot metal/iron benchmark, such **proposed merge (which in practice means allocation/benchmark set by those technologies in several years) should only be made once it is evident that such technologies work at industrial scale and once they are widely applicable across the EU.** Utilization of such alternative technologies is dependent on many conditions, such as hydrogen or gas availability, which are not in hands of operators.

13. Annex I and recital 34 - EAF carbon and high alloy steel benchmarks

The draft text proposes to modify the definition of the EAF steel benchmarks as a result of the new hot metal benchmark definition in order to avoid the potential risk of double counting. Yet, **such modification of the EAF benchmark is redundant** since other provisions of the regulation (article 10.5.b and article 16.7) already address and oblige to avoid the risk of double counting.

The rationale of the modification of the EAF steel benchmarks provided in recital 34 is based on the possible risk of double counting and double allocation. It is evident that such risk exists only for DRI (directly reduced iron) or HBI (hot briquetted iron) that are subject to the EU ETS. Therefore, it is **important that the recital fully clarifies that such rules do not concern DRI or HBI imported from third countries.**

The modification of the EAF steel benchmarks entails that EAF operators without own DRI production using EU produced would lack free allowances for the use of such input. **A solution for that situation is necessary.**

14. Annex I FAR - Sinter benchmark: merger with pellets

There should be no merger of sinter benchmark with pellets as it is not justified from legal, environmental and economic viewpoints.

Justification:

As explained below and pursuant to a legal opinion by the law firm Luther (attached), the extension of the sinter benchmark to pellets is not justified from legal, environmental and economic viewpoints.

The different characteristics and purposes of sinter and pellets were highlighted in 2009 by the consultants advising DG CLIMA on benchmarks definition. For instance, they stated that sinter and pellets *“differ, however, in raw material input, production technology and product characteristics”* and they added that *“due to the function the sinter process has at integrated iron and steel plants to recycle iron containing solid waste, we recommend to treat sinter and pellet production separately within our work”*. The Commission followed the consultants' recommendations and included only sinter plants in the benchmark.

In the court case C-80/16, the European Court of Justice rejected the inclusion of pellets in the sinter benchmark during the 2013-2030 trading period, stating that *“it is apparent from the case file before the Court and the arguments put forward at the hearing that pellets and sintered ore cannot generally be substituted for one another and are not, therefore covered by the same product benchmark. Indeed, pellets and sintered ore are different not only in their product characteristics but also in their composition”*. This ruling was confirmed also in the case T-244/21, when the Court confirmed the distinction between sinter and pellets also for the trading period 2021-2025.

The inclusion of pellets in the sinter benchmark is not justified either by the revised ETS Directive, which foresees the modification of benchmarks for two key reasons, notably: further incentives for emissions reductions or circular use potential.

Firstly, the inclusion of pellets into the sinter benchmark would not be consistent with the objective of providing further incentives for emissions reductions. Sinter and pellets plants have a very different purpose (see next bullet). These purposes of sinter plants cannot be achieved by pellet plants. Hence, even if pellets were to be included in the sinter benchmark, this would not be an incentive for reducing emissions of sinter plants (e.g. by switching from sinter plants to pellet plants), since the activities of sinter plants would still be required to fulfil such purposes. Furthermore, it should be noted that pellets capacity in Europe is concentrated in a single member state and is limited by availability of iron ore mining (around 25 million tonnes per year), while the consumption of sinter in the steel industry is far higher (around 85 million tonnes per year). Finally, it should be stressed and clarified that the incentive to promote new steelmaking technologies is beyond the scope of this benchmark since it is already covered by the relevant revised hot metal benchmark.

With regards circular use potential, pellets do not have the sinter’s ability to support and promote the circular economy in the steel industry, as required by the recently amended EU ETS Directive. While pellet plants are mainly designed to simply agglomerate iron ore, sinter plants contribute also to recycling dust and waste materials. Alternative solutions for such recycling purposes like briquetting are not feasible, especially under the available timeline (i.e. financial constraints and timeline of permitting/investment implementation do not make it viable before the start of the new benchmark rules in 2026).

