ERCST

European Roundtable on Climate Change and Sustainable Transition

ERCST Conference Call - Introduction into Revision of the Guidelines on certain State aid measures in the context of the GHG emission allowance trading system post-2020

January 31, 2019 – 9am

General introduction

The state aid guidelines are up for revision – not review – which means that they could change significantly. The current guidelines expire on 31 December 2020, and the new guidelines would 'indicatively' be ready by Q3 2020 – just a few months before the new ones actually enter into force.

The current state aid guidelines not only cover indirect costs under EU ETS, but also:

- Investment aid to new highly efficient power plants, including new power plants which are CCS-ready
- Aid involved in optional transitional free allowances for the modernisation of electricity generation
- Aid involved in the exclusion of small installations and hospitals from the EU ETS

These aspects need to be brought in line with the Phase 4 Directive.

However, the focus of ERCST work will be on indirect EU ETS costs and how they should be dealt with by the new guidelines.

The new state aid guidelines will need to balance a number of issues, among which:

- carbon leakage risk
- risk of overcompensation and potential windfall profits
- risk of internal market distortion
- how to incentivise cost efficient decarbonization

So how are indirect costs compensated in phase 3?

The Commission has created a list of sectors and subsectors that are eligible for compensation

- 13 sectors, and 7 subsectors
- Largest recipients according to the Commission 2018 State of EU ETS report: chemical sector, non-ferrous metals sector and iron and steel sector
- Sectors on the list passed two criteria:
    - intensity of trade with third countries is above 10 %
    - the sum of indirect costs is at least 5% of gross value added[1]

[1] the sum of indirect additional costs induced by the implementation of the ETS Directive would lead to a substantial increase in production costs, calculated as a proportion of the gross value added, amounting to at least 5 %.

  - Qualitative assessment was also used – but no transparency on whether any sectors are considered eligible only due to qualitative assessment
- Maximum level of compensation is set at the so-called 'maximum aid intensity' defined using[2] aid intensity (which decreases over time and is 75% for 2019-2020), maximum regional CO2 emissions factor[3], (and for most sectors) product-specific electricity consumption efficiency benchmarks, forward EUA prices and baseline output

- Countries choose themselves, but their compensation schemes need to be assessed by the Commission and they must fulfil annual reporting obligations
  - 11 countries give compensation[4] at the moment, both big and smaller MS have compensation schemes
  - But there are large differences in how much each MS is compensating

Revision itself

As it is a revision, nearly all elements from the current guidelines are up for discussion. These elements include:

- Existing criteria for eligibility and the resulting list of eligible sectors
- The issue of proportionality; Member States currently need to demonstrate that the aid given is the minimum necessary, with the current Guidelines clearly stating the 'Maximum aid intensities'. This maximum percentage of indirect costs to be compensated could be changed.

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[2] Amaxt = Ai t × C t × P t-1 × E × BO

Ai t is the aid intensity at year t, expressed as a fraction (e.g. 0,8);

C t is the applicable CO 2 emission factor (tCO 2 /MWh) (at year t);

P t-1 is the EUA forward price at year t-1 (EUR/tCO 2);

E is the applicable product-specific electricity consumption efficiency benchmark defined in Annex III; and BO is the baseline output.

[3] CO 2 emission factor', in tCO 2 /MWh, means the weighted average of the CO 2 intensity of electricity produced from fossil fuels in different geographic areas. The weight shall reflect the production mix of the fossil fuels in the given geographic area. The CO 2 factor is the result of the division of the CO 2 equivalent emission data of the energy industry divided by the gross electricity generation based on fossil fuels in TWh. For the purposes of these Guidelines, the areas are defined as geographic zones (a) which consist of submarkets coupled through power exchanges, or (b) 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. Such regional differentiation reflects the significance of fossil fuel plants for the final price set on the wholesale market and their role as marginal plants in the merit order. The mere fact that electricity is traded between two Member States does not automatically mean that they constitute a supranational region. Given the lack of relevant data at sub-national level, the geographic areas comprise the entire territory of one or more Member States. On this basis, the following geographic areas can be identified: Nordic (Denmark, Sweden, Finland and Norway), Central-West Europe (Austria, Belgium, Luxembourg, France, Germany and Netherlands), Iberia (Portugal, Spain), Czech and Slovakia (Czech Republic and Slovakia) and all other Member States separately. The corresponding maximum regional CO 2 factors are listed in Annex IV,

[4] UK, DE, BE, NL, EL, LT, LU, SK, FR, FI and ES

- The current guideline state that state aid needs to be degressive to avoid aid dependency. Will this decreasing slope of maximum aid intensities continue or be changed?
- How to level the playing field, minimise distortions to the internal market
- Issue of comparable and coherent compensation across EU Member States
- How to ensure the temporary nature of carbon leakage risk mitigation measures
- Key variables: how they are set. This is relevant for baseline output levels and regional CO2 intensities.

In addition, new rules could be added to the guidelines. For example:

- On sectoral eligibility
  - Commission example for a potential new rule is the need for investments in energy efficiency
  - Need for investments in or consumption of renewable energy.
- Hard limit on the amount that Member States can give
- Link with climate action taken by important trading partners and evolutions in the Paris Agreement process

Some aspects of indirect cost compensation are not up for discussion, as they are set in the EU ETS Phase 4 Directive.

- This includes the provision that Member States shall seek to use no more than 25% of auctioning revenues or must publish a report explaining why they exceeded that percentage.
- The use of ex-ante sectoral benchmarks for the calculation of carbon leakage risk is also mandated, with the benchmarks based on electricity consumption per unit of production using the most efficient available technologies and CO2 emissions of the relevant European electricity production mix.

State of play of the revision

- Commission released a document in December just before the holidays called ‘Combined evaluation roadmap/inception impact assessment’
- Provides an overview of what the revision means, and the public consultation process that DG Comp will follow, which includes a
  - Public consultation
  - Three targeted consultations:
    - one on sector eligibility for all stakeholders
    - one for MS on implementation
    - one for interested stakeholders on the draft revised guidelines
  - Meeting with MS in Autumn of 2019 to gather comments on the draft guidelines
    - This means they expect the draft to be ready by then
- When the elements of this public consultation will take place is unclear: no detailed timeline given.
- For the rest not much else known!

List of things that should be modified

- Lack of coherence between Member States
    - Amount of compensation (Finland: only half of maximal aid intensity)
    - UK: criteria are also used on a company level, and different calculation of the cost (UK carbon floor price is included)
- Data:
    - Regional maximum CO_2 intensities
    - Base years for production
    - Electricity intensity of production
- List of sectors: as narrow as possible or as broad as feasible?