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FORTUM'S VIEWS RELATING TO THE REVIEW OF THE EU ENVIRONMENT AND ENERGY STATE AID GUIDELINE (EEAG, 2014/C 200/01)

General remarks

Fortum welcomes the process to review the Guidelines on State aid for environmental protection and energy 2014 - 2020, EEAG (2014/C 200/01). It is important to align EEAG in light of the EU 2030 targets and the Clean Energy Package and to ensure that the revised guidelines will sufficiently reflect the recent technological development, development of other steering mechanisms as well as the EU Commission's objective to reach carbon neutrality by 2050 in line with the Paris 1,5 C target.

The IPCC report together with the EU 2050 long-term climate strategy underline the necessity to go beyond traditional RES and other clean technologies. It's now increasingly understood that also technologies to capture, store and utilization of CO₂ (CCS, CCU) as well as direct air capture of CO₂ (DAC) will be needed if we want to reach the Paris ambition. In the gas sector there is a strong focus on developing synthetic gases. All these technologies are very electricity intensive.

Finally, it is important to ensure that the principle of technology neutrality is applied in a consistent manner across all different horizontal EU policies also in initiatives such as sustainable finance.

Please find below our comments relating to certain specific areas.

Renewable electricity (RES-E)

In general we consider the existing provisions relating to renewable energy to a large extent still valid. Renewable electricity production has to be integrated into the electricity market with the same market rules, rights and responsibilities as other technologies. RES production needs to bear balancing responsibility and market-based dispatch/curtailment and the costs of network connection.

Promotion of renewables should be based on more efficient and flexible power markets and a strengthened carbon price instead of specific subsidies. RES technologies such as (onshore) wind and solar have already reached cost-maturity in some parts of Europe and by 2020 this should be the case more broadly. Where subsidies are still deemed justified, they should be designed as market based as possible to expose producers to market prices; for example, during hours with negative market prices subsidies should not be paid. They should also be

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technology neutral and open for cross-border participation. Tenders have proved to be an essential way to bring down the cost of new technologies.

Retroactive changes in subsidies should not take place without compensation. However, in terms of retroactivity, a distinction should be made between direct financial subsidies and indirect subsidies in the form of exemptions from market obligations. It should be possible to abolish the latter kind of exemptions in order to reach a level playing field.

CO2 price should be the main driver for mature RES technologies in electricity. The revised EU ETS is expected to result in carbon prices that will transform the energy system and increasingly internalize the costs of GHG emissions. As electricity generation is covered by the ETS, as a rule no state aid for RES electricity should be allowed. Sectors remaining outside the ETS, such as parts of the heating and cooling as well as transportation require specific steering mechanisms, also from the state aid perspective.

After 2020 the EU ETS should be the only instrument to steer fuel switching from fossil fuels to non-fossil, including biomass. State aid may be necessary for R&D, innovations and first-of-kind biomass projects that are close to commercialization. As a whole, the use of biomass should be assessed from the system efficiency point of view, giving preference to using biomass for high-value bio-based materials and products and using the reject biomass as a transitional energy source for electricity and heat. Next generation, multiproduct and resource efficient bio-refineries need suitable financing instruments for the commercialization of technologies.

Promotion of low carbon district heating and cooling (DHC)

Heat sector requires urgent and systemic decarbonization, which is constituting development opportunities. Currently only minor parts of heating and cooling sectors are covered by the ETS (electrical heating and district heating and cooling) while some others remain outside (building specific H&C solutions). The policy priority should be to include the whole heat sector to the EU ETS scope - this would ensure the most cost-efficient transition towards decarbonized solutions

The affordability of heating is yet a social and energy policy challenge in many Member States. This challenge originates from several factors e.g. heating prices, household incomes, structure and organization of housing sector, energy performance of buildings and national climate conditions. Therefore to address this challenge systemic solutions to enable transition to energy efficient low-carbon heating are needed. To support this process, EEAG should allow investment and operative aid to low-carbon, efficient and scalable heating solutions. Decarbonization of heating, transport and industries through coupling with renewable electricity market is expected to play an important role in climate mitigation. In the heat sector, this includes wider and swifter implementation of heat pumps, thermal storages, geothermal sources etc. as part of efficient district heating and cooling in urban areas and individual heating in rural areas.

The EEAG should allow effective promoting measures for the efficient¹ individual heating solutions and DHC systems, both in terms of investment and temporary operational aid, or other effective nationally determined measures e.g. taxation.

¹ As defined by Energy Efficiency Directive 2018 (consolidated version) article 2:42-43

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The length of the schemes for energy efficiency measures (other than co-generation) in the criteria shall not be categorically limited to 5 years for operating aid. This is inflexible solution limiting the potential investments and thus slowing down the transformation of the energy sector. The Member States should be given sufficient flexibility to design the aid between investment and/or operative aid within the limits of aid accumulation guidelines. All low carbon heating and cooling solutions should be having parity and sufficient level playing field.

