EEB European Environmental Bureau

CARBON MARKET WATCH

From technical update to industry handout: How EU policymakers are weakening carbon market benchmarks – and deepening fossil dependency

Updating the ETS benchmark values should be a straightforward technical exercise. However, this year the process is being twisted to retroactively hand out more freebies to industrial polluters, disregarding the reality of decarbonisation progress and undermining the EU's own strategic imperative to phase out fossil fuels.

Free allocation of emissions allowances within the Emissions Trading System (ETS) has meant that, since 2021, 97% of total EU energy intensive industrial climate pollution came at no cost. The European Court of Auditors has confirmed that free allocation hampers decarbonisation efforts. Therefore, benchmark updates, which determine the amount of free emission allowances handed out to EU industry, **must reflect the reality of the pace of industrial decarbonisation to minimise the distorting effects of free allocation** until it is fully phased out

The current update process, which sets the benchmarks for the current phase of the ETS (2026-2030), has seen a series of concessions to industry from EU policymakers, treating free allocation as a de facto subsidy and entrenching the EU's fossil dependency. This process repeats a pattern which is becoming all too familiar; **EU policymakers using "urgent" procedural exceptions to speedrun legislative processes that benefit polluting industries.**

In July the Commission proposed to **retroactively lower the maximum annual reduction rate** of fallback heat and fuel benchmarks with a clear objective to "*make full use of*" available allowances under the free allocation cap rather than recognise emission reductions that have taken place in Europe. The European Council and Parliament have since proposed to go even further, including overwriting existing conditionality rules. These concessions mean **an additional €10-13.6 billion is on the table for industry**, relative to the benchmarking methodology mandated by the previous ETS review**.**

These handouts come at a time when EU should be straining every sinew to electrify and decarbonise industry as fast as possible. In 2024 82% of emissions from stationary ETS installations were still from burning fossil fuels. At a time when Energy Commissioner Dan Jørgensen is urging Member States to reduce demand for gas, proposing such measures as limiting temperatures in public buildings, these handouts, which only serve to reward and entrench industrial fossil fuel consumption, cannot be justified. The backsliding on benchmarks also undermines the Commission's own objectives set out in the recent Electrification Action Plan, recognising that "***electrification is technically already feasible for 60% of industrial energy demand that relies on fuels*** ".

If sector-specific fallbacks are introduced to recognise the heterogeneity of fallback installations they must be developed through a transparent, independent and evidence-based process. Sectors for which decarbonisation technologies are available should not be eligible for special treatment, and **the current proposal to provide a blanket handout to industry must be rejected**.

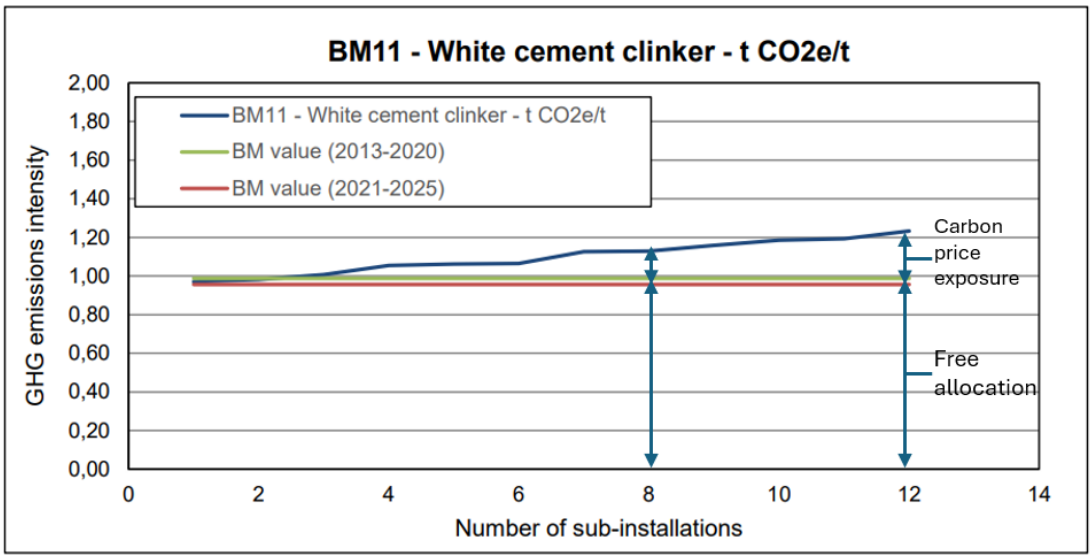
These 2026 benchmark updates have seen a technical process being exploited to become a de facto subsidy for industry. Rather than a mechanism through which free allocation can be 'maxed out', the benchmark updates should reflect the actual pace of decarbonisation, to provide a real incentive to decarbonise and reduce Europe's debilitating fossil fuel dependency.

