

Observations on the draft ETS State aid guidelines

ClientEarth hereby replies to the consultation on the revision of the ETS State aid guidelines¹ (hereafter the "Draft Guidelines") in view of the implementation of the fourth trading period 2021-2030. In the absence of strong evidence of carbon leakage affecting European electro-intensive industries, ClientEarth **does not support the grant of aid for compensating indirect emission costs**. Such compensations undermine the effectivity of carbon pricing mechanisms and remove market incentives for electro-intensive industries to take steps towards energy efficiency, decarbonisation and investments in cleaner production.

Furthermore, although we welcome the principle of a conditionality to aid for compensating indirect emissions costs, if such compensations should continue, we believe this conditionality must be strengthened in order to align the Draft Guidelines with EU's decarbonisation objectives and not to become a paper tiger.

Our observations will follow the contents of the Draft Guidelines.

Introduction

State aid for indirect cost compensation should protect sectors that are exposed to a "genuine risk of carbon leakage" due to indirect costs passed on in electricity prices, if the protection does not cause undue distortions of competition in the internal market. This implies that:

- The risk of carbon leakage due to indirect costs is genuine and significant
- Electricity prices for large industrial consumers have increased under the EU ETS
- Distortions to the internal market are minimal

None of these three items has been sufficiently proven by either the Commission nor by industry stakeholders. Indeed, the Commission's 2019 report on 'Energy prices and costs in Europe' states clearly that over 2015-2018 electricity prices for industry have been falling significantly, while EUA prices remained relatively stable over the same period. Furthermore, there is a large divergence between electricity prices for industry across EU Member States.

State aid should not be given to sectors which have potential to deploy less carbon and/or electricity intensive substitutes as otherwise taxpayer money is being used to subsidise carbon

¹ Commission's Ref.: HT.582

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pollution and wasteful electricity consumption. The state aid scheme - and countries implementing it - does not necessarily support more energy and/or emissions efficient products and producers. In fact, indirect cost compensation could even improve the competitive position of the more inefficient installations within a sector.

It is important to highlight that the burden of proof lies with the EU institutions, national governments and undertakings that will benefit from the scheme and that this burden of proof must be fulfilled before the State aid scheme enters into force. In this light, ClientEarth requests that the Impact Assessment being prepared by the European Commission questions the rationale of the Draft Guidelines before focussing on the efficiency and effectiveness of the various options for the revision. As the consultancy report released by the European Commission admits **there is currently no hard evidence of carbon leakage due to indirect costs**.

1 Scope and definitions

1.1 Scope of application

We support the addition of paragraph 9 of the Draft Guidelines. This clarification is welcome in light of some Member States who attempted to support incumbents in financial difficulties via the grant of free EUAs, notably, using the silence of the former ETS State aid Guidelines.²

Unfortunately, paragraph 10 tends to relax the conditions under which an undertaking which is still subject to a recovery order could be granted new aid. The practice developed so far under the *Deggendorf* case law tends towards a prohibition or suspension of the granting of aid until all old unlawful aid has been repaid. Emphasising in paragraph 10 that the Commission has discretion ("the Commission *may* suspend...") in allowing new aid, without stating any objective criteria for such decision, risks undermining the enforcement of recovery orders: Member States could pursue their support policies regardless of their unlawfulness and undertakings would be less incentivised to repay past unlawful aid in a timely manner. We thus recommend to set a strict principle of suspension and prohibition of the payment of any new aid until *all* unlawful aid has been repaid by a beneficiary (not only at an installation's level).

1.2 Aid measures covered by the Guidelines

As mentioned above, in the absence of strong evidence of carbon leakage affecting European electro-intensive industries, ClientEarth **does not support the grant of aid for compensating indirect emission costs**. Such compensations undermine the effectivity of carbon pricing mechanisms and dis-incentivise electro-intensive industries to reduce drastically their consumption of carbon-emissive energy sources.

² We highlight that State support to the financing of the purchase of mandatory EUAs can also constitute State aid which compatibility shall be assessed under a different framework than the ETS Guidelines.

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1.3 Definitions

The use of only fossil fuel generation capacity to determine the regional CO₂ emission factors is not appropriate. This method does not fit the current trends in the power sector, and leads to even more over-compensation for industry. In light of coal phase-outs and the pressure on the power sector to decarbonise, it is wrong to assume that only fossil fueled power capacity will determine electricity prices throughout the EU until 2030. The CO₂ factors should be based on all electricity generation capacity and storage, and be updated annually. For example, last year, coal generation fell 24% in the EU, leading to a 12% fall in European power sector CO₂ emissions in 2019 alone – the biggest fall since at least 1990 (Sandbag and Agora Energiewende, 2020).

The estimates for EUA prices should be replaced by actual EUA prices rather than averages of forward prices. If actual output levels can be used, why not actual price levels?

2 Common assessment principles

We do not have particular remarks on this section.

