

REVISION OF THE ENVIRONMENTAL AND ENERGY AID GUIDELINES (EEAG)



RECONCILING CLIMATE AMBITION AND INDUSTRIAL COMPETITIVENESS IN THE STATE AID FRAMEWORK

Our key recommendations

- Continue protection of energy intensive sectors (EISs) against undue costs of renewable levies
- Improve the requirements of aid for generation adequacy with regard to cost efficiency
- Allow for reductions in or exemptions from undue financial contributions to generation adequacy funding
- Support the transformation of EISs to contribute to a climate neutral economy

The Commission Communication “A Clean Planet for All”¹ offers the basis for a thorough debate around the legislative framework that is necessary for a successful transformation of the EU economy towards climate neutrality.

European steel companies are already developing major emission reduction technologies and are willing to continue to accelerate this work in order to fulfil this objective. Such a major transformation of the sector will require significant investment in the new technologies while the sector needs to remain competitive throughout the entire transition and beyond. Furthermore, external factors not directly controlled by the sector (most importantly, access to competitive low carbon energy/electricity and feedstock) will play a crucial role.

Therefore, we need – as soon as possible – a comprehensive policy framework that preserves the competitiveness of the sector and creates the conditions for fostering the necessary investment.

In this context, the EEAG, as part of a comprehensive industrial transformation strategy, represent a key element for a successful transition to a climate neutral economy, as they could allow the sector to maintain global competitiveness also in a transformed operation mode. The existing EEAG reflect the priorities of the 2020 climate & energy package and the related pieces of legislation. The ongoing revision of the EEAG needs on one side to retain the elements that are still relevant and on the other side to develop adjustments that are required by the updated policy context.

The main recommendations of the steel sector are summarised below:

- **Continue protection of energy intensive sectors (EISs) against undue costs of renewable levies**

Under the existing EEAG (section 3.7), EISs exposed to international competition are entitled to aid in the form of reductions in or exemptions from environmental taxes and in the form of reductions in funding support for electricity from renewable permits.

¹ COM(2018) 773

The underlying principle and objective of these provisions is very important and should be retained. Especially the fundamental notion that without such reductions and exemptions EEIs would be placed at such a competitive disadvantage that it would not be feasible to introduce the support for renewables at all. Such reductions and exemptions need to be maintained and strengthened, because they constitute effective measures to ensure the competitiveness of these sectors, including steel, and contribute to the overall environmental objectives as they support environmental ambition in the EU while avoiding carbon, investment, jobs leakage to third countries with less environmental ambition. The aid for EEIs involved under these schemes has proved to be based on objective, transparent and non-discriminatory criteria. Without these exemptions, EEIs would face the imminent risk of losing market shares to competitors in third countries where no comparable climate protection measures are in place or where such exemptions are provided. At the same time, the overall costs of support for renewables should be reduced over time as more technologies reach maturity and market competitiveness.

While retaining the principles and objectives of existing provisions, the revision of the EEAG should take into account recent court cases when defining the definition and boundaries of state aid. In the very recent judgment concerning the German law for renewable energy from 2012 (EEG 2012), the European Court of Justice (“ECJ”) found² that funds generated by surcharges paid in accordance with national schemes do not constitute State resources as long as they are not at the disposal of the State but controlled by private parties. Consequently, under certain conditions, exemptions to energy intensive undertakings do not constitute State aid. The revised EEAG should take into account these developments and clarify such conditions.

➤ **Improve the requirements of aid for generation adequacy with regard to cost efficiency**

To reduce the impact of capacity mechanisms on energy prices the guidelines’ emphasis on “facilitating demand side management and increasing interconnection capacity” is essential. In the future, the eligibility of capacity mechanisms could be conditioned to the existence of programs for demand side incentives and capacity investments. Other elements to improve cost effectiveness would be requirements to check that capacity use actually corresponds to physical energy flow. Furthermore, manufacturing industry should have access to capacity markets and objective criteria should be ensured for capacity call order to avoid that manufacturing industry capacities are systematically placed at the bottom of this order.

