

## Position Paper<sup>1</sup>

### F-Gas Regulation and the Issue of Illegal Import

#### INTRODUCTION

The F-Gas Regulation,<sup>2</sup> adopted in 2014, introduced new requirements in EU law to regulate fluorinated greenhouse gases. It established thresholds limiting the amount of hydrofluorocarbons (HFCs) that can be sold in the EU, with a phasing-down mechanism which aims at progressively reducing the quantity of HFCs placed on the market, and a ban on HFC use in certain equipment and products.

HFCs - used in a large variety of products and equipment including refrigeration, air conditioning, insulation foams, solvents and propellants - were introduced as replacements for ozone depleting substances, which are being phased out pursuant to international agreements. HFCs do not deplete the ozone layer but are nonetheless potent greenhouse gases, with global warming potential (GWP).

To address the high use of HFCs and their CO<sub>2</sub> emission impact, the EU has set reduction targets: by 2030, HFC consumption in the EU must be reduced by 79%. In order to ensure compliance with the phase-down, the European Commission has set up an HFC Registry enabling the traceability of quota. Registration is mandatory for all companies covered by the quota mechanism, from bulk gas importers and producers to equipment importers.

This framework is however at risk - and already undermined today - due to the **illegal import of HFCs in the EU**. This is the most pressing issue affecting the market, and it has spread to such an extent that it concerns virtually every operator active in the market:

- More than 80% of companies were aware of or suspected illegal HFC trade and 72% had seen or been offered refrigerants in illegal disposable cylinders;<sup>3</sup>
- The amount of HFCs placed on the market exceeds significantly the 2018 EU target (+16%);

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<sup>1</sup> This position paper has been prepared on behalf of EU Refrigerants and Reclamation companies.

<sup>2</sup> Regulation (EU) No 517/2014 of the European Parliament and of the Council of 16 April 2014 on fluorinated greenhouse gases and repealing Regulation (EC) No 842/2006.

<sup>3</sup> The Environmental Investigation Agency (EIA) recently published provides these data a report entitled *Doors Wide Open - Europe's flourishing illegal trade in hydrofluorocarbons (HFCs)*. The report outlines a decline in the supply of HFC products in the EU as a result of the imposition of F-Gas quotas, resulting in a substantial increase in illegal use and trade in HFCs and HFC products. The report is available at: <https://reports.eia-international.org/doorswideopen>.

- HFCs illegally imported in the EU in 2015 represented at least 10 million tons of CO<sub>2</sub> emissions;
- Since then, illegal import has increased in frequency and severity, in light of market participants' reports of illegal HFC use and trade throughout the EU.

This position paper provides an overview of the issues raised by HFC trading and import of HFCs (1.), a review of the wide-ranging consequences of illegal import of HFCs justifying this issue to be a priority for EU institutions (2.), and recommendations to address this issue (3.).

## 1. ILLEGAL IMPORT OF HFC IN THE EU: WHY AND HOW?

The issue of illegal import is difficult to tackle given the missing elements in the regulatory framework and the lack of willingness of national supervisors to intervene and impose sanctions. **Two major regulatory loopholes contribute to the problem.**

First, the legal framework as it stands today does not enable national authorities and in particular customs services to easily identify and stop illegal imports of HFCs at the borders of the European Union.

HFCs are being illegally imported, notably in illegal disposable cylinders,<sup>4</sup> and are then sold on the EU markets through various channels. Moreover, the current HFC reporting system does not allow customs authorities to determine whether or not HFC shipments at EU borders are within quota.

The current system is wholly inadequate with easy circumvention mechanisms (such as mis-declaring data to the HFC Registry). Thus, it is not possible to confirm the legitimacy of entrants and to prevent fraudulent import in excess of quota.

European customs data indicates that the increased imports come mainly from China. Illegal HFCs come into the EU directly from China via EU-border countries, in particular Russia, Ukraine, Turkey and Albania.<sup>5</sup>

Second, even if such illegal imports were identified by customs services, the sanctions foreseen under the F-Gas Regulation lack deterring effect:

- the level of sanctions is not harmonised, it varies from one Member State to another and is often far from being deterrent;
- pecuniary sanctions are typically set at a (very) low level and therefore not dissuasive: in Belgium, administrative fines of EUR 160 apply;
- sanctions imposed to date are primarily related to record-keeping infringements;
- to date, enforcement remains very limited: 600 inspections in 2017 in Poland, but only one fine issued that year; 23 investigations in 2018 in the UK, but no prosecution;

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<sup>4</sup> Disposable cylinders, banned in the EU since 2007, facilitate illegal trade since they are easy to transport and difficult to trace.

<sup>5</sup> European Environment Agency (2018). Fluorinated Greenhouse Gases 2018. EEA Report No 21/2018. Available at: <https://www.eea.europa.eu/publications/fluorinated-greenhouse-gases-2018><https://www.eea.europa.eu/publications/fluorinated-greenhouse-gases-2018>.

