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RESPONSE TO THE COMMISSION'S CONSULTATION OF ETS STATE AID GUIDELINES – HT.582

1. During the discussion of the new rules for the EU ETS 3rd trading period (2013 – 2020) the issue of carbon leakage was accepted as a real threat for the effectiveness of the scheme. In order to avoid negative consequences of the EU ETS for the global carbon balance, as the result of relocation of production outside the EU, or of increased imports into the EU, the Directive foresees two equally important counter-measures:
 - Free allocation for industry's direct emissions;
 - Financial compensation for industry's indirect emissions.
2. While the rules for free allocation are already fixed and the involved installations can assess their ETS positions and financial exposure until 2020 relatively well, the rules regarding the indirect emissions are still unclear. Industry was desperately waiting for the Commission's draft guidelines for environmental state aid, which will outline the framework for MS's potential compensation measures. The Commission consultation dated 21 December 2011 brings more clarity, but leads to the respective industries being unable to see an end to their fears regarding the carbon leakage risk. IFIEC Europe responds to the main guiding principles for compensation in the consultation document as follows:

No. 11 and 12, 3.1. No. 26: Limiting maximum aid by a reducing factor

3. The Commission foresees an aid intensity factor of 85% for 2013 – 2015, 80% for 2016 – 2018 and 75% for 2019 and 2020.
4. The Commission's argumentation for this incomplete compensation is (page 5):
 - *"11. The maximum aid amount that Member State can grant shall be calculated according to a formula that takes into account the installation's baseline production levels or the installation's baseline electricity consumption levels as defined in these Guidelines, as well as the CO₂ emission factor for electricity supplied by combustion plants in different geographic areas. The formula ensures that the aid is proportionate and that it maintains the incentives for electricity efficiency and the transition from "grey" to "green" electricity, in accordance with the ETS Directive."* and:
 - *"12. Furthermore, in order to minimise competition distortions in the internal market and preserve the objectives of the EU ETS to achieve a cost-effective decarbonisation, the aid shall not fully compensate for the costs of EUAs in electricity prices and shall be reduced over time. Degressive aid intensities will maintain (i) the long-term incentives for full internalisation of the environmental externality and (ii) the short-term incentives to switch to less CO₂-emitting generation technologies, while underlining the temporary nature of the aid and contributing to the transition towards a low-carbon economy."*

5. Unfortunately, we believe that this argumentation is flawed in many ways:
 - 5.1. The argumentation above is not in accordance with the ETS Directive, where the clear purpose of the compensation is the avoidance of carbon leakage while safeguarding the effectiveness of the EU ETS;
 - 5.2. Limiting the financial compensation is not necessary to give an incentive for a shift to more efficient electricity consumption and a shift from grey to green electricity. Such incentives are safeguarded by the benchmark approach, where any benchmark independent of its level (stringent or less stringent) gives an equal incentive. (As with the benchmark for direct emissions, the incentive is the difference before and after an efficiency investment as an addition of the avoided cost plus revenues from sales of allowances). In the case of financial compensation the stringent benchmark already limits the compensation. The benchmark should be set according to the most efficient installations, which means the majority of installations will be faced by under-compensation anyway;
 - 5.3. The argument “*maintain the long term incentives for full internalisation of the environmental externality*” is misunderstanding the reasoning around the compensation mechanism. Full internalisation of the CO₂-costs would be achieved by auctioning. However, in the absence of auctioning globally, this argument is against the will of the Heads of State as laid down in the EU ETS Directive, namely to deliberately protect the industry from the effects of full auctioning;
 - 5.4. “... *contributing to the transition towards a low-carbon economy*”: An effective compensation mechanism would be absolutely in line with this target. As examples, the Roadmap 2050 of DG Climate Action, as well as the ETS Directive. Both make clear that carbon leakage has to be avoided in this way;
 - 5.5. Auctioning is fine, but only if applied globally;
 - 5.6. Any partial or decreasing aid has no “green” argument. As mentioned, the incentive for the efficiency of the use of electricity lies in a correct benchmark approach;
 - 5.7. At least the financial compensation for industries exposed to the risk of carbon leakage should complement – equal treatment – the 100% free allocation for direct emissions according to the benchmark until 2020. Therefore any partial compensation is not consistent with the EU Directive;
 - 5.8. The aid intensity should not decrease over time because the exposure to carbon leakage does not decrease either. Decreasing aid destroys the confidence of companies for long-term investments;
 - 5.9. Also the results of the World Climate Summit in Durban (COP 17) mean that it cannot be assumed that the carbon leakage risk could be reduced gradually until 2020. This approach, reducing the aid intensity factor in intervals, does not support the idea of the emissions trading directive, which aims to deal effectively with the risk of carbon leakage. Only when there is a genuinely improved level playing field regarding carbon costs at installation level could such a gradual increase of financial burden such as is proposed for EU companies be justified.
6. In conclusion, investments in growth for the European economy need a long-term perspective. Mechanisms such as gradually decreasing aid intensity or a price floor ,such as is currently being discussed, would deter such investments. The new suggestions of allowing compensation only if a certain minimum price for emission allowances is

exceeded cannot provide solid profitability calculations, since the calculation depends on a variable and insecure certificate price. That is also contrary to the Europe 2020 strategy, which calls for boosting growth and creating more jobs in Europe, and which sees the necessity to improve legislation to that end.