➤ **Allow for reductions in or exemptions from undue financial contributions to generation adequacy funding**

Rising shares of renewables will most likely be accompanied with increased generation adequacy measures in the form of capacity mechanisms. In analogy to the situation with contributions to renewables, financing such costs could easily undermine the competitiveness of EEIs exposed to international competition, such as steel. Furthermore, EEIs offer solutions in these fields as they contribute to the stability of the grid thanks to their specific consumers’ profiles. Hence, they should be also shielded from an undue extent of such regulatory costs, taking into account their overall contributions to taxes and levies.

➤ **Support the transformation of EEIs to contribute to a climate neutral economy**

The urgency of a successful transformation of EEIs through the development and uptake of several breakthrough technologies has been highlighted in several recent initiatives of the European Commission, including:

- Communication “A Clean Planet for all - A European strategic long-term vision for a prosperous, modern, competitive and climate neutral economy”;
- Commission Delegated Regulation establishing the Innovation Fund;

² ECJ, 28.3.2019, C-405/16 P, ECLI:EU:C:2019:268 – Germany / Commission

- Strategic Forum for Important Projects of Common European Interest;
- High Level Group on EEIs;
- Set Action Plan.

The in-depth analysis accompanying the Communication “A Clean Planet for All” indicates that deep emissions reductions in the steel sector are technically possible through a combination of pathways, including steel recycling, carbon capture utilisation and storage, process integration, and hydrogen-based metallurgy. At the same time, the document confirms that in the context of fragmented climate action the steel sector is the most exposed to carbon leakage risk among all energy intensive sectors, both in terms of possible impact on output and on investment³.

While the existing EEAG mentions explicitly only the possible support for CCS, it is essential that the revision of the EEAG introduces the possibility of granting state aid also to other relevant breakthrough technologies mentioned above. The kind of aid should be tailored to the specificities of those technologies.

A key element for the successful transition to the breakthrough technologies will be to access to low carbon energy sources at competitive prices, since they will play a major contribution to the OPEX. In addition, there can also be other operational costs required to allow the investments of these technologies. For these reasons, and as long as the additional cost of production with low carbon technologies is not addressed by other means such as international agreements and/or border measures, aid should be allowed also for use (not only the production) of low-carbon energy and other operational costs needed for low carbon technology investments. Furthermore, it should be introduced the possibility of granting aid for the costs related to the dismantling and clean-up of heavy-carbon plants.

Finally, building on the experience of the power sector in the last decade, it should be investigated the option of allowing demand-side measures (e.g. contracts for difference, or similar instruments) to support low carbon products/solutions to de-risk investments and create markets for such products. In particular, the EEAG should allow the possibility of developing instruments that address the risks of the investments in decarbonization technologies, such as the risk linked to fluctuations of the carbon price.

Under the current version of the EEAG the aid ceilings, in particular for large companies, are insufficient. Aid should be proportionate to the effort requested to the companies, regardless of their size. Considering the massive financial efforts required by the breakthrough decarbonisation technologies, the maximum aid intensities should be significantly increased. It should be clarified that within the framework of the EEAG it is allowed to combine aid with free allocation for projects enabling emission reductions.

The current notification process requires two separate layers of assessment: firstly, approval by the national funding authority, and secondly, the approval by the Commission (which takes at least two years, in some cases even longer). This needs to be addressed with a swifter process that provides legal certainty in a more timely manner.

³ Please see table 13 at page 221 and table 16 at page 225 of the “[In depth analysis in support of the COMMISSION COMMUNICATION COM\(2018\) 773](#)”.

