

## VIK-Response

# to the Draft delegated act on climate change mitigation and adaptation under the Taxonomy Regulation

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*The German association of industrial energy consumers (VIK e.V.) welcomes an opportunity to provide feedback on the Draft delegated regulation on the technical screening criteria for climate change mitigation and climate change adaptation, which is based on the empowerments set out in the ‘Taxonomy Regulation’<sup>1</sup>.*

### Outline

1. The current relevance of the proposed draft delegated regulation and its impact on future investment activities
2. Definition of the ‘do no significant harm’ principle
3. Political expectations concerning the sustainable manufacturing and the evaluation of the proposed “green shortlist of economic activities”
4. The estimation of technical screening criteria from the view of some energy-intensive manufacturers
5. The legislative implications of the national and subnational competence-sharing concerning the draft delegated act on the EU-Taxonomy

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<sup>1</sup> Regulation (EU) 2020/852 of the European Parliament and of the Council on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088

The Taxonomy Regulation provides criteria for economic activities that can be defined as environmentally sustainable and creates a common orientation framework for all players in the financial system. The main target of the Taxonomy Regulation is to limit the risk of greenwashing and market fragmentation by means of the classification system of green economic activities and investments.

Although the European Commission's intention to intensify the investments in a green economy remains important, the proposed delegated act contains several unclear assumptions and definitions. This paper concentrates on some problematic issues, which from the perspective of the German energy-intensive industry can result in unpredictable or false interpretations throughout the application and implementation of proposed delegated regulation on taxonomy.

## **1. The current relevance of the proposed draft delegated regulation and its impact on future investment activities**

The first chapter of the draft act contains a statement that the corona pandemic “has strengthened the need to redirect capital flows towards sustainable projects in order to make our societies more resilient against the climate risks”. The statement is acceptable for the future strengthening of the health system, however, the Commission's signal that the post-crisis European economy recovery should be guided by green investments seems to be highly controversial: first, the assumption is not taking into account the economic differences and status quo in the member-states; second, the intention to achieve the proposed green investment flow *in a cost-efficient way* seems to be difficult to implement under the terms of the current economic recession and rising government debts.

Apart from that, the still ongoing pandemic might have unpredictable financial consequences and will impact on the investment activities in Europe.

Additionally, several member-states are discussing the possible tax increases as part of measures to overcome the COVID-19 economic recession. Tax increases lead to the restraint in green investments since these fiscal measures have high capital costs and present new and unfamiliar risks: higher costs of innovative technologies, performance risks related to operation and maintenance as well as policy risks on a national and international level. The current European and national budget distributions are provided not as planned, therefore the foreseen subsidies will be probably available only to a limited extent. Consequently, the above-mentioned risks should be definitely addressed in the European sustainable finance regulatory framework.

Chapter 3 of the delegated regulation contains a comment concerning *the new costs* that are influenced by the Taxonomy regulation, and can be incurred “if the companies are falling under the scope of the Non-Financial Reporting Directive” [...]. In this case, companies should “collect and disclose taxonomy-relevant information on their activities”. This statement contradicts the Commission’s earlier assumption regarding the cost-efficiency of the envisaged economic transformation.

The possible benefits of the new legislation are addressed in the following statement: “environmental and social benefits are likely to arise from the increase in capital flows to environmentally sustainable activities”. However, an argumentation background for the suggestion above is not provided, as well as the definitions of “social and environmental benefits”. Besides, the legislative procedure and framework under which the EU-Taxonomy will “help guide financial markets towards a green recovery” is still unclear; in other words, the

question, what exactly should a certain company or a bank do with proposed sustainability conditions, remains open.

## **2. Definition of the ‘do no significant harm’ principle**

The draft delegated act contains a statement that the ‘do no significant harm’ (DNSH) principle should “play an essential role in ensuring the environmental integrity of the classification of environmentally sustainable activities”.

However, the proposed delegated act lacks a clear definition of the ‘do no significant harm’ criteria. That fact has already been criticised by many stakeholders in the previous consultation on the Taxonomy regulation.