The benchmarking exercise

The process of updating benchmark values, mandated by Article 10a of the Emissions Trading System (ETS) Directive, does not usually grab the headlines. It is, however, **an essential mathematical exercise that ensures technological progress and the need for industrial decarbonisation is reflected in carbon leakage protection measures**.

The risk of carbon leakage – industry relocating outside the EU rather than decarbonising within it – is the fig leaf for high levels of **free allocation of allowances to industry within the ETS**. The amount of free allocation handed out is determined by the average emissions of the 10% best-performing[1] installations within each benchmark. Different benchmarks cover different products and processes, such as primary aluminium or hydrogen production. However, two 'fallback' benchmarks are also in place to cover the production of heat and combustion of fuel in activities that do not fall under specific benchmarks.

This benchmarking system, much like the free allocation it determines, is far from perfect. Often, installations covered by a benchmark have similar production processes, meaning the 10% best performers have similar GHG emissions intensities to the remaining 90% of installations. This means that the vast majority of installations within a benchmark receive nearly all of their emissions for free (see figure below), creating minimal incentives to decarbonise and only incremental progress that risks falling behind global technological advancements. This risk is exacerbated by the fact that the maximum annual update rate is conservatively limited to 2.5%.



Example of incremental lowering of white cement clinker benchmark (BM11) from 2013-20 (green line) to 2021-25 (red line), and continued minimal exposure to carbon price of even the worst-performing installations

[1] In terms of greenhouse gas (GHG) emissions intensity

Therefore, as a bare minimum, **benchmark updates must reflect the reality of the pace of industrial decarbonisation** to ensure that there is an incentive for industrial installations to reduce their emissions and catch up to the best-performers. This is crucial to minimise the distorting effects of free allocation until it is fully phased out and replaced by the Carbon Border Adjustment Mechanism (CBAM).

The 2026 benchmark updates: A free allocation feeding frenzy

The current update process, which sets the benchmarks for the current phase of the ETS (2026-30), has seen **a series of concessions to industry from EU policymakers, treating free allocation as a de facto subsidy** and entrenching the EU's fossil dependency by reducing incentives to decarbonise.

In May, the European Commission presented modified benchmark methodologies to allow indirect emissions to be counted in the calculation of some benchmarks, resulting in approximately **€4 billion** more[2] in free allocation for industry. The justification for this amendment is highly questionable, given that the power sector does not receive free allocation and industry is already being compensated through indirect cost compensation (ICC).

This concession opened the door for further objections to the proposed benchmark updates. To secure Member States' approval for the benchmarks in June, the Commission conceded to retroactively revisit the 'fallback' heat and fuel benchmarks.

In July, the Commission proposed a blanket handout to industries covered by the fallback benchmarks, a move that would transfer around 80 million allowances (an additional **€6.4 billion**) directly back into the hands of industrial polluters, nullifying the carbon price signal, supporting polluting-as-usual and reducing incentives to decarbonise. To do this, in a stand-alone legislative proposal **the Commission has modified Article 10a of the ETS Directive to retroactively lower the maximum annual reduction rate for the fallback heat and fuel benchmarks**, tearing up the values in the Implementing Regulation published just weeks earlier.