ANNEX: COMMON ASSESSMENT PRINCIPLES APPLIED TO AID FOR BREAKTHROUGH LOW CARBON TECHNOLOGIES

Mirroring the reasoning underlying the current section on CCS, state aid for breakthrough low carbon technologies in the steel sector (and more broadly for EILs) would fulfil the common assessment principles defined in sections 3.1 and 3.2, notably:

➤ *Contribution to an objective of common interest*

The general objective of the EEAG is to increase the level of environmental protection compared to the level that would be achieved in the absence of aid. The successful transformation of the steel industry is a crucial step for the shift to a prosperous, modern, competitive and climate neutral economy, i.e. the objective defined in the Commission Communication “A Clean Planet for All”. The sector is a strategic contributor to the EU economy, in terms of value added, direct and indirect employment, tax revenues, and support to value chains in infrastructures, transport and mobility (see Fact sheet 1). At the same time, the development, uptake and deployment of the breakthrough technologies in the sector are essential to allow large abatement of emissions in the order of 80%-95% compared to existing levels, i.e. around 250Mt CO₂/y (see Fact sheet 3).

➤ *Need for state aid intervention*

A need for State intervention exists in situations where aid can bring a material improvement that the market cannot deliver on its own. The main objective pursued by environmental legislation, including the EU Emissions Trading System (ETS), is the internalisation of the costs of GHG emissions. However, the experience of more than a decade (in EILs but also in the power sector) confirms that legislation alone is not sufficient to tackle such negative externality.

In particular, the specific market characteristics as well as the business environment in which the steel industry operates corroborate the need for aid intervention. On one side, the investment (around 50-60 bn€ overnight) as well as the increased capital and operating costs of the breakthrough technologies (between 80-120 bn € per year) are well above the financial ability of the sector (see Fact sheet 3). On the other side, a full internalisation of the environmental costs in the context of fragmented global climate action would lead to significant carbon leakage due to the very high exposure of the sector to international competition, often linked to unfair trade practices (see Fact sheet 2).

➤ *Appropriateness of the aid*

In order to deem the aid appropriate, it must present the least distortive policy instrument. As mentioned above, legislation is not sufficient to deliver the pursued environmental objectives. As long as there is no structural solution to the full cost pass through of the negative externalities, aid is a necessary and appropriate measure.

➤ *Incentive effect*

According to the existing EEAG, an incentive effect occurs when the aid induces the beneficiary to change its behaviour to increase the level of environmental protection or to improve the functioning of a secure, affordable and sustainable energy market. Thereby, the beneficiary would refrain from this change in behaviour without the aid.

As indicated in the updated Steel Industry Roadmap to 2050 (see Fact sheet 2), the transformation to the new breakthrough technologies entails much higher investment as well as capital and operating costs compared to the continuation of the conventional technologies. Considering the very low margins of the sector and the very high exposure to competitors in third countries without comparable climate legislation and related costs, state aid is necessary to create the incentives for such transformation. Without aid and without the successful deployment of these technologies, the level of abatement would be significantly lower (i.e. around 15% vs. 80-95%). In addition, there would be a high risk that the unilateral carbon costs

in the EU would lead to an increase of emissions embedded in imports that do not face similar carbon constraints.

➤ *Proportionality of aid*

According to the existing EEAG, the amount of aid granted to the beneficiary needs to be limited to the minimum amount required to achieve the environmental protection or energy objective aimed for.

While it is clear that such assessment needs to be performed on a case-by-case basis, the findings of the updated roadmap clearly indicate the major financial effort required by the breakthrough technologies in terms of overnight investment as well as capital and operating costs. Therefore, the proportionality assessment needs to take into account these elements as well as the limited financial ability of the sector.

➤ *Avoidance of negative effect on competition and trade*

The positive effects of aid in support of development, uptake and deployment of breakthrough technologies clearly outweigh the possible side effects on (intra-EU) competition and trade. In fact, a lack of aid puts all European steel manufacturers, especially those trying to undergo a transformation, at a competitive disadvantage against third countries' producers. Once the aid intervention has fulfilled the proportionality assessment above, it should be granted in order to foster the major emission reductions that are necessary to achieve the long-term climate goals.

➤ *Transparency*

In line with the existing provisions, granted aid should also fulfil the transparency assessment.