Avoiding an accurate and precise definition leaves too much room for interpretation, for example in the future updated annexes. As an international legally binding definition of the “do no significant harm” principle is still not existing, it is vital to reconsider the proposed concept in order to protect companies with cross-border operations.

## **3. Political expectations concerning the sustainable manufacturing and the evaluation of the proposed “green shortlist of economic activities”**

Another critical point is the selection of only 70 economic activities<sup>2</sup> that contribute substantially to climate change mitigation and 68 economic activities that contribute substantially to climate change adaptation. In the early phase of the impact assessment, more than 1000 possible activities were recommended for technical screening criteria. The Technical expert group has selected economic activities based on their current GHG emissions, the potential emissions reductions/removal or avoidance, and a possibility of long-term

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<sup>2</sup> The information is taken from the current draft delegated regulation on the EU-Taxonomy, page 3

carbon storage. The delegated draft act focuses primarily on those economic activities which have “the greatest potential to achieve those aims”.

Nonetheless, the proposed framework overlooks the ‘enablers’ of environmental solutions and transition technologies, which can have a positive environmental impact in a long-term perspective. As the Commission is planning to apply this draft Regulation from 1 January 2022, the additional economic activities which make a substantial contribution to climate change mitigation and adaptation should be included in the current draft<sup>3</sup>.

Articles 11, 12 and 13 of the current draft delegated act address the expectations concerning manufacturing activities. In our opinion, the list of possible transitional manufacturing activities should be extended in order to involve more technologies on the way to a market-based transformation of the economy; sustainable loans and investments should be guaranteed not only for emerging technologies but also for existing ones. Therefore, until all possible activities from all economic sectors are not accurately addressed, financial market participants will have difficulties in the interpretation of the sustainable investments criteria. It is also important to provide explanations on the legal interrelations, especially concerning the state aid law.

VIK recommends avoiding the possible introduction of a “brown taxonomy” that will most likely weaken the investment flow in carbon-intensive manufacturing processes. It is essential to make clear that those economic activities which are not listed in the taxonomy will not inevitably have a negative sustainability impact. Therefore, in our view, the proposed regulation should take into consideration all economic activities and manufacturing processes on the way to climate-neutral transition.

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<sup>3</sup> In case if these economic activities have not been already addressed in the proposed annexes or in the report of the Technical expert group.

Overall, the future financial regulatory measures should primarily guarantee the functionality and stability of the financial system in Europe.

#### **4. The estimation of technical screening criteria from the view of some energy-intensive manufacturers**

From the long-term climate-policy perspective, the threshold values for gas and CHP<sup>4</sup>-power plants ( $100g\ CO_2e/kWh$ ) are not quite appropriate. Due to the coal phase-out in Germany, the operation of gas and CHP-power plants will be necessary for a transitional period. Therefore, the emissions limits should be fixed on the upper level which enables the classification of the investments in these power plants<sup>5</sup> as sustainable. Additionally, the requirements for a ‘sustainable hydrogen’ should be less stringent as proposed. At least in a transitional period, the technical screening criteria for a ‘sustainable hydrogen’, namely the proposed emission intensity  $2,256\ tCO_2e/tH_2$ , should be increased to avoid the exclusion of the relevant hydrogen technologies in the early stages.

*From the perspective of the steel industry, the proposed draft Commission delegated act narrowly focuses on only some parts of the steel production’s CO<sub>2</sub>-emissions. It does this by using the methodology of EU-ETS benchmarks for setting thresholds. However, the EU-ETS benchmarks do not consider the connections between the various production steps that constitute the steel production value chain. A significant portion of the steel industry’s emissions is not even taken into account in these benchmarks, as they are transferred to the power sector. Therefore, the proposed EU-ETS benchmarks would not be*

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<sup>4</sup> Combined heat and power stations

<sup>5</sup> Including the future operation of the mentioned power plants

correct criteria for sustainability concerning the steel industry, and in our view, would not be in line with the Regulation on Sustainable Finance Taxonomy. The alternative for the EU-ETS benchmarks would be the introduction of *EN19694-2 standard* –developed with a mandate from the EU Commission – to assess the relative performance of steel production. This standard will allow the evaluation of the combined environmental impact of the European steel industry, namely the systemic operation of steelmaking – in which single production processes are optimised and connected into a process chain in order to achieve the highest efficiency/highest performance. It is of utmost importance to introduce internationally recognised accounting rules, such as this EN standard, to avoid the global risk of miscalculating emissions.