The merger of sinter and pellets in the same benchmark is unjustified also from an economic perspective. According to publicly available information¹ dated 2022, *“the EU ETS does not directly harm LKAB’s business as LKAB currently receives a free allocation of allowances that cover 100% of their emissions”*.

According to such information pellet installations emit around 30 kg CO₂/t of pellets. With the merger of sinter and pellets, the new benchmark value would be 85.5 kg CO₂/t. Hence, the pellet installations would receive overallocation for around 55 kg CO₂/t (before the application of the CBAM factor). Assuming a production capacity of around 25 Mt and a carbon price of 100€/t, this would result in undue windfall profits of up to more than 135 M€ in the period 2026-2030 without any environmental incentive, since de facto there is no realistic opportunity to increase pellet production in the EU significantly in those years. In the same period, integrated steel sites would face additional costs for their sinter installations of around €3 billion (before the application of the CBAM factor).

This undue disadvantage for sinter would in the next step lead to increasing pellet costs in Europe as well – and by this to further windfall profits for EU pellet producers – because in the EU imported pellets are under the scope of the CBAM-system, thus leading to higher prices for all pellets.

¹ diva-portal.org/smash/get/diva2:1697130/FULLTEXT01.pdf

Considering that the European pellet capacity is concentrated in a single member state and is insufficient to cover domestic demand (as mentioned above, EU supply is around 25 Mt/year vs. demand is around 85 Mt/year), this would create more pressure for import dependency, thus undermining also the objectives of the open strategy autonomy.

15. Annex I and article 10.5.j - Sinter benchmark: products returned in the production process

The additional sentence *“agglomerated iron ore returned to the production process is not to be considered as part of the product”* should not be retained in the final text.

Justification:

The proposal modifies the definition of the sinter benchmark, adding that *“agglomerated iron ore returned to the production process is not to be considered as part of the product”*. This addition creates an inconsistency in the definition of the production volumes that were used to calculate the benchmark values and the new production volumes to calculate the free allocation rules. In fact, the original rulebook on the sinter benchmark stated that: *“reference product is merchant sinter sent to blast furnace as leaving the sinterplant. In case a significant screening operation is carried out at the BF, this volume may be corrected to take account of the screening ratio after the bunkers”*.

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EU ETS post 2026: Definition and system boundaries of the sinter benchmark

The EU's Emissions Trading Scheme (EU ETS) requires Member States to allocate free emission allowances on the basis of union-wide and harmonised rules adopted by the European Commission. For the trading period post 2025, benchmarks will have to be updated. We have been asked by Eurofer – The European Steel Association to analyse whether the European Commission is entitled, under the EU ETS Directive 2003/87/EC, as recently amended by Directive (EU) 2023/959, to enlarge the given sinter benchmark's scope so to cover pellets made from iron ore.

Executive summary

The Commission is empowered by Article 10a of Directive 2003/87/EG to determine the benchmark values and further rules for the free allocation of allowances. The European Court of Justice has granted the Commission a broad discretion in setting up these rules but the Commission has to observe to the legal limits for delegated acts under EU law. So far, both the Commission's independent technical advisers as well as the European Court of Justice have been explicitly in favour of limiting the sinter benchmark to sintered ore only, stressing that sinter and pellets were different products, especially due to significant differences in the composition and the specific characteristic of the sinter process to recycle iron containing solid waste and to deliver the necessary flux materials into the blast furnaces. As it is required by Article 10a para. 1 subpara. 3 of the EU ETS Directive to calculate benchmarks for products rather than for inputs, it would be contrary to this provision to treat sinter and pellets equal and to determine a benchmark that comprises both products only because of iron ore as their common input material. Pellets do not have the sinter's ability to support and promote the circular economy in the steel industry, as required by the recently amended EU ETS Directive. While pellet plants are mainly designed to simply agglomerate iron ore, sinter plants are much more sophisticated, trying to make best use of waste material so to close recycling loops and avoid landfilling. Hence, even if pellets were to be included

in the sinter benchmark, this would not be an incentive for reducing emissions of sinter plants (e.g., by switching from sinter plants to pellet plants), since the activities of sinter plants would still be required to fulfil such purposes. Finally, putting additional costs on the sinter production (around 3 billion euros in the period 2026-2030, according to the industry) and to allow pellet producers to gain windfall profits from an inclusion in the sinter benchmark would also not be consistent with the Directive (EU) 2023/559's explicit acknowledgment of the particular situation of the steel industry such as the high emission intensity and the international and Union market structure. There is therefore a reasonable case for a specific sinter benchmark, covering sintered ore only.