3.1. No. 27 with Annex I: CO₂ emission factor

7. The Commission proposes a CO₂ emission factor based on the weighted average CO₂ intensity of electricity produced from fossil fuels in different geographic areas (see definition in Annex I, p. 18 and 19). The important merit of this proposal is that it is reflecting the fact that the marginal power production facilities are the relevant ones to be considered for a realistic assessment of the CO₂ price effect in the power price. This is an important progress compared to former considerations of the Commission, where an average was taken as the basis for the emissions factor. The proposed calculation methodology thereby is a simple proxy to calculate such marginal CO₂ factor, which according to our experience, results in a figure very close to the actual marginal factor. Such an approach should therefore be possible and applied. However, there should also be the alternative option for any MS to conduct a more complex calculation whenever the resulting CO₂ emission factor of the proxy seems not to be appropriate and realistic.
8. The different geographic areas proposed on p. 18 and 19 are based on the consideration that equivalent price effects exist within these regions coupled through power exchanges and having price divergences of maximum 1 % in a significant number of hours. In an internal EU electricity market which comes closer and closer together, regions which consist of more than one MS will become more the reality and the concept of the marginal CO₂ emissions factor becomes easier to handle. So it is very likely that by the time the 3rd trading period starts, the regions could be determined on a larger scale as proposed now. Therefore, the regions should be determined based on an assessment regarding the above mentioned quantitative criterion (1 % price difference) close to the start of the compensation mechanism.
9. IFIEC sees the breaking-apart of the Central-Western Europe region into two regions as inappropriate and would propose sticking to one uniform CO₂ factor in the price region Central-West Europe, as this reflects the real situation of one market region within the EU internal market. The split of the Central-West European region into “CWE-1” (Belgium, Luxembourg, France) and “CWE-2” (Germany, Austria, Netherlands) is not justified, as energy market coupling is already in place and will develop further before the 3rd trading period. The coupling of day-ahead exchanges within the CWE-region was already fully established from Nov. 2010.

3.1. No. 27 (a) with Annex I and III: Electricity consumption efficiency benchmark

10. The Commission proposes applying electricity consumption efficiency benchmarks as defined at Prodcom 8 level, which means the product-specific electricity consumption per tonne of output achieved by the most electricity efficient methods of production for the product considered.

11. The inclusion of an efficiency benchmark for calculating the compensation level is important and appropriate and can ensure that financial incentives for more efficiency remain for all groups of installations, whatever the current level of efficiency. However, benchmarks should be challenging, but also realistic and there is no reason to deviate from the concept of defining benchmarks as realized for the free allocation of direct emissions. In this context, the Directive gives clear guidance on defining benchmarks: "*the starting point shall be the average performance of the 10 % most efficient installations in a sector in the Community in the years 2007-2008*" (Art 10a, 2.). For a consistent and fair approach, this basis must also be applied to benchmarks for the indirect emissions. So instead of the (one) most efficient method, as indicated in the proposed guidelines, the average of the 10% most efficient installations should be the basis according to the Directive.
12. For products with interchangeable input of fuel vs. electricity (14 of 54 product benchmarks defined according to C(2011) 2772) the benchmark values found in the benchmark exercise for direct plus indirect emissions have to be taken directly for the compensation mechanism.¹ No new definition and no different basis have to be made!

3.1. No. 27 (b) with Annex I: Fallback electricity benchmark

13. IFIEC requests that this factor be modified from 70% to 97%. Without this modification there is an unjustified requirement especially for the most efficient installations and a clear incentive to shift production outside. In fact, this factor of 97% corresponds to the factor that has been determined in the decision methodology for free allocation for direct emissions under fall-back approach, for the "process emissions sub-installation". It would also mean a balanced equal treatment in these two fields of EU-ETS.
14. The guidelines should ensure that electricity savings in plants producing products under the fallback approach will not lead to a lower financial compensation, similar to the principle in case of decision for free allocation of allowances for direct emissions. Without this principle the incentive to invest in higher efficiency would be nullified.

3.1. No. 27 (a) with Annex I: Baseline output (production)

15. The Commission proposes the average production at the installation over the reference period 2005-2011, with provisions for a change of compensation in case of production increases if at least plus 40%.
16. IFIEC's assessment is that actual, rather than historical production, should be applied. The present ex-ante rules for the allocation of direct emissions cause a host of fundamental problems.² The Commission should have learned from these problems and should not repeat the same mistake in this new context of indirect emissions.

