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Draft ETS State Aid Guidelines

This document represents the input of the sectors deemed eligible for compensation under the draft ETS State Aid Guidelines. The EU ETS Guidelines are an essential element of the legal framework that aims at preventing the risk of carbon and investment leakage. In line with the spirit and wording of the EU ETS Directive, both free allocation and indirect costs compensation should ensure that the best performers do not face undue direct and indirect carbon costs. With EU ETS prices higher than in Phase III and expected to further rise in Phase IV, the impact of electricity prices (“indirect ETS costs”) will increase substantially as electricity producers pass the carbon price on via the electricity price. Thus, it is essential that the new ETS Guidelines provide an adequate carbon leakage protection against rising indirect carbon costs Phase IV. In this paper, we comment on the following areas of the draft ETS Guidelines; 1) conditionality, 2) level of Aid, 3) regional pass-through factors and 4) benchmarks.

1. Conditionality

Given our energy-intensive nature and the fact that we face global competition, the sectors eligible for compensation have the strongest incentive to be as energy efficient as possible. Thus, compensation should not be made conditional on additional requirements. Since the eligible sectors are already acknowledged as being at a risk of carbon leakage, these additional conditionality conditions only serve to increase the risk of carbon and investment leakage.

In fact, compensation for the indirect costs of the EU ETS aims at reimbursing partially energy-intensive consumers for the indirect carbon costs passed on in their bill. If compensation is made conditional on additional measures to be taken by a company such as investments in energy efficiency and emissions reduction or a carbon free power purchase agreement, de facto it no longer represents a (partial) reimbursement of incurred costs since it requires additional expenditure to the company.

Elsewhere, it should be noted that compensation of indirect costs does not distort incentives for energy efficiency investments because it is still based on very strict benchmarks reflecting the best performance in the sector. Furthermore, the “incentive effect” is also preserved by the fact that the benchmarks will be updated during the phase 4, so that companies have further interest to constantly improve their performance. (Such mid-term update was not applied in phase 3).

Furthermore, the proposed conditionality requirements are actually linked to the implementation and enforcement of other pieces of legislation (notably the Energy Efficiency Directive and the Renewable Energy Directive). However, Member States retain the possibility of adopting different instruments to promote energy efficiency and renewables in order to achieve the targets set in such legislation. Therefore, the conditionality requirements would overlap and possibly collide with different national measures.

With regards, the three proposed conditionality requirements outlined in paragraph 54 we wish to share the following input;

- a) The energy efficiency investments with a payback period of 5 years do not reflect the reality of business decisions in our sectors, which are bound to a significantly shorter period. Furthermore, the draft text does not take into account early actions such as recent energy efficiency investments.
- b) The requirement to install an onsite renewable energy generation facility covering at least 50% of the electricity needs does not match with the very large energy consumption of industrial sites and the physical limits of such on-site generation. Considering the land requirements and also the regulatory restrictions to the installment of wind turbines, for some eligible sectors, this conditionality requirement is not technically nor financially feasible, hence it cannot be achieved realistically.
- c) The requirement to invest at least 80% of the received state aid into investments to reduce direct emissions of the installation is not consistent with the scope of the Guidelines which are targeting indirect costs.

2. Level of Aid

As a principle aid intensity should be set at 100% of the benchmark for the best performers in order to be in line with the spirit and wording of the ETS Directive. A level of aid less than 100% undermines the spirit of the ETS Directive and the effectiveness of the carbon leakage provisions as there remains no comparable climate legislation in regions beyond the EU. Moreover, the risk of carbon and investment leakage is even greater today, given that we are seeing more higher EU EUA prices compared to what we have experience up until 2017.

Paragraph 26 of the draft Guidelines say that at the sectoral level, the level of compensation would be 75% until 2030. While aid should rather be set at 100% for best performers, a system of 75% compensation, provided a GVA limitation is included, is an important step to ensure better protection.

Degressive aid serves no function and instead, the best way to capture improvements in an installation's performance is to update the benchmark values. Indeed, the Commission explanatory note says that it *"considers that this update of the efficiency benchmarks is better suited to capture any potential efficiency gains in the sectors concerned than a per-se reduction of the aid intensity"*. We agree with the Commission's assessment that aid intensity should be stable throughout the ETS period with a mid-term update of the electricity consumption efficiency benchmarks to consider most recent data and production processes.

In addition, paragraph 30 in the draft Guidelines introduce the possibility for Member States to further limit the exposure of beneficiaries to indirect costs as a function of their gross value added ("GVA"). This possibility is aimed at limiting the exposure of the most electro-intensive companies for whom indirect carbon costs, after applying 75% compensation, can make up a disproportionate amount of their GVA. The GVA limitation should be capped at 0.5% of GVA. In addition, the possibility should be open to all undertakings in the list of eligible sectors provided they reach the agreed threshold.

3. Regional pass through factors & geographical regions

Paragraph 10 plus Annex III define the maximum regional CO₂ emission passthrough factors (tCO₂/MWh) per geographical area. The draft Guidelines include the proposed geographical areas and a methodology for calculating the passthrough factors. The actual applicable factors for each region will be established at a later stage.

The main purpose of the CO₂ emission passthrough factor in the Guidelines is to identify the impact of CO₂ emission costs (EUA allowances price) on power prices in each market. The draft Guidelines are correctly based on market principles where the emission passthrough factor is delinked from the total electricity generation's greenhouse gas footprint and decided by the marginal price setter in each given market.

However, the emission pass through factors and geographical areas are intrinsically interlinked and both need to be accurate. The proposal of splitting existing regions in more areas does not provide details on the underlying evidence and contradicts the political objective of linking more the national energy markets. Furthermore, the overly strict methodology for defining regional areas (1% price divergence in significant number of hours per year) does not capture the reality in certain energy markets where the emission pass through is influenced by the emissions pass through neighbouring member states due to interconnections.

For instance, the Nordic countries have been interconnected with a common price setting mechanisms the last 20-30 years, and there is sufficient information available to re-establish a single factor for this 'Nordic' region encompassing Norway, Sweden, Finland and Denmark. Elsewhere, the Central West Europe (CWE) region encompassing France, Germany, Belgium, Netherlands, Austria and Luxembourg have also registered a growing convergence over the years and should be re-established as a geographical region.

4. Benchmarks

Benchmarks are the best instrument to incentivise energy efficiency and emissions reduction. We support that the benchmarks be updated in 2025 to take into account technological developments in the sector (as mentioned above, this update as well as the stringency of the benchmarks makes the conditionality unnecessary).

We believe that benchmarks should be based on actual data of the 10% best performers (instead of single lowest installation) so that they reflect economic and technical feasibility within the relevant sector. Where appropriate, benchmarks should take into account also relevant energy carriers such as industrial gases.

We support the continuation of current definitions at Prodcom 8 level. We would recommend that the European Commission, working in tandem with a consultancy company, collect electricity data at Prodcom 8 level with the involvement of respective commodity associations which request them. This would be a similar exercise to the process run in 2011/2012.

With regards the fallback benchmarks, the 80% value should not be reduced further. Indeed, it should be noted that even with this level of aid, installations in the fall back benchmark category will only receive 60% of the incurred costs (75% of 80% = 60%).