

Position paper on the draft of the EU ETS State Aid Guidelines 2021-2030

EU ETS State Aid Guidelines will continue to play crucial role in carbon leakage protection which is becoming even more important in the context of increasing EU climate ambition while at the same time no similar steps are taken in other parts of the world. Such role is even more important due to the higher carbon price compared to phase 3 and in view of the development and uptake of low carbon technologies that will increase substantially the (direct and/or indirect) electricity consumption in many sectors. However, the presence of the State Aid itself (next to the free allocation of EU ETS allowances) is not sufficient, as its effectiveness is clearly dependent on how it will be set, including its individual parameters, and how appropriately it will complement other carbon leakage measures. As the Czech Republic has decided not to continue implementing the system of free allocation of EU ETS allowances for electricity generators in the 4th EU ETS trading period, **the following comments will only be focused on the draft rules for compensation of indirect carbon costs post 2021.**

Generally, we welcome that the Commission proposal stems from experiences and some methodologies used during the 3rd EU ETS trading period. Nevertheless, despite there are aspects of the proposal that we deem appropriate, we see urgent need to amend several parameters of the Commission proposal so that the compensation of indirect costs can become fit for purpose, i.e. will help to ensure sufficient protection of competitiveness of EU industrial sectors at risk of carbon leakage (and thus prevent carbon leakage), while, at the same time, not jeopardizing the motivation of beneficiaries to further invest in relevant environmental measures.

The following text contains our main concerns in terms of individual compensation parameters proposed by the Commission. All these points and recommendations need to be perceived in mutual relations.

1) Sectoral eligibility

In comparison with the current trading period, the number of sectors (NACE) eligible for compensation is proposed to be reduced almost by a half. However, to make the compensation effective, the industrial value chain of eligible sectors proposed must be taken into account both in terms of supplying sectors (e.g. raw material or energy inputs such as industrial gases which will be also very important for long term transformation of some sectors) and downstream processes/sectors that are at risk of carbon leakage due to electricity prices (e.g. the seamless tubes, etc.). Without this and due to further reduction of compensation proposed by the Commission (in aid intensity and benchmarks, see point 2 and 4 below), the compensation even for some sectors already proposed to be eligible for aid, like steel making, could cover less than 50 % of the actual indirect costs borne by the companies. This undermines significantly the effectiveness of the provisions to prevent the risk of carbon leakage. The downstream processes or subsectors at risk of carbon leakage will also face increased costs of carbon, energy and material inputs which further reduces their competitiveness.

Furthermore, the proposed possibility for member states to exclude eligible sectors (paragraph 21) creates major legal uncertainty and may lead to unintended effects and distortions within the EU. Thus, it should not be retained in the final text.

Other sectors/activities that should be eligible for indirect cost compensation:

The steel sector uses significant amounts of industrial gases (NACE code 2011) for unavoidable purposes such as oxygen which have an important electricity consumption embedded. On the basis of the data from the Best Available Techniques Reference document (BREF), the embedded electricity consumption is estimated at 24 kWh/t crude steel in the EAF route and 92 kWh/t in the BF/BOF route (which is around 20-25% of the total electricity consumption in BF/BOF route). The lack of compensation for the indirect costs linked to industrial gases further exposes the steel sector to carbon leakage risk. Therefore, similarly to the allocation of free allowances to the heat consumer under the rules on free allocation for the direct emissions, the consumption of industrial gases should also be considered as eligible for financial compensation when it occurs in a sector that is exposed to indirect carbon leakage such as steel and state aid should be granted to the exposed sector. Such treatment would be important in the context of the medium to long term transformation of the sector, whose breakthrough technologies will need large consumption of industrial gases like hydrogen.

Furthermore, in the EU ETS phase 3 seamless steel pipes were also included in the list of eligible sectors as they are closely linked to the steel sector because they represent a very electro-intensive process similar to other hot/cold rolling processes. Therefore, they should remain eligible.

2) Maximum level of aid intensity

We welcome that the Commission is proposing to keep the State Aid intensity factor stable over the whole 4th trading period. However, there are several reasons why we are convinced that the percentual figure should be higher than 75 % (concretely 100 % of the benchmark) as a basic rule, instead of the proposed possibility for individual member states to compensate by intensity higher than 75 % in individual cases (see point 3).

The eligible sectors, including steel sector, are facing high exposure of carbon leakage linked to indirect costs and are unable to pass through unilateral regulatory costs without genuine risk of losing market shares. This risk is even more relevant in the context of much higher carbon prices compared to those experienced in the recent past.

Furthermore, affordable and competitive electricity prices are essential to facilitate the transition to breakthrough technologies which will require even larger amounts of electricity.

Thus, the aid intensity factor needs to be set at 100 % of the benchmark because any factor reduction undermines the effectiveness of the carbon leakage provisions as long as there is no comparable climate legislation in competing countries. No one can say that this intensity would mean full compensation of indirect costs, as the aid will still be capped by the very strict benchmarks which are to be even updated in the middle of the period. It is clear that

energy efficiency improvements are a must for industries with high energy costs in order to remain competitive.

