

9 March 2020

PUBLIC VERSION

EUROALLIAGES' submission to European Commission's public consultation on the draft ETS State aid Guidelines aiming to reduce carbon leakage risk related to indirect ETS costs

1. Introductory remarks

EUROALLIAGES¹ is the voice of ferro-alloys and silicon industry in Europe. As a key provider of essential qualities (alloys) for steel, aluminium, electronics, chemicals and solar panels, our member companies are considered critical economic actors enhancing EU strategic and sustainable value chains and will play an essential role in the Green Deal agenda.

In this context, an adequate, predictable and effective design of the State aid Guidelines (SAGs) aiming to reduce carbon leakage risk related to indirect ETS costs (2021-2030) is a fundamental pre-condition to preserve the global competitiveness of our sustainable and efficient operations. The lack of a proper regime will simply put under serious threat the future of our business, investments, innovations and jobs.

Besides the particular proposal to define the SAGs regime on indirect compensation costs, there are two overarching factors that will create an extra pressure to our capabilities when protecting our jobs and delivering critical materials to enhance the sustainability of European value chains:

A) Overcapacity remains a huge obstacle and may persist in the next decade (2020-2030)

As stated in the targeted consultation of interested sectors on the revision of the state aid guidelines in April 2019, both ferro-alloys and silicon are exchanged on a global level with globally set prices. All our European companies are price-takers facing fierce and unfair

¹ EUROALLIAGES represents almost 100% of Europe-based ferro-alloys and silicon production (EU+EEA). The association has 12 member companies located in 10 countries, with a global turnover 2.7 billion €, a Gross Value Added of 480 million € and a workforce of 4,300 persons. Our sector supplies key values chains such as Steel, Aluminium, Electronic, Chemicals, Solar and Batteries. Silicon is classified as critical raw material. For further information, please visit our website: <http://www.euroalliages.com/>

competition from third countries (i.e. China). For the vast majority of ferro-alloys and silicon products, there is acute overcapacity in third countries. In this context, it is impossible for European companies to pass on CO₂ costs without a loss of market share.

B) The EU carbon price will tend to increase and reach new peaks

The current ETS reform has already triggered a substantial increase of the EUA price. According to several analysts, the EU carbon price will remain beyond 20 EUR/t and may well reach peaks of 30 or 40 EUR/t in the next years. Further reform of the ETS system (i.e. Green Deal planning to expand the scope) and more ambitious targets by 2030, may continue to push the price up to unprecedented levels. The indirect costs increase proportionally with the CO₂ price, but according to our internal assessment as the EUA price overcomes 25 EUR/CO₂t, the indirect costs linked to ETS becomes massive, putting an unbearable and unfair burden on the viability of most of our operations, including cash flow issues in some countries². This new phase of ETS cost burden will require, more than ever, a strong and proportionate indirect compensation support to the most exposed sectors and installations to carbon leakage risks. Either a weak level of aid or inappropriately timed support could rapidly erode the economic viability of efficient and competitive European plants.

2. Design and goals of the proposed Draft State Aid Guidelines

EUROALLIAGES welcomes the overall design of the proposed draft guidelines in line with the need to address three specific objectives: minimising the risk of carbon leakage in critical industries, preserving the EU ETS objective to achieve cost-efficient decarbonisation and; minimising competition distortions in the internal market.

We understand that the future SAGs regime for indirect costs shall mitigate the risk of the most exposed sectors and, within each eligible sector for compensation, all its installations in a fair and non-discriminatory manner during the next trading period (2021-2030) and beyond.

We notice and encourage the very positive recognition that an inadequate protection will, as stated in the draft proposal, result in “no reduction of global emissions” due to the consequent carbon leakage, and this will frustrate the efforts of the EU and its industries to meet the global climate objectives of the Paris Agreement. The global dimension of GHG emissions reductions policies is and should remain a relevant context by which EU policymakers should reform regulation.

² Increasing EUA price may also create severe cash flow challenges in some companies operating in the EU. For instance, compensation for indirects in Poland is provided in the month of October of the year that follows the costs incurred. This means the average payment term is 16 months. Assuming the further increase of the CO₂ prices, the impact on cash flow becomes more and more significant. We therefore recommend to Member States to provide compensation every 30 days after each month.

With these principles in mind, EUROALLIAGES has outlined the positive elements of the new architecture of the Draft Guidelines but has also stressed some important concerns that may hamper the expected positive outcome from the future aid.