The Commission's proposal reduces the maximum update rate of these fallback benchmarks from 2.5% to 2%, with a clear objective to "make full use of" available allowances under the free allocation cap rather than reflect the true pace of emission reductions and the EU's industrial decarbonisation objectives. **This handout is also effectively retroactive**, with adjustment to free allocation levels for the year 2026 achieved by artificially inflating the update rate of the benchmark values from the year 2027.

The legislative proposal to amend the benchmarks reveals **a worrying approach towards free allocation** among EU policymakers, treating it as a blunt subsidy scheme and sticking plaster for European industrial competitiveness when, as recognised by the European Court of Auditors, it actually represents a barrier to transformative investment. For example, a limit exists on the amount of free

[2] All calculations conservatively assume a carbon price of 80 EUR/EUA

allocation that can be provided before a 'cross-sectoral correction factor' is applied. It is clear that this is being treated as a target to be reached, rather than a safeguard that should be steered well clear of:

- The legislative proposal declares: "*To address concerns expressed by certain industrial sectors [...] it is appropriate to adjust the maximum annual update rate applied for the fallback benchmarks* ***by using the totality of the allowances available for free allocation***".

- A sector-specific sub-benchmark approach could have addressed legitimate concerns around the heterogeneous nature of installations covered by the fallback benchmarks, but was clearly not generous enough for Member States: "*The option for sector-specific fallbacks was presented to Member States and* ***highlighted as generating insufficient increase to free allocation levels***".

It is therefore perhaps no surprise that the **European Council** has proposed to go even further than the Commission. In September, the Council proposed to lower the update rate further to increase the handout to 88 million allowances (**€7 billion**), as well as rewriting existing conditionality rules to channel an additional 33 million allowances (another **€2.6 billion**) to industrial emitters.

The 2023 ETS reform introduced conditionality to free allocation so that failure of installations to meet energy efficiency requirements resulted in reduced free allocation. It was specified that the value of those unallocated allowances should be redirected toward the Innovation Fund and auctioning. The Council's newly proposed amendment attempts to retroactively change this by returning the value of forfeited allowances to the free allocation system[3], creating a damaging situation whereby **installations who have had had to forfeit free allocation due to not implementing basic energy audit recommendations could see these allowances come back to them without strings attached**. As if this was not enough, the Council's position also reduces future conditionality forfeits by basing them on the originally proposed, lower benchmarks, rather the more generous free allocation they would actually now receive under this update.

Timeline of developments relating to updates of the ETS benchmarks for 2026-30, which mean an additional €13.6 billion is on the table for industrial emitters

[3] By amending Article 10a, paragraph 1, subparagraph 6

Finally, the **European Parliament** has got in on the action. A breakneck urgency procedure has been followed, which did not require the publication of a report from the rapporteur. While not going as far as the Council, the Parliament is still set to propose an extra 99 million allowances (**€8 billion**) relative to the update values signed off in the Implementing Regulation in June. Relative to the originally mandated methodology, an additional **€10-13.6 billion** is set to be handed out.

Such a frenzied process retroactively changing established pieces of legislation is deeply problematic. Not only does it create a sense of policy uncertainty that freezes investments, it also does not allow proper scrutiny of the measures proposed by the Commission; measures that are set to reward those not investing in industrial decarbonisation, in spite of the availability of solutions.

Disregarding reality and electrification objectives

Proposals to relax the fallback benchmarks have cited a lack of mature technologies with which to reduce emissions. However, the lower fallback benchmark values agreed in June are based on data collected in 2021-2022. Therefore, they undeniably reflect the reality of emission reductions that have already taken place across European industry. **The Commission's proposal to artificially and retroactively inflate the benchmarks is disregarding this reality**.

