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## **HT.582 - Public consultation on draft ETS State aid Guidelines**

Following the publication of the draft New Guidelines on certain State aid measures in the context of the system for greenhouse gas emission allowance trading post 2021<sup>1</sup> ('draft New ETS Guidelines') which is due to replace the 2012 ETS Guidelines<sup>2</sup>, COMPO EXPERT GmbH (COMPO EXPERT) offers the following observations.

In general, we believe that the following sectors should be included in the list of sectors entitled to compensation for indirect costs:

NACE 20.15 Production of fertilizers and nitrogen compounds.

Achieving climate neutrality will require a strong and competitive industry on a global scale, capable of proposing innovative solutions and improving production processes to achieve low-carbon products. Compensation of indirect emission costs is an indispensable instrument to fight carbon leakage and to support the EU's efforts to electrification at the same time, which will naturally lead to an increase in the share of electricity costs (and associated indirect emission costs) in total production costs (while reducing direct emissions).

<sup>1</sup> [https://ec.europa.eu/competition/consultations/2020\\_ets\\_stateaid\\_guidelines/index\\_en.html](https://ec.europa.eu/competition/consultations/2020_ets_stateaid_guidelines/index_en.html)

<sup>2</sup> Communication from the Commission – Guidelines on certain State aid measures in the context of the greenhouse gas emission allowance trading scheme post-2012, OJ C 158, 5.6.2012, p. 4.

I. PERVASIVE LONG-TERM CARBON LEAKAGE IS OCCURRING IN THE EU FERTILIZER SECTOR

COMPO EXPERT believes the consultant and the European Commission massively underestimated the occurrence of carbon leakage in the EU fertilizer industry. The trade data relevant to ammonia, the key building block of all nitrogen fertilizers, as well as many other mineral fertilizers, unequivocally shows continued, long-term carbon leakage, i.e. loss of EU industry's export potential and massive increase of imports.

For example, as for imports:

- Ammonia imports into the EU increased by 62% between 2004 and 2019;
- Urea imports into the EU increased by 59% between 2004 and 2019;
- Total nitrogen fertilizers imports into the EU increased by 57% between 2005 and 2019.

With respect to EU exports:

- EU ammonia exports decreased by 56% between 2005 and 2019;
- EU ammonium nitrate exports decreased by 29% between 2004 and 2019;
- EU UAN exports decreased by 90% between 2005 and 2019; and
- EU ammonium sulphate exports decreased by 31% between 2003 and 2019.

Overall, there can be therefore no doubt that EU industry is losing market share with respect to most types of finished fertilizers, both on the EU domestic market, as well as on export markets.

This of course leads to carbon leakage, as the non-EU countries with main production of key raw materials and fertilizers have no comparable costs of climate policy. This distorts competition and leads to a steady increase in amount of global CO<sub>2</sub> emissions connected not only with the production itself but also with the transport and logistics of these products to Europe. Therefore, fertilizer producers located in Europe should be supported by EU to have impact on lowering carbon footprint.

Inability to pass increased costs to customers. With their favourable access to cheap energy Non-EU producers from Russia, the United States, Middle East, North Africa and China increasingly penetrate the price sensitive EU fertilizer market (with import market share in nitrogen fertilizers up to 30% and higher, and still rapidly growing). Consequently, the EU fertilizer sector has no possibility to pass increased costs to their

clients (nor should it be forced to even consider such attempts given the role that EU farming plays in the EU social fabric and in the EU food security).

Distortion of raw material prices. Moreover, oligopolistic position of Non-EU companies in case of critical raw materials i.e. phosphate rock further contribute to a non-level global playing field in terms of the NACE 20.15 sector. Hence, we fear that in such unfavourable market conditions on both supply and demand side, exclusion of the NACE 20.15 sector from the list of sectors eligible under the revised Guidelines on State Aid for Compensation of Indirect ETS Costs may confront the fertilizer industry with another competition distortion that will drive more fertilizer manufacturers out of the EU.

This is already happening. Large investments in the USA, MENA, and Russia have been announced by fertilizer producers while at the same time they are announcing business consolidations in the EU.