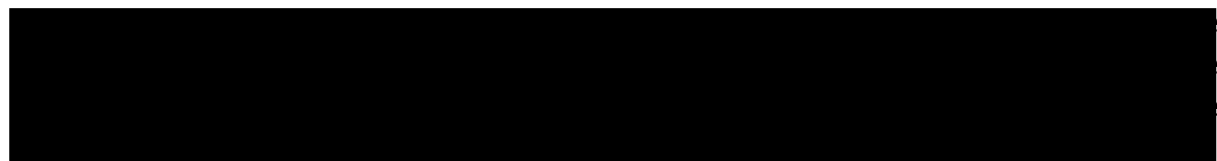
3. Full support of the eligibility list, a non-degressive aid intensity approach and the possibility to limit carbon leakage throughout a Gross Value Added (GVA) cap system

We fully support European Commission's new eligible sectors (6) list based on the indirect carbon leakage indicator of 0.2, a trade intensity of at least 20% and an indirect emission intensity of at least 1 kgCO₂/EUR. The combination of those criteria enables to identify the most exposed undertakings³. In addition, EUROALLIAGES endorses a non-degressive aid intensity approach that should provide a minimum aid of 75% for the entire trading period 2021-2030 in combination with the possibility for installations to further limit the carbon leakage exposure aiming to reach 100% coverage, based on a GVA-cap system.

EUROALLIAGES believes that the three elements *together* constitute a solid, fair, proportionate and encouraging foundation to address the increasing pressure of carbon leakage.

More specifically, we believe regular updates of the regional pass through factors using accurate power market modelling is an objective, fact-based and fair method to apply degressiveness.

As the ferro-alloys and silicon sector is already fully electrified, our most recent calculations shows that: 1) the impact of indirect emissions costs over total energy costs ranges between



some particular cases. According to recent estimations conducted by EUROALLIAGES, many elements such as the location, regional price-through factors, estimated future electricity prices and the level of electro-intensity of the product manufactured (silicon, different types of ferroalloys) show a wide variety of impacts on GVA and a different level of sensitivity per plant assessed. Therefore, we highly recommend that all ferro-alloys and silicon installations in Europe to be eligible for compensation up to a maximum of 100% of the overall indirect carbon emissions costs when electro intensity is at least 20% and these the indirect carbon emission costs represent more than 0,5% of GVA after the CO₂ compensation has been granted.

4. Benchmarks

Since the NACE-4 level cannot adequately picture the specificities of our industry, we fully support the continuation of current electricity consumption benchmarks definitions at PRODCOM 8 level.⁴

5. Inaccurate definition of geographical market areas

We regret the inappropriate definition proposed by the Guidelines on market areas (i.e. “within which no declared congestion exists and, in both cases, hourly day-ahead power exchange prices within the zones showing price divergence in euros -using daily ECB exchange rates- of maximum 1 % in significant number of all hours in a year”).

The proposed methodology constitutes a too strict criteria for market integration. During the last years the amount of physical interconnectors has increased, and market coupling has ensured more optimal power flows between power markets. Still, the Commission’s study point to increased divergence in hourly price levels between markets. We believe this is explained by the ever increasing amount of intermittent renewable power, causing more price volatility and hourly price differences between markets. This is an indication that power markets have evolved and the methodology that worked well for ETS3 may not work that well any longer.

Therefore, we believe the best metric for the integration of different national power markets is not the absolute price difference between the markets but the co-variance between them. The reason for this is that two neighboring markets are often structurally different and thus have a fundamentally different price level. The box below provides one example.

One example is when different generation sources or one market features a CO2 price floor. Such markets will not have equal prices before all bottlenecks are removed and the transmission capacity between them is not a limiting factor. This is not economically viable as it would require excessive investments in transmission capacity and it is also not the case internally in countries, where there are many bottlenecks at any time but the price is kept equal through interventions in the power market. As there is no such price intervention to equalize the price between countries there will always be a certain price difference between power markets as long as transmission capacity is not unlimited. As thus a price difference will often exist, the best metric for the integration between power markets is to consider how much they affect each other and this is done by evaluating how prices correlate. This is a measure on the extent to which the price in one market influences the price in another and thus also to which extent the CO2 element in one country spills over to another.

⁴ An assessment at NACE-4 will underestimate these costs as the NACE code at stake, in particular under the “other inorganic chemicals” code which comprises a wide product range.

Nowadays, the most accurate and recommended approach is to use power market models to evaluate the interconnectedness of national markets. Sophisticated power market models are now available from several suppliers covering most European regions. We suggest using market models for these areas. These models will also be able to determine the CO₂ emission factor of each region with good accuracy, especially for regions with a high share of non-fossil power production such as the Nordics and France where the CO₂ emission factor is mostly determined through exchange of power with neighboring countries.

We therefore call the European Commission to avoid fragmenting the CO₂ pass through factors into multiple national blocs since this is not reflecting the market coupling and convergence of power markets across different borders and EU regions.

In turn, we encourage the European Commission to keep the same electricity market areas as in the current guidelines with regular updates and include Norway as part of the Nordic market power together with at least Sweden and Finland. Prices in those countries are closely connected using both metrics; both the absolute price difference is small, and correlation is high. We believe the same applies to France which shows high price correlation with Germany. The current Central Western European (CWE) region should persist.