Waste management

EEAG shall cover energy, environment, circular economy as well bio-economy related topics. The measures shall enable synergy effects between those areas and lead to the decarbonization and strengthening of the environmental protection. Thermal treatment of waste as an environmental alternative to diverting waste from landfills and treating residues from recycling processes is an important part of circular economy and should remain eligible for aid in full accordance with the requirements to prioritization within the EU waste hierarchy. Aid for decontamination technologies for waste streams that need decontamination should be recognized in order to enable the move towards a more sustainable non-toxic circular economy.

As it would make sense from an environmental as well as economic and efficiency point of view to exploit the already existing WtE capacities in the EU as efficiently as possible, state aid consideration could even be extended to issues like free movement of waste to recovery options, taking into account the relevant EU legislation. E.g. forbidding waste export to another EU country for recovery purposes should be considered as a form of state aid for domestic recovery operations.

Support for RDI and commercialization/piloting of new technologies

State aid may be necessary for R&D, innovations and first-of-kind technologies that are close to commercialization, including synthetic gases which are expected to play an important role in replacing fossil gases. However, technology neutrality should be a guiding principle in any state aid.

Carbon removal technologies

Since the approval of the existing State Aid Guidelines, carbon removal technologies have developed and CCS is not anymore the only solution. Both CCU, direct capture of CO₂ from the air (DAC) and material substitutions based on carbon removals are becoming feasible and should be considered in the framework of the guidelines.

Sufficiently strong market-based incentives are not yet in place for the development of CCS/CCU, new carbon sinks and material substitutions. In order to achieve the 1.5-degree target, the EU needs to develop a mechanism to reward these, including removal of CO₂ from flue gases or directly from the air.

State aid can contribute to fostering the development of these technologies. State aid should be focused on CCS/CCU/DAC technology development and industrial scale demonstration projects to make CCS/CCU/DAC financially sustainable without state aid in the long run.

Taxation

In general, in order to avoid market distortions caused by different tax treatment or aggressive tax competition, taxes between different energy generation technologies within

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an individual member state as well as between the member states should be as much aligned as possible. This applies to all taxes applied to these activities including energy, real estate and company taxes. Level playing field both in terms of subsidies and taxes would be in the interest of tax payers too.

There is room for clarification of the State Aid Guidelines' provisions relating to taxation, especially concerning situations where the same energy product – electricity, heating or cooling - is subject to different tax treatment because of different production technology.

Taxation is a powerful tool to support energy transition. Regarding aid in the form of tax exemptions or tax reductions, the EEAG revision should reflect the overall aim to decarbonize all sectors i.e. going beyond energy production such as heating and cooling, clean gas production etc., and the role of electrification in decarbonisation should be recognized. Electricity tax rate will have an important role in speeding up electrification and thereby decarbonisation of societies.

Also, the forthcoming review of the EU Energy Tax Directive (2003/96/EC) should address the role of taxation in support of energy transition. It is important to ensure that the provisions are clear and aligned in both legislative instruments.

It's necessary to ensure compatibility between the EU ETS, state aid and taxation. All CO2 emitting production should be subject to ETS driven carbon pricing or (national) CO2 tax but not both. This principle should be clarified both in the EEAG and in the Energy Tax Directive. For example, in some countries, district heating production is covered by the EU ETS, but it is also subject to additional (and increasing) national CO2 taxation whereas heating of individual buildings is not always subject to any CO2 steering - not ETS or CO2 taxation. This effectively distorts competition between different competing heating methods. Such overlapping policy steering on certain production technologies is in practice a hidden national subsidy to those production forms that are not subject to overlapping policy steering.

Capacity mechanisms and market design

The section related to aid to generation adequacy should be updated in connection with the requirements laid down in the Market Design package (European generation adequacy, plan to remove market distortions, investigate strategic reserve prior to considering wide-encompassing market mechanism, generation capacities etc.). As capacity markets are gradually developing, it is important that the next edition of state aid guidelines have a stronger regional and EU level focus instead of just national. Attention should be paid to defining consistent capacity products and promoting cross-border participation of generators. DG COMP should issue recommendations on detailed aspects such as derating of interconnectors that can substantially affect the ability of delivering capacity from neighboring markets.

The EEAG should also clarify the role of regulated versus commercial operations (e.g. regarding flexibility assets) from the state aid point of view, placing specific attention on provision setting out a delineation between market and regulation to ensure that from a state aid point of view there are sufficient safeguards against cross-subsidies and conflict of interest. It is vital for the development of commercial flexibility market that there are no distortions in the market or undue benefits in investing in such assets by regulated players.

Tradable permit schemes

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In sectors regulated by EU legislation (e.g. Industrial Emissions Directive and LCP BREF setting emission limits and standards) tradable permit schemes should be preferably EU wide. These schemes should achieve environmental objectives beyond those to be achieved on the basis of EU legislation.

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