

PUBLIC CONSULTATION ON DRAFT ETS STATE AID GUIDELINES (REF: HT.582)

UNIDEN POSITION

For an efficient mechanism to preserve European industry capacity to innovate and lower European carbon footprint

UNIDEN welcomes the European Commission's public consultation on the draft guidelines regarding the compensation of indirect costs of the EU ETS.

Directive 2003/87/EC of the European Parliament and of the Council established a system for greenhouse gas emission allowance trading within the Union, in order to promote reductions of greenhouse gas emissions in a cost-effective and economically efficient manner.

According to Article 10a(6) of the ETS Directive, indirect ETS costs can be compensated by Member States in order to address the carbon leakage risk related to the EU ETS, with the aim to avoid an increase in global greenhouse gas emissions due to shifts of production outside the Union, in the absence of a binding international agreement on reduction of greenhouse gas emissions.

The CO₂ emissions costs passed on in electricity prices severely impact the competitiveness of the European electro-intensive industry, thus increasing the risk of carbon leakage and exposing Europe to an increase of the carbon imported from abroad and therefore the European carbon footprint. When total emissions, direct and indirect, linked to the production of one ton of aluminum in France are around 2.5 tons of CO₂ (scopes 1 and 2), they are six times higher for aluminum imported from China.

During EU-ETS phase 3, this efficient and targeted system, put in place in more than ten Member States enabled to maintain the competitiveness of electro-intensive industries and to lower European carbon footprint. For these reasons, UNIDEN recommends:

- **The emission factors should continue to be set at regional level:** indeed, compensation should reflect the actual cost of the EU ETS passed on in electricity market prices, without creating distortions of competition between Member States within the EU. And, as confirmed by the study carried out in 2019 by Compass Lexecon on behalf of UNIDEN¹, the adequate market place to capture CO₂ impact on electricity price is the regional level;
- **All electro-intensive sectors exposed to a high risk of carbon leakage** (direct + indirect) and/or whose transition towards a low carbon model involves high level of electrification should be eligible to compensation. This includes all sectors that were eligible during EU-ETS phase 3 and also requires the ability to expand the sectors list based on a **qualitative assessment**;
- The conditions for receiving the compensation should include **proportionate energy efficiency efforts** that take into account the different level of maturity of the different sectors in the decarbonisation path as well as the availability of low carbon alternatives.

The Emission Factors should continue to be set at regional level

As demonstrated by the study carried out in 2019 by Compass Lexecon on behalf of UNIDEN and despite French very low carbon production mix (less than 0.05 tonne of CO₂ per MWh in 2018), the electricity wholesale market price in France incorporates a CO₂ component of around 0.76 tCO₂ / MWh almost equal to its neighboring countries'.

The Compass Lexecon study also concludes that the proxy proposed in the draft (the weighted average of the CO₂ intensity of electricity produced from fossil fuels at national level) is very well adapted at regional level but absolutely not relevant at national level. For example, for France, the proxy will be far lower than the actual CO₂ price impact on electricity wholesale market price (< 0.5 t/MWh vs. 0.76 t/MWh).

For France, using the proxy proposed by the EU Commission, the Center-West Europe area is the only relevant geographic scope (see note on Market Convergence in appendix).

The Commission proposal to set a national emission factor based on this proxy will lead to widely diverging national emission factors within the CWE area, while the industries located in the region incur the same indirect costs of EU ETS. **Different national emission factors while it has been demonstrated a very similar CO₂ impact on power prices within already defined regional zones will create a significant and unacceptable distortion between competing industries in different Member States, penalizing the least emitting countries without any economic justification.**

¹ <https://www.fticonsulting.com/fti-intelligence/energy/research/carbon/analysis-co2-power-emission-factor-indirect-compensation-related-eu-ets>

All electro-intensive sectors exposed to a high risk of carbon leakage (direct + indirect) assessed through quantitative and qualitative criteria and/or whose transition towards a low carbon model involves high levels of electrification should be eligible to compensation.

The list of sectors eligible to the future compensation of the indirect costs of the EU ETS proposed by the European Commission is too restricted and excludes most of the electro-intensive sectors.

This very restricted list is only based on quantitative data which are not capturing the trend of the sectors (some sectors are highly cyclical and data differ significantly from one year to the other), their capacity to absorb a significant additional cost (whether a sector is in capacity to pass through the additional costs to its customers or not), the technological evolution to come (electrification, major process changes, significant growth or decrease, etc.).

For the sectors eligible during phase 3, the negative shock to their competitiveness represents a high risk of favoring imports from other countries over a local low-carbon production. **The sharp reduction of the number of eligible sectors is thus a very negative decision in the fight against climate change.**

In addition to dramatically increasing the risk of carbon leakage, it would also send a very negative signal to industrials looking into electrification as a key technological pathway towards a low-carbon energy-intensive industry. Removing the compensation for the indirect costs of the EU ETS would needlessly set the bar towards a low-carbon business model much higher in the related sectors.

Finally, electro-intensive sectors not in the list are suppliers of sectors that are in the list (e.g. manufacture of industrial gases) which increased costs will affect the competitiveness of downstream sectors, deemed to be highly exposed to carbon leakage risk.