1. Technical background: Sinter and pellets

Iron ore sinter is a product which is used in blast furnaces to produce hot metal.¹ Sinter plants are a typical component of integrated iron and steel works for the production of hot metal and steel. In the sinter making process, iron ore, which cannot be used directly in the blast furnace process due to its fine-grained nature, is processed or baked into agglomerated ore lumps. For this purpose, fine ore, fuel (coke) and fluxes and additives (e.g. lime) required for the hot metal melt as well as iron containing recycling materials are piled up on a sintering belt, ignited and baked together into agglomerated lumps by fusing the uppermost layers at approx. 1,300-1,500 °C. This leads, as some chemical reduction of the iron ore takes place, to process-related CO₂ emissions. Such emissions also arise from the use of lime. The sinter is then mixed with coke, pellets and other additives in the blast furnace area to form the so-called burden and fed into the blast furnace process. The sinter making process is characterised by the use of recycled materials from the blast furnace and other parts of the iron and steel works. For example, ferrous residues from the residual gas dust from the blast furnace after gas scrubbing as well as sludges and ferrous material are reused. Sinter plants are therefore an integral part of iron or steel works, as they close recycling loops and avoid landfilling.

Pellets are small balls made from very fine iron ore, some of which is also derived from residues from ore processing and transport. This fine ore and some additives are formed into pellets of about 10 to 15 mm in diameter using high temperature.² For this purpose, the fine ore is moistened and a binding agent is added. This mixture is then rolled into pellets in rotary drums or on rotary plates. Then those pellets are dried and fired at temperatures of approx. 1,000-1,300 °C without chemical reduction processes or process-related emissions. This is one of the reasons for the lower emissions intensity of the pellet production. In contrast to the sinter making process, the pellet production process does not use ferrous recycling material from the iron and steel works or fluxes and additives such as lime that are needed for iron smelting. Pellets cannot be fed into most of the European blast furnaces as the sole iron ore carrier, but only together with other aggregates

¹ More information on sinter and sinter plants is provided by the European Commission's Best Available Techniques (BAT) Reference Document for Iron and Steel Production, 2013, p. 89-180.

² More information on pellets and pellet plants is provided by the European Commission's Best Available Techniques (BAT) Reference Document for Iron and Steel Production, 2013, p. 181-203.

and iron ore sinter as mixed components of the burden. Iron ore sinter cannot therefore be replaced by pellets *per se*, partly because of their different structure and behaviour in the blast furnace. Moreover, pelletisation plants are unsuitable for the production of iron ore sinter, as the two products are fundamentally different and their production requires different technical processes.

2. EU law provisions for the determination of product benchmarks

The principles for the determination of the product benchmarks are laid down in Article 10a of Directive 2003/87/EC (EU ETS Directive), as recently amended by Directive (EU) 2023/959. Article 10a para. 1 of the Directive empowers the Commission in accordance with Article 290 TFEU (delegated acts) to adopt Union-wide and fully harmonised rules for the free allocation of allowances.³ According to Article 10a para. 1 subpara. 3 of the Directive,

“the benchmarks shall be calculated for products rather than for inputs, in order to maximise greenhouse gas emission reductions and energy efficiency savings throughout each production process of the sector or the subsector concerned. In order to provide further incentives for reducing greenhouse gas emissions and improving energy efficiency and to ensure a level playing field for installations using new technologies that partly reduce or fully eliminate greenhouse gas emissions, and installations using existing technologies, the determined Union-wide ex-ante benchmarks shall be reviewed in relation to their application in the period from 2026 to 2030, with a view to potentially modifying the definitions and system boundaries of existing product benchmarks, considering as guiding principles the circular use-potential of materials and that the benchmarks should be independent of the feedstock and the type of production process, where the production processes have the same purpose.”