Crucially, the backtracking on benchmarks undermines the Commission's own findings and recommendations in its recent **Electrification Action Plan**, which provides the following recommendations for electrification of industry:

> ***"Immediate efforts should focus on applications with the highest potential for electrification with commercially available technologies. Electrification technologies can already deliver process heat up to 400-500°C, for industries such as food and beverages, pulp and paper or textiles, using industrial heat pumps or electric boilers. Certain higher-temperature applications, and further industries like ceramics, building materials or glass manufacturing, can to a large extent be electrified through resistance heating and electric arc furnaces."***

The Commission also recognises that "***electrification is technically already feasible for 60% of industrial energy demand that relies on fuels, using in particular industrial heat pumps***", citing a 2023 study by Agora, which also shows that this percentage is set to rise to around 90% by 2035. Fallback benchmarks must be updated in line with this technological progress. The concessions on the table would both reduce incentives to invest in industrial decarbonisation at installation level and deprive the EU of auctioning revenues that are used to help fund these investments.

The current geopolitical context must also not be ignored. High energy prices and geopolitical tensions undermining the EU's sovereignty are primarily caused by a continued dependency on fossil fuel imports. At a time when Energy Commissioner Dan Jørgensen is urging Member States to reduce demand for gas, proposing such measures as limiting temperatures in public buildings, **these handouts, which only serve to reward and entrench industrial fossil fuel consumption, cannot be justified**. The EU should be straining every sinew to electrify as fast as possible, which this benchmark proposal completely undermines.

Moving to sector-specific fallbacks

While the lack of available decarbonisation solutions has been exaggerated and the update rates should not be revised, **it is right to recognise limitations of the fallback benchmarks that should be addressed in the future.** These limitations include:

- **The false "zero rating" of biomass** leading to unfair distortions regarding access to this energy source, the use of which can have a significant climate impact.

- **The heterogeneity of installations falling into the fallback benchmark values**. Some industrial processes covered by the fallback benchmarks require extremely high temperatures, while benchmarks are set by lower temperature processes for which low carbon solutions are more readily available at commercial scale.

The Commission has proposed to move to sector-specific fallbacks from 2031, while the Parliament is looking to introduce some in the current phase (2026-30). If this course of action is followed, these **sector-specific sub-benchmarks must be developed through a transparent, independent and evidence-based process and supported with clear justification.**

The benchmarking exercise must consider the availability of solutions to decarbonise their heat production and fuel consumption. **Sectors for which decarbonisation technologies are available should not be eligible for special treatment**. The emergence of alternative low carbon products and processes in the sector, and the extent to which this additional free allocation for incumbent industry will disadvantage these, must also be considered. Additionally, if sector-specific benchmarks are introduced, the fallback values should reflect the change in scope of the installations falling within these benchmarks. In other words, providing more free allocation to the sectors for which solutions are not currently mature should mean less is provided for the sectors where progress has been made and decarbonisation options are available.

A clear parallel can be seen with the handling of the **hot metal benchmark**, where intense lobbying has sought to protect the carbon-intensive blast furnace production route. Just as retroactively lowering the update rates for fallback heat and fuel benchmarks, special concessions have been granted for carbon-intensive steelmaking (e.g. pig iron production) undermining the transition toward true technological alternatives (e.g. direct reduced iron based on green hydrogen and direct electrification). It is crucial that the benchmarking exercise for sector-specific fallbacks does not end up as another opportunity to further lock-in fossil-based industrial processes.

Importantly, we are aware of further proposals to revise the benchmark rules arguing that the 10% most efficient installations may not be "*sufficiently representative*" of the sectors. **This is a dangerous move which should be rejected, as it could see first movers disregarded**, meaning benchmarks lower at an even slower pace than they already are, and the EU falling ever further behind in the clean industrial race.