For these reasons, **based on additional qualitative criteria, UNIDEN strongly recommends to expand the list of sectors**, at least to the 15+ sectors eligible during phase 3 + Manufacture of refined petroleum products + Manufacture of industrial gases + Manufacture of batteries and accumulators for their expected role towards a low carbon economy.

The list proposed by UNIDEN (< 20 sectors) remains targeted and restricted to electro-intensive sectors which are highly exposed to carbon leakage risks which undemonstrated potential low incentive to accelerate their efforts to reduce their emissions will be covered by their commitment on energy efficiency proposed in the draft.

Real but proportionate energy efficiency efforts

UNIDEN welcomes the introduction of energy efficiency commitments from industrial receiving compensation. Energy efficiency is key to achieving a transition to a low-carbon model. It has contributed in the 50%+ drop of greenhouse gases emissions of the industry in France since 1990.

However, the subsequent and additional criteria proposed by the Commission are ignoring technical and economic barriers to implementing efficient technologies. They also do not consider past investments and efforts from the industry.

Industrial facilities that have already implemented the best available technologies, that invested a lot in energy efficiency and/or have a very low indirect carbon footprint should be able to benefit from the compensation of indirect costs. Otherwise, the guideline would favor the least performing facilities, whose potential for energy efficiency is far greater.

For these reasons, UNIDEN recommends to remove paragraph (54) which is not relevant and not adapted to the diversity of the situations of the industrial facilities. Example: would it be relevant for a benchmark facility to invest 80% of the compensation received? Probably not.

Carbon compensation is an essential competitiveness measure for electro-intensive industries. It contributes very significantly to the maintaining and developing the corresponding facilities in Europe, with best available technologies and, in France, with a low carbon power production mix. Such mechanism, targeted and efficient, will avoid relocations out of Europe and the increase of the CO2 content of our imports and consequently the carbon footprint of Europe. Maintaining and developing a high-performance and competitive industry in Europe will make it possible to bring out the solutions of tomorrow to fight against global warming.

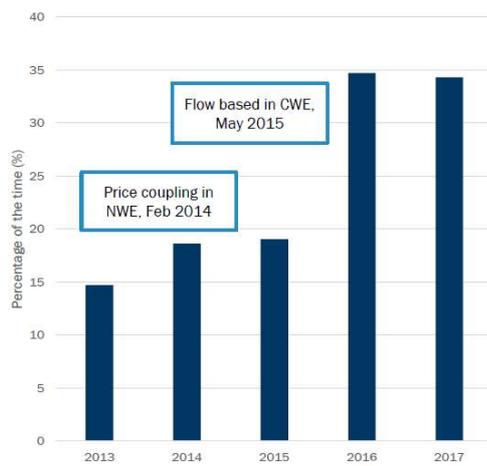
APPENDIX: CONVERGENCE OF THE MARKET IN CWE, FOCUS ON GER-FR SYSTEM

HOW TO ASSESS THE “MARKET CONVERGENCE” IN THE CWE ZONE?

In the CWE zone, the day ahead prices are built through a market coupling mechanism.

This mechanism pools the prices of the different neighboring countries, reflecting the high integration of the countries' respective market places thanks to cross border capacities.

Occurrence of one unique price within the CWE zone



Source: FTI-CL Energy analysis based on RTE data

Notes: The price convergence translates in one unique price within the CWE zone.
2018 data was not available when the analysis was performed.

In this respect, due to the development of the cross border capacities and market coupling, prices were equal 15% of the time in 2013, 30 % of the time in 2017.

Additional cross border capacities within the CWE zone will further increase the market integration within the CWE zone in the coming years². We expect the following additional capacities over the next 6 years:

- FR-BE : +1 GW
- DE-FR: +0.7/1.2 GW
- BE-DE: +1 GW
- BE-NL: +1/2 GW
- DE-NL:+0.75 GW

Physically, we expect a higher level of market coupling with higher percentage of equal prices in the coming years due to these new cross border capacities.

The Day ahead market is by nature highly regional, being a way to accommodate regional unbalancing:

- Day ahead prices in the whole CWE zone cannot be equal 100% of the time, otherwise, it would be a unique market place. As a consequence, analyzing only the situations where the prices are equalized is not relevant to measure the carbon prices pass through. Indeed, what does matter is only the **correlation between the prices**, not their absolute value.
- On top of the correlation of the prices on the Day Ahead market in the CWE countries, an assessment of the **correlation of the Futures prices** must be considered in order to assess the transfer of the carbon price within the electricity prices, producers and consumers being active on the full range of the forward curve.

And, when we have analyzed on day ahead or forward basis the correlation between CWE countries, we found a very good correlation (more than 0,8). **Which means that the impact of the CO2 prices is almost equal from one country to the other within the CWE zone.**

We would then recommend to analyze the prices correlation to correctly assess the impact of ETS on power prices.

² Notwithstanding the effect of cross-zonal capacity allocation for the exchange of balancing capacity to be expanded up to **70%** target versus circa 20-50% today (see **ACER Recommendation published 08/08/2019 on the implementation of the minimum margin available for cross-zonal trade pursuant to Article 16(8) of Regulation (EU) 2019/943**)