No Similar Restrictions in 3<sup>rd</sup> Countries. Given the fact that the key Non-EU competitors of the EU NACE 20.15 sector have no comparable GHG reduction schemes (in other words they are fully carbon emitting on their electricity source, production and transport and more NO<sub>x</sub> emitting on their production), their constant expansion and increased market presence increases carbon emissions globally.

To stop carbon leakage, companies that manufacture fertilizers should qualify for compensation of indirect emission costs.

No conflict with other Guideline objectives. Allowing for compensation of indirect ETS costs NACE 20.15 sector threatens no other goals addressed by the State Aid ETS Guidelines, i.e. neither maintaining a level playing field in the EU nor preservation of incentives for a cost effective decarbonisation. On the contrary, the exclusion of the fertilizer industry from the list of eligible sectors increases risks in the afore-mentioned perspectives. Finally, there are no viable substitutes to mineral fertilizers. Therefore, no other sector is disadvantaged by allowing fertilizer industry to continue to be eligible for compensation of indirect emission costs.

EU fertilizer producers are among the most efficient in the world in terms of energy and raw material consumption. Therefore, increasing EU producers' indirect emission costs will deprive it of cash necessary to fund necessary environmental investments. If the NACE 20.15 sector was eligible for compensation of such costs, the industry could continue its emission reduction efforts.

## II. EUROPEAN COMMISSION USED WRONG METHODOLOGY TO ESTABLISH LIST OF ELIGIBLE SECTORS

COMPO EXPERT considers that the European Commission misapplied the ETS Directive, when deciding which sectors are eligible for compensation of indirect emission costs under Art. 10a(6) of the Directive.

By way of introduction, Art. 10a(6) of the ETS Directive:

1. mandates the Member States to compensate indirect emission costs (*“Member States should adopt financial measures...”*);
2. circumscribes the list of eligible sectors to those *“exposed to a genuine risk of carbon leakage due to significant indirect costs that are actually incurred from greenhouse gas emissions costs passed on in electricity prices”*, without specifying which sectors these are; and
3. instructs that such compensation measures must be *“in accordance with State aid rules and in particular do not cause undue distortions of competition in the internal market.”*

Most importantly, Art. 10a(6) of the ETS Directive:

4. does not explicitly authorize the Commission to create a list of sectors eligible for compensation of indirect costs (in contrast to Art. 10b(5) of the ETS Directive, which explicitly authorized the Commission to adopt delegated acts concerning the determination of sectors and subsectors deemed at risk of carbon leakage);
5. does not in any way mention the Commission’s role in determining the list of eligible sectors;
6. does not use any of the terms or concepts used in Art. 10b such as *“intensity of trade”*, *“emission intensity”*, *“gross value added”* or others, nor use any of the values referred to in Art. 10b, nor does it suggest that such terms or concepts should be used when determining which sectors are eligible;
7. does not in any way cross-reference Art. 10b, i.e., does not in any way state that the *“sectors exposed to genuine risk of carbon leakage due to significant indirect costs”* should be defined through use of criteria or thresholds used in Art. 10b.

COMPO EXPERT considers that the above analysis leads to the following conclusions:

First, the Directive clearly orders Member States to compensate eligible sectors. It does not provide them an opportunity, but expressly ask them to compensate. This means that compensation is considered by the legislator as an important and quasi-mandatory measure.

Second, as the Directive does not explicitly allow the Commission to prepare a list of eligible sectors and yet provides certain wide criteria (risk of carbon leakage must be “genuine” and due to a specific factor: significant indirect costs from greenhouse gas emission costs, actually incurred, passed on in electricity prices) this means that the Directive leaves it to Member States to determine which sectors should be eligible. If the Commission wanted the Commission to prepare the list, it would have explicitly said so.

Third, the Directive does not want Member States to be circumscribed in their duty to compensate sectors exposed to risk of carbon leakage by criteria or thresholds set out in Art. 10b, because if it did, it would have explicitly linked the two articles or used similar terms. Yet both articles use different terminology and have a different purpose, which prevents automatic use of concepts and criteria from Art. 10b to limit the list of sectors eligible in Art. 10a(6).

