

2 August 2021

“Public consultation on the revised Climate, Energy and Environmental Aid Guidelines (CEEAG)” – Polish Steel Association contribution

Polish Steel Association is a non-profit trade organization of steel manufacturers and steel processing plants that represents Polish steel industry. We support all initiatives supporting energy-intensive sectors of the European industry.

The revision of the *Guidelines on State aid for environmental protection and energy objectives* (EEAG) entails a number of regulatory changes affecting the steel industry.

The Polish Steel Association therefore postulates the following changes to the CEEAG.

- a) To protect steel industry against undue energy costs, we propose to:
 1. Extend reductions/exemptions for energy intensive users to other levies that directly or indirectly fund implementation of EU climate change policy objectives, such as those related to capacity mechanisms, network costs and other similar charges.
 2. Abandon the introduction of a minimum level of levies (before any reduction) allowing for reductions for energy intensive users.
 3. Modify of the eligibility criteria to include the industrial gases sector in the scope of application of the reductions.
 4. Restore current state aid intensity for reductions (85% or 0,5% GVA).
 5. Abandon the introduction of conditionality on state aid.
 6. Restore the targeted and distinct approach on harmonized and not-harmonised environmental taxes.
- b) To support decarbonization of steel industry, we propose to:
 1. Allow the granting of state aid to cover the full difference in production costs between low-carbon steel and conventional steel.
 2. Introduce state aid for dismantling CO₂ intensive production sites.
 3. Allow state aid for long term PPAs.
 4. Allow state aid for industrial self-production of energy in the case where RES generating unit is located elsewhere than energy consumption unit.

A. PROTECTION OF STEEL INDUSTRY AGAINST UNDUE ENERGY COSTS

Introduction

Achieving the climate objectives requires that Member States implement ambitious decarbonisation policies to significantly reduce the EU's greenhouse gas emissions by 2030 and achieve climate neutrality by 2050. The proposed CEEAG continue to allow such policies to be financed through regulatory levies on energy consumption. As a result, we expect existing levies to be maintained and new ones to emerge, which will increase energy costs for industry.

Energy costs have a key impact on the cost competitiveness of the steel sector and its share of the global market. Carbon leakage in the steel industry is already a reality, as evidenced by the decisions of steel companies closing plants in Poland. Meanwhile, maintaining production capacity in the EU not only ensures jobs and economic development in the EU, but also secures the basis for financing climate policy, including the development of renewable energy sources and other environmentally friendly technologies. In addition, the green transformation in steel industry, involves the electrification of production processes associated with introduction DRI / hydrogen / EAF technologies and as a result significant increase in electricity consumption. In Poland we estimate that electricity consumption will increase from 6 TWh to 28 TWh.

The practice of Member States shows that provisions for regulatory levy reductions in the EU related to energy and the environment should be maintained in the CEEAG. Most Member States apply various types of regulatory levies reductions for energy-intensive users, which become all the more important given the cost of meeting the EU's ambitious climate targets.

1. Extend reductions/exemptions for energy-intensive users to other charges that directly or indirectly fund implementation of EU climate change policy objectives, such as those related to capacity mechanisms, network costs and other similar charges (par. 354, CEEAG)

Member States may grant reductions from regulatory charges on electricity that finance climate objectives. However, the CEEAG limits the possibility to provide reductions only to levies that finance support of RES, combined heat and power, social tariffs, and energy prices in isolated regions. Reductions on levies financing capacity mechanisms, charges for other forms of energy and network tariffs are excluded.

The CEEAG introduces a more holistic approach in pursuing the decarbonisation of the economy. Various actions and areas leading to GHG emission reductions are indicated. Unfortunately, along with this, it was not decided to expand the approach to levies reductions applied to energy-intensive users, the most vulnerable to carbon leakage. The green transformation is a multi-faceted challenge, and the development of RES (and CHP) in the electricity sector is only one of many important elements of this process. Moreover, the possibility to develop RES in the electricity sector is also a very complex issue and does not only depend on direct support for green energy producers.

One of the most important aspects of increasing RES capacity in the electric system is the technical capability of the power grid. The existing grid infrastructure was designed to operate under a different energy model, and therefore needs to be urgently upgraded and developed. For example, there is already a growing problem of generation in the low-voltage network (by prosumers), where energy cannot be received by the technological limitations of distribution networks. Large-scale projects, such as wind power, also have problems obtaining conditions for connection to the grid. In the coming years, the EU and Poland expect further development of RES capacity in the system, but this will not be possible without a grid that is able to receive green energy and enable its flow to end users. It is also necessary to increase the possibilities of cross-border exchange, introduce smart grids and build infrastructure for power evacuation from offshore wind farms. All this translates into major network investments, which might be financed by additional network tariffs imposed on end consumers, including particularly vulnerable steel industry.