Accordingly, the following crucial points should urgently be reflected in the delegated act:

- The introduction of the EN19694-2 standard instead of the EU-ETS benchmarks for the steel manufacturing;
- Using a more integrated lifecycle approach, taking into account that steel is an enabler for CO<sub>2</sub>-mitigation in multiple value chains;
- Acknowledging as a screening criteria the mitigation measures incorporated into an investment plan that lead the activity to meet the threshold.

From the view of the *gypsum industry* some adjustments would be needed to better account for constructional thermal insulating systems in energy-efficient buildings. The application of lightweight construction materials such as gypsum products decreases the need for heavy building materials and enables better energy efficiency in buildings as well as gypsum use in urban renovation

programs. Therefore, gypsum-based product manufacturing should be included in subchapter 3.4. “Manufacturing of energy-efficient equipment for buildings” in Annexes 1 and II with a reference to NACE codes C23.52 and C23.62. In this sense, the following formulation for the economic activity, contributing substantially to climate change mitigation and adaptation should be included in subchapter 3.4.:

“wall and roofing elements performing the function of constructional thermal insulation and/or temperature equilibration in buildings”.

From the perspective of the *chemical industry*, the implementation of the EU-Taxonomy will require an evaluation of the entire value chains, and companies will need flexibility for incorporating the EU-Taxonomy into their business processes. The chemical and mechanical value chains require the mixing and co-processing with virgin fossil material during the transition towards a circular economy. Therefore, mixing and/or co-processing at later value chain steps should be considered as taxonomy eligible.

Concerning the circular economy, we support the taxonomy-eligible recognition of plastic recycling. However, in the material recovery from non-hazardous waste, only mechanical and separate collections are included in the activities list. Chemical recycling technologies allow the use of plastic waste as feedstock to produce new chemicals and plastics, including high-quality applications such as food contact and food packaging. Therefore, the word “partially” should be included in the screening criteria for chemical recycling, as the request that “manufacture of plastics originate from chemical recycling” is difficult to fulfill for some chemical recycling processes. Similarly, the word “partially” should also be added to plastics manufactured via mechanical recycling.

The application of the EU-ETS benchmarks is debatable since they exclude by definition 95% of the installations from the criteria and do not represent a proper methodology for debottlenecking. It is essential that the calculation of GHG-emissions only apply to new taxonomy-conform projects and not to the company as a whole.

Concerning the crackers, the benchmark is defined in ton CO<sub>2</sub>e per ton HVC. In the annexes, that HVC is limited to acetylene, ethylene, propylene and butadiene. This omits benzene and hydrogen which are part of the HVC defined in the ETS-benchmark. The principles of benchmarks are not appropriate for the debottlenecking projects (where modifications are made to existing plants to increase production while improving energy efficiency and GHG emission reduction), for example in the case of steam crackers. To be below the threshold value in the debottlenecking projects, the consideration of an alternative threshold based on the following ratio is recommended: increase in GHG emissions over an increase in capacity.

### **5.The legislative implications of the national and subnational competence-sharing concerning the present draft delegated act on the EU-Taxonomy**

Finally, it must be pointed out that the proposed delegated act on the Taxonomy enables far-reaching *industrial policy competencies* for the European Commission which the member-states delegate from the national on the European level and which are possible to amend only with a qualified majority in the European Council. It should be considered that the delegated act has a direct impact on the jurisdiction of the economic activities in the member-states and future investment flows; this circumstance may have adverse effects on some companies and stakeholders of the banking industry.

*VIK is the association of industrial energy consumers in Germany. For more than 70 years VIK represents in his role as industry-wide association the interests of companies from e.g. aluminum, chemicals, glass, paper, steel and cement. VIK advises it´s members in all energy and energy-related environmental issues.*