- last, in cases where suspected illegal refrigerant is being detected at the borders, the material is not being confiscated. Trucks are simply sent back, allowing them to do more attempts to cross the border until they eventually succeed.

In light of this, infringers face very limited risks; they simply factor penalties (if any) into their regular business costs, and the gap between risks (very low) and profit is so wide that this is an incentive to engage in illegal trading.

## 2. ILLEGAL IMPORT OF HFC: ASSESSING THE CONSEQUENCES

Illegal import of HFCs in the EU has very negative consequences: not only does it directly undermine the functioning of the regulatory framework, but it also has very negative environmental, economic and societal impacts, in the EU and on global warming.

### **The integrity of the F-Gas Regulation as a whole is at stake**

First, illegal trading has produced a false sense of security in terms of availability of HFCs. **Market operators** are supposed to meet certain phasing-down requirements from 2018 onwards, which will require them to adjust the volumes of HFCs put on the market and to equip their production with climate-friendly technologies.

However, instead of being encouraged to change their behaviour and longer-term strategy by focusing their efforts on the appropriate actions (such as switching to new technologies/equipment, purchase of weaker greenhouse gases such as naturals and hydrofluoroolefins (HFOs)), EU companies are incentivised to hold on to the previous system.

**As a consequence, the** rise in HFC illegal imports in the EU (imports of F-gases into the EU in 2017 increased by 21% compared with 2016) results into further safety hazard, and calls into question the HFC reduction target, as well as the clear CO<sub>2</sub>-equivalent reduction goals set out in the F-Gas Regulation (an important piece within the EU action plan to reduce carbon emissions in different sectors).

The continued availability of HFCs outside the HFC phase-down schedule hinders the uptake of the deployment of smart technologies as well as technical building systems with the vision of decarbonised buildings and ultimately makes the F-gas Regulation void. Such failure to convert to lower GWP alternatives due to illegal imports would eventually contribute to the collapse of the EU market.

### **Breach of international environmental agreements and EU commitments**

Illegal trade results in additional HFC emissions that accelerate global warming, thus putting the EU at risk of breaching its international environmental agreements.

The EU has committed, under the United Nations Framework Convention on Climate Change (UNFCCC), to reduce emissions of greenhouse gases by 20% by 2020 compared with 1990 levels. Under the 2016 Paris Climate Agreement, the EU is also committed to a 40% reduction in domestic emissions by 2030, compared with 1990.

However, illegal imports undermine the objectives of these international agreements to reduce emissions. Since illegal imports represent up to 30% of quota in 2018, it is obvious that the international commitments of the EU are unlikely to be met if nothing is done to change the current trajectory.

It is estimated that the use of illegal HFCs has the same greenhouse effect as adding 20 - 30 million tonnes of carbon dioxide. In other words, instead of seeing a reduction in emissions, the HFC illegal trading is the equivalent of putting another 20 million vehicles on EU roads.

Such a lack of action - and of result - may eventually engage the liability of both Member States and the EU in this regard. Previously the European Commission referred several Member States to the European Court of Justice for failure to properly comply with, and effectively enforce, EU environmental legislation, and there is also an increasing number of court cases at national level where the liability of the administration/governments is invoked on similar grounds.

### **EU industry suffers from unfair competition and environmental dumping**

Illegal trade results in additional HFC emissions that hinder the activities of legitimate businesses and discourage compliance with the F-Gas Regulation. The market as a whole is significantly disrupted, with lower price and volumes of legitimate HFCs; high volatility and unpredictable patterns for supply and demand in the coming months and years.

In order to comply with the quotas set out by the F-Gas Regulation, EU companies have significantly invested to supply refrigerants; equipment and services within the constraints set out in the Regulation; but these efforts and investments are loss making due to the unfair competition with illegal trading.

The non-compliant traders exploit a demand for cheap HFCs. The current framework allows foreign traders (notably from China) to obtain quick profits, exploiting a demand for cheap HFCs with little risk of punitive measures. This situation results in a lack of level-playing field between compliant and non-compliant operators, with a very negative impact on financial results (EBITDA) of compliant operators.

Furthermore, the illegal HFC import has impact on the whole refrigeration and air-conditioning industry and its supply chain, with ripple effects on related downstream markets at EU and global level.

### **Since polluters do not pay, taxpayers do.**

Finally, illegal trade and resulting additional HFC emissions have negative impact on a wider, societal scale, notably by significantly reducing tax revenues and government income related to customs duties as well as direct and indirect taxation.

Governments are losing considerable tax revenues notably through direct loss of VAT and import duty, but also through the indirect impact that illegal trade has to lower the price of legal refrigerants.

