

## **MMTA TRADE AND LOBBY COMMITTEE'S NEWSLETTER**

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### **CLIMATE CHANGE MEASURES IN THE EU: A GAME CHANGER?**

The EU is currently working on different legal initiatives in the area of climate change that – if adopted – will start having a major impact as of 2013, especially given that they are likely to partially overlap:

- Companies will have to buy “emission rights” for their greenhouse gas (“GHG”) emissions under a strengthened Emission Trading System (“EU ETS”);
- Companies will have to comply with Best Available Technology (“BAT”) or pay fines;
- Energy will be taxed on the basis of its CO<sub>2</sub> emissions and energy content.

#### **1. European Emissions Trading System**

On 1 January 2013, a revised EU ETS will enter into force.<sup>1</sup> The revised EU ETS will increase the costs of doing business for EU companies through the following main changes:

##### *Less emission allowances*

The overall cap for EU emissions will be set at 2.039 billion metric tons and will be reduced annually to achieve a 20% reduction in emissions by 2020 compared to 1990. The Commission is analyzing the option of expanding the reduction target to 30% below the levels of 1990, which would further increase the price for emission allowances as there will be less emissions allowances on the market.

##### *Extension of the EU ETS to cover new sectors and gases*

The EU ETS will cover more industrial sectors, including for example CO<sub>2</sub> emissions from the petrochemical, ammonia, aluminum and aviation sectors. It covers a broad range of activities related to the steel sector, such as roasting or sintering of metal ores, production of pig iron or steel. Similarly, the new EU ETS also covers more industrial gases such as N<sub>2</sub>O from the production of nitric, adipic and glycolic acid and perfluorocarbons from the aluminum sector.

##### *Auctioning of emission rights and transitional free allocation*

Previously, companies received their emission allowances for free. Under the revised EU ETS, however, emissions rights will be auctioned and companies will have to pay for the right to emit CO<sub>2</sub>. The EU has introduced a system of gradual auctioning: in 2013, 20% of emission rights will be auctioned; this percentage will rise to 70% by 2020 and to 100% by 2027.

In the meantime, the EU will grant allowances for free on a transitional basis. In order to determine which companies will receive free allowances, the EU is currently developing product benchmarks

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<sup>1</sup> Directive 2009/29/EC of the European Parliament and of the Council amending Directive 2003/87/EC so as to improve and extend the greenhouse gas emission allowance trading scheme of the Community, *OJ L 140, 5.6.2009, p. 63.*

based on the performance of the 10% most efficient manufacturer. This means that only the 10% most efficient producers will receive sufficient free allowances to cover all their emissions. A report commissioned by the EU suggests that, for example, the EU could set a benchmark of 0.058 ton of CO<sub>2</sub> emissions per ton of electric arc furnace crude steel produced. All emissions above this level will have to be purchased on the EU ETS.

Moreover, and importantly, as the power-generating sector will not benefit from the transitional period and will have to purchase all their emissions as of 2013, the steel industry's power costs are expected to increase significantly.

It is estimated that in a well-functioning auctioning system, the price of emission allowances will range between EUR 20 to EUR 40 per ton of CO<sub>2</sub> emitted, whereas the current price for emissions varies between EUR 1 and EUR 30. The current estimate is that paying EUR 20 per ton of CO<sub>2</sub> would increase production costs of steel producers by more than 25% of gross value added.

Additionally, as emissions auctioning will occur at Member State level, emission allowances will have different prices in different Member States. This could lead to distortion of competition in the EU market.

## 2. Energy Taxation Directive

The EU is expected to issue a proposal for the revision of the Energy Taxation Directive ("ETD") sometime mid-2011.<sup>2</sup> It is already known that the revised ETD will introduce a company tax on energy sources based on (i) their energy content and (ii) their CO<sub>2</sub> emissions.

The EU has stated that it will avoid overlaps between the ETS and ETD. Thus, companies that must buy their emission allowances on the EU ETS will only pay the tax on the energy content of the energy used, and not on its CO<sub>2</sub> emissions. However, it is very likely that companies that receive free allowances under the ETS will have to pay both the energy content and CO<sub>2</sub> components of the tax.

Thus, even the most efficient EU producers will have to pay for the emissions related to the energy sources used in the production process.

## 3. Industrial Emissions Directive

Since 6 January 2011, under the Industrial Emissions Directive ("IED"), industrial installations must implement BAT and respect emission limit values in order to be eligible for operating permits.<sup>3</sup> Installations that exceed these limits will be subject to hefty fines.

Broadly speaking, the IED applies strict limits on air pollution and lays down rules on the integrated prevention and control of pollution resulting from industrial activities. It also sets rules designed to prevent/reduce emissions into air, water and land and to prevent the generation of waste. In particular, it sets stricter limits on pollutants such as nitrogen oxides, sulphur dioxide and dust, which are responsible for acid rain and smog, and cause respiratory diseases like asthma.

The IED is especially important for the steel industry, as it encompasses the following activities:

The production and processing of metals, including metal ore roasting or sintering;

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<sup>2</sup> Council Directive 2003/96/EC restructuring the Community framework for the taxation of energy products and electricity, OJ L 283, 31.10.2003, p. 51.

<sup>3</sup> Directive 2010/75/EU of the European Parliament and of the Council of 24 November 2010 on industrial emissions (integrated pollution prevention and control), OJ L 334, 17.12.2010, p. 17.

- The production of pig iron or steel - primary or secondary fusion - including continuous casting with a capacity exceeding 2.5 tons per day;
- The processing of ferrous metals;
- The operation of ferrous metals foundries with a production capacity exceeding 20 tons per day;
- The processing of non-ferrous metals and the surface treatment of metals or plastic materials using an electrolytic or chemical process where the volume of treatments vats exceeds 30 cubic meters.

#### 4. Implications of EU climate change measures

The revision of the EU ETS, the ETD and the IED will impose significant costs on EU manufacturers, which in its turn will affect their competitiveness on the world market. Indeed, companies will either have to pay significant sums to continue emitting at their current levels, or will have to invest in costly cleaner technologies. In addition, the steel industry will face additional costs that are passed-on by their raw material and energy suppliers.

Steel producers in countries where similar climate change legislation is not imposed, however, will be able to continue operating as previously. Without a level playing field in climate change policy, non-EU steelmaking competitors will enjoy a significant competitive advantage that will affect the global market for steel.

To counteract the imbalance, the EU is examining options for leveling the playing field. One option being examined is a so-called “border tax” on imports, which would be based on the amount of CO<sub>2</sub> emitted during the production process. A number of Member States such as Belgium, France and Italy, and the Council of the European Union support such an option. Another idea is to include installations from third countries in the EU ETS. The law suits following the inclusion of the aviation sector in the EU ETS indicates however that including non EU installations may be more difficult to justify legally.

In addition, the EU has been working on introducing qualitative restrictions to Clean Development Mechanism projects (“CDM”), and is considering similar rules for Joint Implementation projects (“JI”). CDMs and JIs are flexible market-based mechanisms first established under the Kyoto Protocol aimed at encouraging investment in emission-reduction projects in developing and transitioning economies. In exchange for such investments, companies receive additional emission allowances for use in their home market .

If you have any questions about these rules or how they operate in your specific situation, please do not hesitate to contact us.

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