For example, in case of using fall back benchmarks, the compensation will be reduced by 20 % compared to the baseline electricity consumption. If the 75% aid intensity level would be set, the installations in fall back may receive compensation only for maximum of 60 % of their indirect costs (75 % of 80 %). This is absolutely not consistent with the aim to ensure sufficient carbon leakage protection.

3) Possibility of MSs to compensate beyond the 75 % intensity

As stated in point 2, we are convinced that the aid intensity must be kept at the level of 100 % of the benchmarks to make the compensation fit for purpose.

Nevertheless, if the default aid intensity is not increased to such level, introducing the possibility for member states to grant additional compensation beyond the default value is an important step to reduce indirect costs to eligible sectors. Then, the additional compensation should be set so that indirect costs are capped at no more than 0.5 % of the GVA (adequacy of using GVA is commented below). At the same time, this possibility should be open to all eligible sectors and not limited only to some of them.

Example: in the steel sector this top up possibility should be accessible to both the electric arc furnace (EAF), which has very high electro-intensity because it uses large amount of electricity to melt and recycle scrap, and the integrated route, which consumes electricity produced from the combustion of recovered waste gases generated unavoidably by the steel making process. Financial compensation for this case is explicitly mentioned in recital 13 of the post 2020 EU ETS Directive in order to preserve the incentive to recover waste gases, since free allocation is granted only partially for waste gases' emissions. In fact, financial compensation of indirect costs related to waste gases' electricity consumption is not only linked to the electro-intensity of the process but mainly to the objective of balance the lack of free allocation that the steel producer bears for its waste gases.

Finally, it should be noted that undertaking specific assessment needs to consider the actual specificities of the sites. The GVA of companies is highly dependent on their structure, including the configuration of the production steps where the higher share of value added is generated. Hence, a site assessment would also be necessary where appropriate.

Furthermore, company-specific assessment on electricity consumption should not lead to unintended results in case energy efficiency measures that have already been implemented.

4) Update of the fall back benchmarks

The draft guidelines do not indicate the default value of the fall back benchmark. In phase 3, this was 80 % of the reference electricity consumption. Since this represents a major reduction of aid, it should not be reduced further, otherwise the state aid would be insufficient to achieve its objective of avoiding the risk of carbon leakage.

It should also be noted that the reference fall back benchmark in the free allocation rules for direct emissions is the process emissions benchmark, which is much higher than the electricity fall back benchmark (97% of historical process emissions) and most importantly has not been further reduced between phase 3 and phase 4.

5) Regional emission factors

As a matter of principle, the CO₂ emission factor must reflect the full indirect CO₂ burden, i.e. the actual CO₂ cost passed through into prices. The approach of using historical empirical data on the fossil emission factor in the relevant regional market should be maintained in order to ensure a consistent and stable framework. The calculation of the factors should be based on reliable and transparent sources in order to reflect the real costs faced by the industry.

6) Conditionality

Generally, there is an urgent need to respect the essence of the “compensation” measure. Therefore, the aid should not be conditional upon additional requirements as it aims at reimbursing the energy consuming sectors for the indirect costs passed on in their energy bill. The proposed conditionality on additional measures to be taken by the beneficiaries (i.e. investments in energy efficiency or emission reductions and carbon free power purchase agreement) requires additional expenditures and this would cause that the purpose of the compensation which is to reimburse incurred costs is lost as well as the proper carbon leakage protection effect.

As the eligible sectors are acknowledged as being at risk of carbon leakage (on the basis of market characteristics, profit margins and abatement potential), any missed reimbursement would create further conditions for the materialisation of such risk, leading to, inter alia, an increase in global emissions. The beneficiaries must have a right to invest their capital, including the money received through the compensation, to measures according to their actual needs as possibilities, and they should not be obliged by any rules to do some concrete steps. In this context, it is also necessary to add that energy efficiency improvements are a must for industries with high energy costs in order to remain competitive. 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 in improving performance, where technically possible.

Moreover, 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.

Finally, the three proposed conditionality requirements present specific crucial limitations:

- a) The energy efficiency investments with a payback period of 5 years do not reflect the reality of business decisions (e.g. in the steel sector), 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. We strongly disagree with any conditionality. If

there is no political will to delete it, the only and possibly acceptable requirement in this sense would be that the beneficiaries should strive, according to their possibilities, to follow recommendations of the energy audits (i.e. without payback time requirement).

- b) The requirement to install an onsite renewable energy generation facility covering at least 50 % of the electricity needs absolutely does not match with the very large energy consumption of industrial sites and the physical limits of such on-site generation. Furthermore, the RES can never match with the typical non-stop production nature of the sites, as they are not able to ensure stable and permanent supply of enough energy needed. And moreover, in many plants it would not be possible to build up the required RES capacities due to their land capacities and requirements. This conditionality requirement is therefore not technically nor financially feasible, hence it cannot be achieved realistically by the eligible sectors.
- 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. This requirement completely undermines the purpose of the compensation. Furthermore, the condition to ensure that the investment must lead to emission reduction well below the benchmark values does not take into account neither existence and availability of the technologies, nor the fact that investment in such technologies would require far more financial sources, including private sources, of which the 80 % of compensation would be negligible.