- in 2018 it has been estimated that Poland's treasury lost €7 million due to illegal refrigerant imports valued at €55 million, some 40% of Polish demand;
- Lithuania's exchequer lost up to €5m in 2018 due to increased sales of illegal refrigerants;<sup>6</sup>

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<sup>6</sup> Cooling Post (2018). Baltic states hit by illegal imports. Available at: <https://www.coolingpost.com/world-news/baltic-states-hit-by-illegal-imports/>

- illegal refrigerants from countries such as Albania, Macedonia and Turkey costed the Greek State over €20 million in lost VAT and taxes.<sup>7</sup>

### 3. RECOMMENDATIONS

Since the Regulation is not working as intended and in light of the consequences of illegal trading, urgent action is needed. Recommendations are provided below in order to address the challenge of HFC illegal trading/import.

#### **Tackling illegal import of HFC must be a political priority for EU institutions**

The illegal import and subsequent marketing harm the EU industry, present a safety hazard and threatens the achievement of the CO<sub>2</sub>-equivalent reduction goals of the EU and under international agreements.

Therefore, the European Commission should make it a top priority of the “New Green Deal” to explore all relevant ways to prevent, identify, fight and sanction illegal trading, so as to stop illegal imports.

Unless strong measures (in coordination with non-EU countries) are adopted, the EU will not reach its objective of becoming the “first climate-neutral continent”, and increasing emission reduction target by 2030, from 40% to 50 or 55%.

#### **Ensuring appropriate monitoring at EU border and sharing of information**

There is an urgent need to improve the enforcement of the F-gas Regulation, particularly by customs authorities at the EU borders. The EU should significantly improve reporting and monitoring of HFC trade with exporting countries; and the pilot project of the EU Customs Single Window initiative (implementation expected for 2021 at the earliest) will come too late to prevent lasting damage to the market.

In light of this experience, it appears paramount to strengthen the current legal set-up. The wide scope of the F-Gas Regulation (it encompasses any “placing on the market”), although a good thing in principle, results in fact in a dilution of responsibility amongst EU authorities.

While the F-Gas Regulation explicitly states that the placing on the market includes customs release for free circulation in the Union, the latter stage, which is where the loophole lies and where controls should focus on, is not appropriately addressed.

To fill the existing gap, a fully functional licencing system should urgently be implemented, which allows customs officials to obtain necessary, real-time information to determine if HFC imports are within the specified quota for a particular company. Given the seriousness in customs law of offences relating to licencing, the introduction of such obligation would provide the F-gas Regulation with a more effective toolbox than what is currently applicable.

The HFC Registry could also contain a blacklist with the names of companies identified or sanctioned for illegal trading/import of HFC. This could further discourage companies in engaging in illegal trade and warn EU companies so as to avoid any trading with the latter.

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<sup>7</sup> ACR Journal (2018). Greece calls for action on illegal refrigerants. Available at: <http://www.acrjournal.uk/international/greece-calls-for-action-on-illegal-refrigerants>

## Stronger, harmonised sanctions

To ensure sufficient deterrent effect, the penalties for infringement of the F-Gas Regulation should first be **harmonised**. Without dissuasive penalties applicable across all Member States, jurisdictions with lesser penalties will undermine efforts undertaken by neighbouring countries.

The penalties must also be **reinforced**. Unless penalties are high enough, black market traders will simply factor sanctions into regular business costs.

Last, the framework must be **enforced proactively by national authorities**. Without proper enforcement, investigations and sanctions being imposed, HFC illegal import will remain. There is therefore an urgent need to immediately carry out the appropriate checks across all Member States.

Beyond this harmonisation of sanctions applicable at national level, the European Commission should also monitor the enforcement of the F-Gas Regulation by Member States and, where needed, initiate infringement procedures against non-compliant Member States.

## Incentivising stakeholder's compliance with the phase-down mechanism

EU funding could be provided by individual Member States and/or under EU programs to support the transition to low GWP refrigerant-based technologies. The low-GWP energy efficient technologies should be promoted through technology-neutral incentives, such as tax rebates.

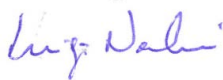
## CONCLUSION

The ultimate objective of the EU F-Gas Regulation is to reduce emissions of HFCs with the HFC phase-down as one of its main measures to reduce their consumption. It thus needs effective enforcement from both the EU and the Member States. However, there is clear evidence that the framework is not adequate.

If the EU framework is not improved, sanctions not reinforced and actually applied, then illegal HFC and black market will prosper, the EU industry will suffer from unfair competition and the ambitious emission reduction targets and related international commitments of the EU will be breached - not to mention safety hazard resulting from illegal refrigerants of unknown composition.


Therefore, the new European Commission should make the targeting of illegal trade a priority of its "Green deal" agenda, and carefully consider all legal and practical measures which could effectively encourage the reduction of F-Gas emissions in the near-future.

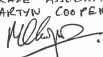
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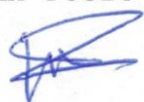
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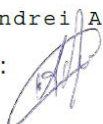
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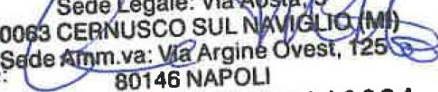
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Company: ECO SCANDIC OY  
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