In addition to the technical capability of the grid, RES development also depends on the ability of the system to provide capacity reserves. RES such as photovoltaic and wind are characterized by a non-controllable, variable production profile and in order to ensure system security and continuity of supply, dispatchable, controllable capacity is needed to provide energy in times of insufficient production from RES. In the foreseeable future, this role will be played mainly by conventional units. On the other hand, the increasing amount of cheap RES in the system displaces dispatchable but more expensive and emission-intensive units from the market, limiting their operating time and worsening their financial performance. That affects the profitability of their maintenance or construction. Thus, further development of RES depends on the presence of

a sufficient amount of controllable capacity. This problem has led to the implementation of capacity mechanisms, in which end users bear the costs of maintaining capacity in the system. The capacity, which is necessary for further, even more intensive development of RES.

Further development of RES is also related to the development of modern solutions for energy storage and increasing network flexibility, including hydrogen technologies. It is possible that in the future dedicated support mechanisms will be created for such technologies, financed by levies paid by end users.

The Polish Steel Association considers that the CEEAG should secure reductions for energy-intensive users for all mechanisms contributing to the decarbonisation of the economy and the development of RES, that are financed by levies on electricity, including in particular levies related to the capacity mechanisms.

2. Abandon the introduction of a minimum level of levies (before any reduction) allowing for reductions for energy intensive users (par. 356, CEEAG)

From an industry perspective, any modification aimed at increasing electricity levies will significantly weaken its competitive position, which may eventually lead to a decision to reduce or cease operations in the EU.

In the opinion of the Polish Steel Association, there are no reasons for introducing such a restriction. The arbitrary establishment of a fixed minimum level of levies based on unknown premises and without taking into account the individual characteristics of a given country is also questionable. Different member states have different forms of RES and CHP support and different needs to support these technologies in a given time horizon. Moreover, for example in Poland, CHP units also benefit from support in the form of a capacity market. The amount of payments for individual mechanisms is also variable in time, so setting a quota limit would introduce unjustified complications.

RES units are becoming increasingly cost-competitive compared to conventional units, but their development may be limited by the capacity of the grid or the possibility to balance power and ensure flexibility. In such a situation, a temporary reduction of RES support costs is not excluded, while at the same time there will be high price of energy from highly emitting conventional sources and the high other regulatory costs related to capacity mechanisms and network modernisation costs that are not eligible for reductions.

3. Modify of the eligibility criteria to include the industrial gases sector in the scope of application of the reductions (par. 357 and related Annex I, CEEAG)

Limiting the list of sectors eligible for support will have a negative impact on the economic situation across the EU and may weaken the EU's competitiveness on international markets, particularly in view of the effects of the COVID-19 crisis. An example of this, is the lack the industrial gases sector on the eligible sector list. This sector is an important part of the value chain of steel production. Consideration should be given to amending the criteria proposed in the CEEAG so that key sectors for other sectors directly exposed to the greatest risk of carbon leakage also have the opportunity to benefit from reductions.

4. Restore current state aid intensity for reductions (85% or 0,5% GVA) (par. 359-360, CEEAG)

The Commission has proposed that aid should be considered proportionate if beneficiaries bear at least 25% of the costs. This reduces the previously applicable maximum level of reduction (bearing at least 15% of the costs). It also reduces the possibility of limiting costs for the most

energy-intensive users to 1.5% of GVA (previously there was a possibility of limiting costs to 0.5% of GVA). The reduction in the level of reductions is a disadvantageous measure for steel industry, significantly limiting its competitiveness. In the face of increasing decarbonisation challenges and pressure from third country entities, increasing the burden on steel industry in the EU could have disastrous consequences. The prudent solution would be to maintain the maximum levels of reductions at current levels.

5. Abandon the introduction of conditionality on state aid (par. 364-365, CEEAG)

The introduction of the conditionality of support, analogous to the compensation solution contained in the ETS guidelines (audit investment with a payback period of no more than 3 years, or reduction of the carbon footprint of the energy consumed (30% of consumption), or investment of at least 50% in emission reductions) is a further burden for energy-intensive users most exposed to carbon leakage. Steel industry is in a difficult situation due to high electricity costs, the rising cost of CO₂ emission allowances, strong competition from third countries and the effects of the COVID-19 crisis. This situation alone forces companies to maximise production effectiveness and energy efficiency. At the same time, steel sector is constantly striving to reduce emissions. Very high levels of savings have already been achieved for the technologies used, and the production plants in Poland and the EU are characterised by a significantly lower environmental burden than plants in third countries. Further efficiency improvements and decarbonisation measures require very high investments and innovative technological solutions and may imply permanently higher operating costs. Steel industry needs support in implementing innovative green solutions, not the introduction of additional burdens and reduced possibilities to secure its operations.

Moreover, the proposed conditionality has not yet been tested in practice. It is very risky to introduce analogous, untested methods to two mechanisms that are key from the point of view of steel industry, i.e. ETS indirect cost compensation and regulatory cost reductions.