Improving coordination across EU climate policy architecture

This benchmarking exercise has exposed several areas in which the Commission should seek to improve coherence between different climate instruments. The current revision of the benchmark values has again highlighted flaws with current benchmark definitions. Moving further towards a 'one product one benchmark' approach would align better with the embedded emissions approach developed for the CBAM and help to ensure a truly level playing field between European and overseas installations as CBAM is phased in and free allocation is phased out. There is also a need to **improve existing product benchmark definitions to recognise the emergence of new technologies and avoid disincentivising circular practices**. For instance, moving from a clinker to a cement benchmark is necessary to prevent low carbon technological evolutions, such as clinker alternatives and clinker recycling, from being disadvantaged.

Furthermore, the inclusion of indirect carbon emissions in benchmark calculations while industrial installations also receive indirect cost compensation (ICC) should be revisited as it will lead to double compensation of industries for the carbon cost of energy they consume, weakening the carbon price signal and undermining the functioning of the ETS. The **phasing out of ICC must be considered** by the Commission, as this would also help facilitate the inclusion of indirect emissions within the CBAM.

The benchmarking process is also highly relevant to the information exchange on best available techniques (BAT) Reference Documents pursuant to the Industrial Emissions Directive, which aims to set standards for emission reduction and prevention. The data used for derivation of EU ETS benchmarks should be made transparently available, in particular to stakeholders providing progress on pollution prevention and control standards. This approach would ensure that best performers information is used for preparing regulatory standards, thereby **driving ambition for decarbonisation of industrial activities regulated by both the EU ETS and the IED**.

Ultimately, the shortcomings exposed in this benchmark update process highlight **the urgency with which free allocation must be phased out**; by 2034 for sectors covered by CBAM and as soon as possible thereafter for other sectors. The vulnerability of the process to corporate lobbying also underlines how **making free allocation truly conditional to investment in decarbonisation in Europe** would be a no-regret move to mitigate the risk of industry free-riding on free allocation until it is phased out. This should be enacted within the current ETS review.

Playing fast and loose with legislative procedures… again

This benchmarks update process repeats a pattern which is becoming all too familiar; **EU policymakers using "urgent" procedural exceptions to speedrun legislative processes that benefit polluting industries.** These fast-tracked procedural tricks frequently ignore scientific recommendations, democratic decision-making standards and favour business input over the public interest. For example, in June 2026 the EU Ombudswoman identified procedural shortcomings in how the Commission has prepared legislative proposals, including the increasingly frequent use of urgent procedures and a selective approach to consultations. More recently in September the EEB, in conjunction with several

other NGOs, submitted another complaint alleging maladministration of the European Commission in its decision to revise the Water Framework Directive.

The process followed for the benchmarking updates echoes issues exposed in these cases. While a consultation on the Implementing Regulation establishing the original benchmark values did take place in June, the Commission stated at the time that a sector-specific fallback approach would be proposed as part of the ETS review in July. Instead, the Commission opted for a blanket and retroactive revision of the update rates. While an Ordinary Legislative Procedure has been followed for the subsequent revision, it has been conducted at breakneck speed, allowing for limited scrutiny of the proposed changes which have not been the subject of consultation and were not specifically assessed in the Impact Assessment accompanying the present ETS review. The Commission has also created a **complex legislative house of cards** with these proposed updates to fallback benchmarks depending on changes to the parent ETS directive, the negotiations around which are likely to drag on into 2027. These tweaks to existing methodologies also set a dangerous precedent, implying that any part of the present ETS review can apparently be reopened at a whim in the future which greatly reduces policy certainty for those industrialists looking to invest in decarbonisation.

The 2026 benchmark updates have seen a technical process being exploited to become a de facto subsidy for industry. Rather than a mechanism through which free allocation can be 'maxed out', the benchmark updates should reflect the actual pace of decarbonisation, to provide a real incentive to reduce industrial emissions and reduce Europe's crippling fossil fuel dependency.

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