Fourth, the Directive only mandated the Commission not to prepare a list of eligible sectors (misusing criteria from Art. 10b), but to carry out a classical EU state aid analysis do determine whether such measures could be in accordance with State aid rules and not cause undue distortions. Instead of carrying out State aid analysis, the Commission conducted some circuitous indirect carbon leakage analysis, when that was not its job under Art. 10a(6).

Fifth, leaving it entirely to Member States to individually decide which sectors could qualify for compensation under Art. 10a(6) could pose some challenges (e.g., divergence among Member States). Those challenges could have been addressed by the Guidelines, if the Commission applied some State aid concepts or distortion of competition analysis to the list of eligible sectors. However, the list of eligible sectors does not appear to be created based on State aid concepts, but based on indirect carbon leakage concepts, leading to circuitous carbon leakage analysis, but no actual State aid analysis at the end.

This leads us to the following final conclusions:

First, the Commission should have left it to Member States which sectors qualify.

Second, if the Commission did not want to leave it entirely to Member States, it should have applied a widely accepted and encompassing analysis that would allow Members a wide range of discretion which sectors qualify, relying entirely on a qualitative analysis. However, if the Commission wants to use the methodology of Art. 10b, it should do so consistently and apply the qualifying thresholds specified in it for qualitative analysis and assume – specifically - that sectors with an index between 0.15 and 0.2 should be subject to qualitative analysis, which was taken into account in previous Guidelines. In the proposal of new guidelines, European Commission raised the qualification threshold for qualitative analysis to 0.2. As a result, NACE 20.15, fertilizers were deprived of the possibility of qualitative analysis.

Third, when the Commission conducts a quantitative analysis, it should do so using most recent and available data. In the proposed Guidelines, the Commission takes into account the data of individual indicators (e.g. trade intensity, intensity of indirect emissions or GVA) from 2013-2015, which from today's perspective is already old, and at the end of the ETS period will be 15-17 years old. In the decade of application of the guidelines, the data will be completely outdated.

Fourth, the analysis is static - it does not notice technological changes and their consequences; it does not take into account the exchangeability of indirect emissions for direct emissions during electrification. In addition, it seems that the adopted methodology does not reflect the purpose of including compensation for products which, due to the specificity of energy-consuming technological processes and international trade in the sector, are exposed to the risk of carbon leakage, including the form of production leakage (i.e. loss of share in global and European markets) and the so-called investment leakage (i.e. decreasing EU share in global fertilizer production). These defects should be corrected at the qualitative analysis stage.

### III. SAFEGUARDING INCENTIVES TO DECARBONISATION EMBEDDED IN THE ETS SYSTEM

Lack of compensation for indirect ETS costs is against the direction set by the European Green Deal, and more specifically against the drive to promote electrification of EU industry as one of the main pathways for industry decarbonization. Electricity made of low-carbon or carbon-neutral sources can be used to produce hydrogen for ammonia and to replace natural gas and steam as energy inputs, which could reduce industry's carbon footprint.

Instead, electrification is de-incentivized. Companies would pay a penalty by losing the allowances instead of getting an incentive for electrification by getting more State aid.

We urge the Commission to reconsider its proposition on conditionality for beneficiaries. It is valuable to promote energy efficiency and commitments to use clean energy or abate direct emissions. Nonetheless, we are afraid that such a specific wording may turn counterproductive to the Commission's goals of reducing carbon leakage risk while quickly increasing renewable energy sources (RES) presence in energy mixes of Member States.

In order to support the objectives of the European Green Deal, the ETS State Aid Guidelines should support EU's efforts to reduce global carbon emissions and prevent carbon leakage and relocation of industries. They should encourage key European manufacturing sectors with strategic value chains to implement electrification investments in ETS Phase IV since electrification will require significant process changes.

Best regards

A handwritten signature in blue ink, appearing to read "JK", is positioned above the printed name of Joerg Krueger.

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A handwritten signature in blue ink, appearing to read "M. Keller", is positioned above the printed name of Martin Keller.

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