Also, Article 10a para. 2 subpara. 1 of the Directive requires the Commission to use the average performance of the 10 % most efficient installations in a sector or subsector in the Community as the starting point in defining the principles for setting the benchmarks.

For the period from 2026 to 2030, the benchmark values shall be determined on the basis of information submitted for the years 2021 and 2022 and on the basis of applying the annual reduction rate in respect of each year between 2008 and 2028 (Article 10a para. 2 subpara. 3 third point (c) of the EU ETS Directive). There is an exemption from this rule for the steel sector stipulated in Article 10 para. 2 subpara. 3 point (e) according to which the annual reduction rate for the product benchmark for hot metal shall not be affected by the change of benchmark definitions and system boundaries applicable pursuant to Article 10a para. 1 subpara. 8 of the Directive. That exemption is justified, according to recital (49) of Directive (EU) 2023/959, *inter alia* by the consideration to incentivise new breakthrough technologies in the steel industry and in light of the particular situation of the steel industry such as the high emission intensity and the international and Union market structure.

³ ECJ, judgment of 8 September 2016, case C-180/15, *Borealis*, ECLI:EU:C:2016:647, para. 60.

The Commission's power to adopt the union-wide rules for the free allocation has been subject to various rulings by the European Court of Justice (ECJ). The ECJ accepts, as a starting point of its settled case-law, that the Commission has broad discretion in determining the benchmarks in individual sectors or subsectors. The Court argues that determining benchmarks entailed choices and complex technical and economic assessments. Therefore, the legality of a measure adopted in that area could be affected only if the measure is manifestly inappropriate.⁴

Accepting the Commission's broad discretion does not mean that there is no legal review of the benchmarks and further rules for the free allocation possible. The ECJ has explicitly acknowledged that the Commission, when adopting acts on the rules for the free allocation, is obliged to respect the legal framework established by Directive 2003/87/EC. The court has also stressed in this context that it is necessary to interpret the provisions of the Commission's rules for the allocation of allowances in the light of the requirements arising from the EU ETS Directive.⁵ As the ECJ held in case C-696/15 P (*Czech Republic*), the Commission, when exercising delegated powers, has to respect the bounds the legislature has itself fixed in the basic act.⁶

3. Sinter benchmark and current benchmark review process

Since 2013, the free emission allowances for sinter plants have been allocated based on a product benchmark for sintered ore. The product covered by this benchmark is defined by Annex I of Commission Delegated Regulation (EU) 2019/331 (FAR) as follows:

“Agglomerated iron-bearing product containing iron ore fines, fluxes and iron-containing recycling materials with the chemical and physical properties such as the level of basicity, mechanical strength and permeability required to deliver iron and necessary flux materials into iron ore reduction processes. Expressed in tonnes of sintered ore as leaving the sinter plant.”

The system boundaries (processes and emissions covered) of that benchmark are defined by Annex I FAR as

“all processes directly or indirectly linked to the process units sinter strand, ignition, feedstock preparation units, hot screening unit, sinter cooling unit, cold screening unit and steam generation unit are included.”

Both the product definition and the system boundaries of the sinter benchmark are closely aligned with the technical characteristics of sinter and sinter plants as described in the European Commission's Best Available Techniques (BAT) Reference Document for Iron and Steel Production.

⁴ ECJ, judgment of 8 September 2016, case C-180/15, *Borealis*, ECLI:EU:C:2016:647, para. 45; judgment of 26 October 2016, case C-506/14, *Yara Suomi*, ECLI:EU:C:2016:799, para. 37; judgment of 26 July 2017, case C-80/16, *ArcelorMittal Atlantique et Lorraine*, ECLI:EU:C:2017:588, para. 31.

⁵ ECJ, judgment of 17 May 2018, case C-229/17, *Evonik Degussa*, ECLI:EU:C:2018:323, para. 29.

⁶ ECJ, judgment of 26 July 2017, case C-696/15 P, *Czech Republic*, ECLI:EU:C:2017:595, para. 51.

