CEEAG reaction w.r.t. Carbon Contracts for Difference

Deltalinqs represents the joint interests of more than 95% of all logistics, port and industrial companies in the main port of Rotterdam. More than 700 companies from fourteen different sectors are affiliated with our business association. Together they contribute 6.2% to the Gross National Product of the Netherlands and offer direct and indirect employment to over 385,000 people.

On behalf of our members, we are committed to strengthening the competitiveness and sustainable growth of the Rotterdam Port and Industrial Complex through entrepreneurship and innovation. This is in regard of the energy-transition and in context of the GreenDeal as proposed by the European Commission done from an approach of reaching Industrial Symbiosis. This approach is concretized through a 3 steps development towards a sustainable industrial cluster Rotterdam – Moerdijk in 2050. https://www.portofrotterdam.com/sites/default/files/three-staps-towards-a-sustainable-industry-cluster-rotterdam-moerdijk-2050.pdf?token=Zo7BSWOU

Instruments that would accommodate this process of transition towards a competitive and sustainable industry should support these developments. So we can deliver on a consolidation of industry in the most energy-efficient clusters and safeguard jobs and necessary production for the society.

In this context we want to reflect on the proposed CEEAG and more specifically on the Carbon Contracts for Difference instrument.

CCfDs - Explainer

Currently there is a significant gap between the CO2 price required to create a business case for low carbon hydrogen projects and the ETS price. In order to accelerate investment and carbon emissions reductions in the industrial sector additional policy support will be required to bridge the cost gap until carbon prices are sufficiently high, while remaining closely coupled to effective carbon leakage protection mechanisms, until a Global level playing field emerges.

In the context of the EU Green Deal, the Commission is considering new mechanisms to support the EU industry's decarbonisation in the coming years. The Commission explicitly referred to Carbon Contracts for Difference (CCfDs) in the draft Communication on State aid Guidelines for climate, environmental protection and energy [renamed Climate, Energy and Environmental Aid Guidelines (CEEAG)] published on 7 June 2021, as well as in the EU Hydrogen Strategy published in July 2020. Therefore, CCfD is likely to be one instrument available for Member States to support investments in innovative energy solutions aimed at decarbonisation.

A Carbon Contract for Difference is a contract by which a government or institution agrees with an agent on a fixed carbon price over a given period, making CO2 emission reduction projects at CO2 contract prices investable. In the European context, this would be closely linked to users who participate in the EU's emissions trading system (EU ETS).

During the length of the agreed contract, governments pay out the difference between the actual price of emissions allowances (EUAs) and the contract price, thus effectively ensuring a guaranteed carbon price for the project. This reduces the risk of the project and therefore leads to lower financing costs as well.

CCfDs – latest developments EU and Member States

- The Commission is considering the use of CCfDs to motivate the uptake of renewable and low carbon energy carriers [as suggested inter alia in the EU hydrogen strategy]. The draft Communication on State aid Guidelines for climate, environmental protection and energy [renamed Climate, Energy and Environmental Aid Guidelines (CEEAG)] published by the Commission on 7 June 2021 for public consultation, mentions the introduction of new aid instruments such as CCfDs. The draft Communication also mentions that the revised rules would generally allow for aid amounts covering up to 100% of the funding gap. CEEAG guidelines are expected to be published

in Q4 2021 but CCfD may have to wait for the revision of the EU ETS system to be implemented. The revision of the EU ETS system may last about 18 months and subsequently needs to be transposed by Member States; secondary ETS legislation needs to be revised by the EU as well.

- In a joint paper dated February 2021, on the revision of the EU's industrial strategy, Germany and France called for a "new instrument to support operating expenses (OPEX) for innovative production in a cost-efficient way, e.g. with Carbon Contracts for Difference".

Why the Dutch SDE++ is not sufficient for high temperature industrial processes?

- The Dutch SDE++ scheme, which is an OPEX subsidy, functions as a kind of a CCfD for industrial electrification and for the production of renewable hydrogen, as well as for projects that aim to add CCS to their current grey hydrogen production, whereby the obtained low-carbon hydrogen is used as feedstock. It is not yet developed to stimulate the fuel-switch on the side of the end-users or producers for substituting fossil fuels for low-carbon hydrogen. The SDE++ does not support the production and use of low-carbon hydrogen as a fuel. To realize high temperature industrial processes, building a new low-carbon hydrogen production plant would need to be eligible for support under the SDE++.
- Hydrogen is currently primarily used as a feedstock but has a huge potential as an energy carrier and for high temperature heat.
- The business-case gap will be different depending on the application.
- The PBL (Netherlands Environmental Agency) sees the SDE++ as a suitable instrument for enabling low carbon hydrogen. In reality, the SDE++ is insufficient to realize high temperature industrial processes. The abovementioned subsidy category is based on CO2 capture at installations for raw material use, which is not the case for high temperature industrial processes projects. Costs for building and operating the reforming installation, and the additional OPEX for the end-users are not covered. On a stand-alone basis the SDE++ can only cover 40-45% of the business case gap.

Benefit of CCfDs

- CCfDs are expected to be used to enable the first large-scale projects before moving to (gradually decreasing) more market-based forms of support.
- If tendered, CCfDs are cost effective and, therefore, the higher the degree of technology neutrality, the more cost-efficient the CCfDs would be.
- CCfDs can be an instrument to help producers and end-users in the industry switch toward low-carbon and renewable hydrogen.
- CCfDs reduce the risk of the project and therefore lead to lower financing costs as well.
- Contrary to the Innovation Fund which is limited to 60% of the business case gap, CCfD should be able to bridge the entire gap and hence make projects investable.

General design principles

- Allocation of CCfDs should be done through a competitive tendering process.
- The fact that the Commission's draft Climate, Energy and Environmental State Aid Guidelines (CEEAG) consider allowing CCfDs is a good signal. In this context, the EU should put in place the following elements:
    - The conditions under which Member States could develop a CCfD mechanism must be clear.
    - Develop guidelines for assessing the full life cycle GHG emission savings threshold determining the eligibility of projects to participate in the tender process.

- Therefore, we urge policy makers to develop the CCfD mechanism with a sense of urgency, without waiting for all other regulatory updates. The CEEAG guidelines are expected to be published in Q4 2021 and CCfD may have to wait for the revision of the EU ETS system to be implemented. The revision of the EU ETS system may last about 18 months and subsequently needs to be transposed by Member States; secondary ETS legislation needs to be revised by the EU as well.
- CCfDs could be co-funded by the ETS system. ETS revenues from Industry should flow back to Industry to support industrial decarbonisation.
- The CCfD mechanism should be capable of bridging the full gap towards a viable business case, and should not be limited to any percentage thereof.
- CCfD sectoral scope should be consistent with carbon pricing mechanism(s) sectoral scope.
- Principle support for broadest possible technology scope (as that enables lowest cost), but a hydrogen-specific CCfD as long as it is technology-neutral (i.e. open to all hydrogen technologies, both renewable and low-carbon) can also be supported. CCfDs should be compatible with other subsidies and policies: e.g. Clean Public Procurement, EU Innovation Fund. If a project benefits from other subsidies or policies, its CCfD strike price versus the ETS price should be more competitive.