¹ For these products interchangeability has to be taken into account, which was rightfully acknowledged for the allocation of allowances for direct emissions. Otherwise financial compensation would be incorrect (far too low). To be consistent, the formula for the compensation must be: $\{(the\ regional\ CO_2\ factor/0.465) \times the\ over\text{-}all\ benchmark\ based\ on\ 0.465\ ton\ CO_2/MWh\} \times \{(electricity)/(steam + fuel + electricity)\}$ of the individual installation.

² Ex-ante allocation rules inhibit production growth cause an overhang of allowances in case of crisis and are a clear incentive for carbon leakage. It is no wonder that the ex-ante approach is the cause of most problems of the (extremely complex) Guidance Documents on allocation. Therefore the ex-ante approach is no longer appropriate; this must be changed to actual production (ex-post) in the next revision of the EU ETS Directive.

17. An ex-ante financial compensation would need many extra rules in case of production changes and capacity extensions. This would make the system both much more complex and more discrimination-prone. The threshold of 40% mentioned by the Commission is purely arbitrary and means a significant discrimination for installations with an increase just below this point. Besides, the present text seems to suggest that for a production increase above 40%, (for example 60% or 100% through a new plant), the financial compensation would only be increased by 40%.
18. IFIEC questions the meaning of point 27.: *an ex-post payment adjustment mechanism must be in place to ensure that any over-payment of aid will be repaid before July in the following year ...* If this is an ex post adjustment based on actual production, then the baseline output approach would be annulled, which we would welcome. However, such ex post adjustment cannot be only a one way exercise, but must seriously take into account any changes both down and up!
19. In conclusion, a full ex-post approach avoids over- and under-compensation and is both simple and predictable for business and justified in relation to the requirements and objectives of both the EU ETS Directive and the Europe 2020 strategy.

3.1. No. 27 with Annex II: Eligibility of sectors for the aid

20. The Commission lists 10 sectors eligible for the compensation (Annex II), whereas the following criteria have been applied: 10% intensity of trade with third countries and 5 % increase in production costs from ETS. Regarding the latter, the average EU emission factor for electricity has been applied as in Commission Decision 2010/2/EU (the Carbon Leakage List).
21. Furthermore, if the eligibility were to be limited, which IFIEC would regret, to sectors and sub-sectors with an indirect cost impact of 5% or 2% (with qualitative assessment) of GVA, further disaggregation down to product (PRODCOM) level should be allowed as well. Otherwise discrimination would occur between such products and the presently selected 10 sectors eligible for the compensation.
22. IFIEC requests that in such a restricted approach, companies or federations will have the right to propose sub-sectors or products on PRODCOM level become eligible for the financial compensation, both before and after the date that the state aid guidelines are finalised. This is necessary, because we don't expect that every sub-sector or product in the EU-27 that should be eligible will know about this possibility before the end of next month. Therefore we suggest that each request by a party, company or federation, shall be submitted to the European Commission by a Member State receiving such request, irrespective of whether the Member State agrees with the argumentation. The Member State should of course make their deviating or confirming judgment publicly known to the Commission. A second request in case of a restricted approach is that sub-sectors or products should also be able to qualify for the financial compensation if their own characteristics do not fulfil the criteria, but if their customers in the value chain are eligible for the financial compensation. For example, certain industrial gases have a low trade intensity (and a high electricity use per unit of product leading to a very high impact on

GVA), but the sectors using these gases and bearing the cost for the indirect emissions are eligible: mainly refineries, the chemical industry and the steel industry.

23. It is essential to understand that many subsectors (at the Prodcom) level form a critical part of the value chain for trade exposed sectors at risk of carbon leakage. For example Soda Ash and Industrial Gases are both key to Glass production, similarly Coke and Industrial Gases are critical for Iron & Steelmaking. The final mechanism must treat such outsourced intermediates in a fair and equivalent manner to in-sourced ones.
24. In IFIEC's view the financial compensation should not be arbitrarily restricted but should fully complement the allocation for direct emissions. It is therefore not logical and not in the spirit of the Directive to apply additional criteria apart from those for indirect free allocation for the eligibility for financial compensation. This is especially true when considering the fact that the ratio direct/indirect emission per unit of product varies between sectors, but also between sub-sectors and even between individual installations producing the same good within a sub-sector (interchangeability between fuel, heat and electricity).
25. IFIEC therefore recommends the aid for all sectors acknowledged to be at risk of carbon leakage. The German government aired an alternative view with a similar result based on another criterion, namely 1 kWh electricity use per EURO GVA (18 May 2011).

Yours sincerely,



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IFIEC Europe represents energy intensive industrial consumers where energy is a major component of operating costs and directly affects competitiveness.