They explicitly take into account the special characteristic of sinter plants to use fluxes and iron-containing recycling materials.

The European Commission's Climate Change Expert Group (CCEG) is currently in the process of reviewing and updating the benchmarks in relation to their application in the period from 2026 to 2030. One of the product benchmarks for which an update of either the product definition or system boundaries might be considered is the benchmark for sintered ore (sinter benchmark). It is said that sinter was a type of agglomerated iron ore that was used as input in steelmaking. The agglomeration was needed to ensure good process conditions in the blast furnace. Sinter and pellets were different to some degree in their composition, particle shape and particle size but pellets were an alternative type of agglomerated iron ore that could also be used as input material in blast furnaces. Sinter was thus a product that could be substituted by pellets. Some members of the CCEG therefore argue that the sinter benchmark's scope could be enlarged so to cover other types of iron ore agglomerates like pellets. So far, there is no product benchmark for pellets and free allowances have been allocated to pelletising plants on the basis of the fallback approach.

4. Legal analysis

From a legal point of view, the current product definition and system boundaries of the sinter benchmark fit well with the specific characteristics of sinter. The existing benchmark definition takes into account the special feature of sinter to recycle residual substances from the iron and steel works and to deliver not only iron but also the necessary flux materials into the iron ore reduction processes of blast furnaces. Pellets do not have those features, thus leaving them without a corresponding justification for their inclusion into the sinter benchmark.

The given benchmark definition is not an invention by the steel industry but based on a recommendation from the Commission's technical advisors, an industry-independent consortium made of Ecofys, Fraunhofer and Öko-Institut. Those advisors stated that a common benchmark for sinter and pellets could not be applied as composition and product characteristics of pellets differ significantly from sinter.⁷ The consortium highlighted that sinter had a higher emission intensity than pellets but should be treated separately from pellets due to the function of the sinter process to recycle iron containing solid waste.⁸

Those considerations were explicitly supported by the European Court of Justice (ECJ) in case *ArcelorMittal Atlantique et Lorraine*: In its ruling of 26 July 2017, the court held that pellets and sintered ore were not direct substitutes. They were not covered by the same product benchmark

⁷ Ecofys et al, Methodology for the free allocation of emission allowances in the EU ETS post 2012, sector report for the iron and steel industry, 2009, p. 10.

⁸ Ecofys et al, Methodology for the free allocation of emission allowances in the EU ETS post 2012, sector report for the iron ore industry, 2009, p. 6.

because the composition and product characteristics of pellets were different.⁹ In preparation of that ruling, the *Advocate General* had emphasised that those differences between sinter and pellets were significant.¹⁰

The current view of some members of the CCEG, sinter was a product that could be substituted by pellets, is therefore remarkably at odds with the existing ECJ case law and the 2017 ruling. Benchmarking is not a mere technical job. It is rather a complex legal task that has to be done within the statutory limits set by EU law and its interpretation by the ECJ.

Taking into account the revised EU ETS Directive's provisions for the determination of product benchmarks, there is also no specific legal justification for an inclusion of pellets into the sinter benchmark. According to the revised ETS Directive, the possible modification of benchmark boundaries and definitions should fulfil the following objectives:

- Providing further incentives for reducing greenhouse gas emissions and improving energy efficiency and
- Ensuring a level playing field for installations using new technologies that partly reduce or fully eliminate greenhouse gas emissions, and installations using existing technologies.

Firstly, the inclusion of pellets into the sinter benchmark would not be consistent with the objective of providing further incentives for emissions reductions. Sinter and pellets plants have a very different purpose: While pellet plants are mainly designed to simply agglomerate iron ore, sinter plants are much more sophisticated, trying to make best use waste material so to close recycling loops and avoid landfilling. These purposes of sinter plants cannot be achieved by pellet plants. Hence, even if pellets were to be included in the sinter benchmark, this would not be an incentive for reducing emissions of sinter plants (e.g. by switching from sinter plants to pellet plants), since the activities of sinter plants would still be required to fulfil such purposes. Consequently, the inclusion of pellets into the sinter benchmark would simply increase the unavoidable compliance costs of sinter plants without a tangible environmental incentive on sinter plants.