6. Restore the targeted and distinct approach on harmonized and not-harmonised environmental taxes (section 4.7, CEEAG)

The CEEAG exclude the targeted and distinct approach on harmonised and non-harmonised environmental taxes that apply under the current EEAG guidelines. The Commission proposal abandons the simplified assessment route for reductions in harmonised taxes (where reductions are granted within the limits of the relevant directive). Consequently, the strict criteria for assessing necessity and proportionality of aid (points 269 and 270 of the CEEAG) will apply to all beneficiaries and to all types of environmental taxes. This will have the effect of limiting the granting of state aid in this area and of placing an excessive, disproportionate burden on the European steel industry, which will consequently increase the risk of carbon leakage. The distinction between harmonised and non-harmonised taxes and the related separate approach set out in paragraphs 172-175 of the current EEAG guidelines should therefore be reinstated.

B. STATE AID FOR DECARBONIZATION OF STEEL INDUSTRY

Introduction

The commitment of the steel sector is essential if the EU is to achieve its climate targets for 2030 and 2050, particularly in countries such as Poland. The industry's green steel transformation agenda envisages achieving climate targets by investing in further energy efficiency improvements in the steel production process, self-generation of electricity from RES, reduction of direct and indirect CO₂ emissions from the steel industry and solutions supporting a circular economy.

Specific and dedicated support programmes should be formulated for the energy-intensive sectors, like steel, in terms of decarbonisation-related investments by entrepreneurs. Support should be available both in the form of investment aid and operating aid. The above is particularly important in the context of the use of European Union funds, which are currently placed at the disposal of Member States to finance the implementation of the provisions of the Green and Digital Transformation and the objectives formulated in the framework of the Green Deal. With regard to the CEEAG, the most important modification is the possibility to grant aid for decarbonisation measures in steel industry, both for additional operating costs and investment costs.

In this context, the scope of the CEEAG should be adapted in a way that provides much needed financial support to EU steel producers. Decarbonisation of steel industry requires huge upfront investments, higher operating costs and therefore it justifies an increase aid intensity to 100% of full funding needs.

1. Allow the granting of state aid to cover the full difference in production costs between low-carbon steel and conventional steel (par. 40, 78, 103, CEEAG)

Investments in low-carbon production technologies in the steel sector, such as the use of renewable energy sources and hydrogen, entail both very high investment costs and permanently higher operating costs. In order for steel produced with innovative low-carbon technologies to compete in the marketplace with conventionally produced steel, it is necessary to ensure sustainable business conditions and compensation for higher production costs.

The Commission's proposed CEEAG is inadequate in this respect, as it does not explicitly take into account the possibility of granting state aid to cover the full difference between the costs of producing steel using low-carbon technologies and the costs of producing steel in the conventional way. The Commission does allow for state aid in the form of contracts for difference, but the current provisions on this issue seem to primarily address carbon contracts for difference in relation to ETS costs. A support mechanism that will only compensate for the risk associated with changes in the price of emission allowances will not provide sufficient security to undertake risky, capital-intensive investments in low-carbon production processes. In a situation of high emission allowance prices, it will not guarantee any support to cover investment costs.

It must also be possible to combine various aid instruments, in accordance with state aid rules, taking into account effective mechanisms for preventing carbon leakage.

2. Introduce state aid for dismantling CO2 intensive production sites (section 4, CEEAG)

Conversion to low carbon production processes in the EU will often occur in existing facilities. Current state aid rules under the EEAG do not envisage aid for dismantling of CO2 intensive production, while 100% aid intensity is possible for the remediation of contaminated sites. Granting of aid for dismantling CO2 intensive production sites after transformation to low carbon production should be allowed under the revised state aid rules, with a level of 100% aid intensity similarly to aid for remediation of contaminated sites.

3. Allow state aid for long term PPAs (section 4, CEEAG)

The involvement of steel industry in the development of green generation capacity is crucial to achieving the EU's climate targets. One of possible forms of such engagement is the purchase of green electricity under long-term PPAs. The CEEAG should include incentives for major electricity consumers to enter into such contracts. A possible form of support for such undertakings, which should be included in the new guidelines, is the reduction of or exemption from electricity-related regulatory costs for energy-intensive users with long-term PPAs.

4. Allow state aid for industrial self-production of energy in the case where RES generating unit is located elsewhere than energy consumption unit (section 4, CEEAG)

Entities in the steel sector can directly contribute to additional RES capacity. However, in the case of steel plants, it is usually impossible to build RES installations covering a significant part of the energy demand directly on-site or connected via direct line. Due to very high energy consumption, a photovoltaic or wind farm supplying such steel plant would require a very large amount of land, which may not be physically available in the immediate vicinity of the plant (e.g. due to other buildings or use of land) or it may not ensure favorable conditions for energy production.

The solution is thus to incentive largest energy consumers to be directly engaged to development RES units which are located off-site. Support for such operations could take the form of exemptions or reductions in regulatory levies and network tariffs, and also grid access preferences.