In this respect, we suggest as a matter of clarity to also indicate at the beginning of the Guidelines that the text is of EEA relevance.

6. Inaccurate definition of CO₂ emission factor

The definition of the CO₂ emission factor provided in §14(10) may be accurate for power system with predominantly fossil power production but may be inaccurate for power systems with a high proportion of renewable or nuclear power production as the CO₂ emission factor in these systems mainly stems from the neighbouring power markets.

For regions with such power systems, mainly Nordic and France, we propose using power market modelling as recently done by the consultancies Pöyry and Compass Lexecon in a very accurate manner⁵. Power market models may also be used for establishing market areas.

Furthermore, the recent introduction of national CO₂ price floors will influence the CO₂ price passed into the power price domestically as well as in neighbouring countries. Only power market models are able to account for such local CO₂ prices.

Alternatively, if models are not used, the market areas defined in ETS phase 3 must be kept in order to calculate an accurate pass through factor for markets with a small share of fossil based power production such as France and Nordic.

⁵ Carbon Transfer Factor in the Nordic Power Market - A report to Norsk Industri (August 2018): https://www.norskindustri.no/contentassets/901ccb8bf6c441fbb92e3e6b909b8c02/norskindustri_nordiccarbontransferfactor_finalreport_v200-1.pdf

7. Optimal definition of EUA Forward Price

EUROALLIAGES welcomes the definition of the 'EUA forward price' as it is stated: "means the simple average of the daily one-year forward EUA prices (closing offer prices) for delivery in December of the year for which the aid is granted, as observed in a given EU carbon exchange from 1 January to 31 December of the year preceding the year for which the aid is granted". This provides for a very transparent, objective and simple calculation of the appropriate aid.

8. Too vague and unclear definition of Electricity Consumption Efficient Benchmarks

EUROALLIAGES is deeply concerned by the proposed vague or incomplete definition of "electricity consumption efficiency benchmark". Being one of the most electro-intensive industries, electricity remains a costly raw material for our production. Therefore, there is an urgent need to clarify what "the most electricity-efficient methods of production for the product considered" is and whether the so-called qualitative method will play an important role to define efficiency production⁶.

9. Energy Efficiency Audits and Management Systems & conditionality items

Historically, our companies which are operating the best available technologies have constantly cooperated and went through strict obligations to conduct energy audits in line with the Energy Efficiency Directive (2012) or through the EMAS. This requirement will not be new for our sector and will ultimately recognize the efforts made by the industry over the last twenty years.

However, our industry stresses serious concerns on the line 54, points (A), (B) and (C) that intend to influence/govern/direct the purpose of the aid challenging the original purpose of it, which is to mitigate the unfair indirect emission costs that the industry is incurring, and hence carbon leakage. This measures will put under serious threat the entire viability of our industry in the EU market and worldwide. These two conditionality items are therefore unrealistic, disproportionate causing serious distortions to the competitiveness of our operations.

⁶ Our sector, within the limits of the current technology, has achieved the highest possible level of improvement via energy efficiency. Regular updates of the benchmarks should consider such a structural limitation.

We therefore propose what follows:

54 (B)

Directing the aid to reduce the carbon footprint is a desirable goal but it should not be confused with the fact that the aid is needed to avoid the carbon leakage effect by mitigating an unfair *incurred indirect cost* that the industry should pay, affecting massively its economic viability. The aid cannot become conditional to finance new technologies as this is not its primary function. **We encourage to delete this paragraph as its wording distorts the overall purpose of the system.**

54 (C)

Investing 80% of the aid in projects that lead to substantial reductions of GHG and *well below the applicable benchmark* is simply rejecting or ignoring the state of play of the technology of some sectors, including the ferro-alloys and silicon sectors that are limited *de facto* by the unavoidable level of emissions due to the electro-metallurgical process, and the principles of the aid. The aid serves to avoid carbon leakage and new closures. Electricity intensive users cannot influence the energy mix when purchasing electricity and hence their investments. Our sector is firmly committed to continuing to deploy efforts to reduce the carbon footprint and increase the energy efficiency. **Therefore, we propose to delete this paragraph and to add in the chapter the paragraph: “The aid should primarily help the industry to preserve its jobs and competitiveness. However, when technologically possible, aid should continue to support the ongoing improvement defined in the energy efficiency audits of the undertakings and thus contributing directly and indirectly the GHG emissions reduction of its value chains”.**

We want to conclude by stating that we fully support the ETS as an effective way to fight climate change and compensation for indirect CO₂ emissions as an effective tool to prevent carbon leakage. The European Commission should keep in mind that other regions in the world will follow EU’s ambitious climate policy only if the EU succeeds in retaining a thriving and competitive industrial sector while reducing its emissions.

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