Secondly, the inclusion of pellets into the sinter benchmark would not be consistent with the objective of ensuring a level playing field for installations using new technologies that partly reduce or fully eliminate greenhouse gas emissions, and installations using existing technologies. This principle is relevant only in case of installations using different technologies to produce the same products. Yet, as mentioned above, sinter and pellets plants produce products which have different characteristics and different purposes.

⁹ ECJ, judgement of 26 July 2017, case C-80/16, *ArcelorMittal Atlantique et Lorraine*, ECLI:EU:C:2017:588, para. 40.

¹⁰ Advocate General, opinion delivered on 9 March 2017 in case C-80/16, *ArcelorMittal Atlantique et Lorraine*, ECLI:EU:C:2017:192, para. 65.

Furthermore, the revision should be consistent with the following guiding principles:

- The circular use-potential of materials and
- the principle that the benchmarks should be independent of the feedstock and the type of production process, where the production processes have the same purpose.

With regards the first principle, the inclusion of pellets in the sinter benchmark would especially get in conflict with the specific function of sinter to recycle iron containing solid waste from the iron and steel works and to deliver the necessary flux materials into the blast furnaces. Pellets, which are not a new or innovative product, do not have this characteristic, thus being unable to support and promote the circular economy in the steel industry, as required by the EU ETS Directive. This specific function of sinter can also compensate to a certain extent for the disadvantage of higher emissions compared to the production of pellets, also taking into consideration that some of the emissions resulting from the sinter process, especially those from reduction processes, will not be reduced when pellets are used but will only be shifted to the blast furnace process where the reduction then takes place.

With regards the second guiding principle, although pellets and sinter are both mainly made from iron-bearing materials which are being agglomerated, as explained above, they are different products with different characteristics, produced by different kinds of technical installations and for different purposes. As it is required by Article 10a para. 1 subpara. 3 of the EU ETS Directive to calculate benchmarks for products rather than for inputs, it would be contrary to this provision to treat sinter and pellets equal and to determine a benchmark that comprises both products only because of iron ore as their common input material.

In addition to the above considerations concerning Article 10a para. 1 subpara. 3 of the EU ETS Directive, one also has to take into account the consistency of an inclusion of pellets in the sinter benchmark with other provisions of the Directive. Pellet plants, which are currently receiving free allowances on the basis of the fall-back approach (especially heat and fuel benchmark), would most likely benefit from being included in the same benchmark like sinter plants with their higher emissions. It is very likely that they would be able to achieve over-allocations. Their operators would thus benefit whereas operators with sinter plants will not be able to shift their installations into pellet production due to the specific technique of sinter plants and the limits of the given blast furnaces to be fed with pellets instead of sinter. This would, according to the industry, result in significant additional costs for integrated iron and steel works of around 3 billion euros in the period 2026-2030¹¹ although the legislator has acknowledged, by way of recital (49) of Directive (EU) 2023/959, that the steel industry is in a particular situation with respect to the international and Union market structure and its current transformation process from using the coke-based blast

¹¹ The calculation takes into account that the inclusion of pellets in the benchmark curve would increase the annual reduction rate from the current 0.53% to 2.5%, assuming a carbon price of 100€/t and total sinter production of 85Mt/y.

furnace route to producing iron and steel by direct reduction and electric smelters or electric arc furnaces. That recital is a clear indication that the legislator intended to limit the financial burden imposed by the EU ETS on the steel industry. It would not be consistent with that approach to put additional costs on the sinter production and to allow pellet producers to gain windfall profits from an inclusion in the sinter benchmark.

5. Conclusion

The legal analysis demonstrates that it would not be in line with Directive 2003/87/EC to enlarge the sinter benchmark's scope so to cover other types of iron ore agglomerates like pellets. There is a reasonable case for a specific sinter benchmark covering only sintered ore, making it quite appropriate to stick with the given definitions and system boundaries set by the existing FAR (Delegated Regulation (EU) 2019/331).

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