3 Compatibility assessment

3.1 Aid for indirect emissions costs

Under paragraph 21, **demonstration by a Member State that there is no genuine risk of carbon leakage of some of the sectors listed** in Annex I should be deemed to be an objective, non discriminatory and transparent criteria to justify excluding some of those sectors from an aid scheme. A Member State should also be allowed to grant lower amounts of aid to some of the sectors listed in Annex I, on the basis of objective, non discriminatory and transparent criteria i.e. when genuine risks of carbon leakage vary. Again, there is no general evidence that such risks truly exist and would materialise absent State aid schemes and the ETS Draft Guidelines.

Paragraph 22 should add that **aid should also be granted in principle in a different way to competitors in the same sector if are in a different factual situation**. It could be the case when some of the undertakings have already achieved a number of investments that limit their exposure to increased electricity costs or are supplied with non-fossil fuel energy sources that reduce the passing on of ETS costs. This would ensure that only those undertakings within a sector listed in Annex I which are *individually*, exposed to a genuine risk of carbon leakage benefit from aid and that consequently, aid is limited to the minimum necessary to achieve the objective of reducing greenhouse gas emissions.

At paragraph 24, paying the aid **only the year after the costs are incurred** (and not in the same year) would increase exposure of the beneficiaries to carbon prices and incentivise them to reduce this exposure in a continuous manner – this would thus also help contributing to the objective of reducing greenhouse gas emissions in a more direct manner than compensations for indirect costs, while not unduly exposing the beneficiaries to alleged risks of carbon leakage. Such a balance and possibility to contribute to both objectives at once seems practicable. If payment in the same year were to be maintained, paragraph 25 would indeed be necessary.

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At paragraph 26, the aid intensity threshold is now set at 75% whereas it used to be degressive in the previous ETS Guidelines. A **degressive aid intensity** and a sunset clause (0% before 2030) should ensure that aid is phased-out overtime.

In-house renewable electricity production is still covered, meaning companies with significant in-house renewable electricity production are being compensated for the 'opportunity cost' of selling their electricity on to the grid and shutting down their production facilities. The Draft Guidelines should not compensate industry for opportunity costs.

Paragraph 32 on **cumulation of aid** should be redrafted. The positive language ("aid may be cumulated") contrasts with previous negative language adopted in all other guidelines. Whilst it may have the same consequences, this new language signals to the electro-intensive operators that they could cumulate a series of exemptions and compensations, which is not welcome in principle. This is particularly problematic for (b) cumulation of aid for the same eligible costs "*partly or fully overlapping*" and "*any state aid without identifiable eligible costs*".

The main concern is the possibility (or appearance thereof due to current wording) to get State aid for making the investments that fall under the conditionality clause (section 5). Although we welcome the principle of a conditionality and some of the eligible investments proposed in section 5, the conditionality clause must be effective. Authorising aid for making those investments (under the EEAG mainly) would result in giving the conditionality for free. The electro-intensive operators can already make those investments under the EEAG so the environmental objectives pursued by para. 54 could already be achieved without the Draft Guidelines. It would be wiser to make the EEAG more flexible and increase aid intensity for energy efficiency investments there than trying to incentivise RES or efficiency investments by the backdoor (and with much less chances of success) in the ETS guidelines.

3.2 Optional transitional free allowances

The main issue with this scheme is that there is still no explicit exclusion of all fossil fueled generation for funding. Conditions related to climate change are placed on which projects (>12.5 million EUR) are eligible for the competitive bidding process, but these conditions do not rule out investments in fossil fueled generated power. For smaller projects (<12.5 million EUR) the Draft Guidelines do not contain any conditions related to climate impacts of projects at all.

There is an urgent need to phase out all - especially public - funding for CO2 polluting power capacity to avoid carbon lock in and speed up the clean energy transition. While the Draft Guidelines do seek to channel funding towards increased sustainability of energy sectors, there are still large loopholes for countries to fund emission-intensive electricity generation.

The Article 10c Derogation should explicitly exclude the possibility of fossil fueled generation and infrastructure receiving aid.

Besides, paragraph 38 should be strengthened in four manners. Firstly, with an addition: " the operator concerned must also demonstrate that a corresponding amount of electricity-generation capacity with (**add: significantly**) higher emission intensity has been decommissioned...".

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Secondly, operators should not be free to decommission any type of capacity they so wish based on operational criteria (e.g. loss-making activity) rather than environmental ones and leave the most polluting assets on the market. To this end, the beneficiary must demonstrate that environmental considerations have prevailed and an assessment of the environmental impact of that decommissioning should be produced to the Member State, to the Commission as part of the reporting obligations, and made public as part of the transparency requirements.

Thirdly, in order to ensure that the most polluting assets are removed from the market, the operators could also be required to decommission first the most polluting assets, then the second most polluting and so on.

Fourthly, the operators should commit to decommission their own assets and not the ones of an unidentified "associated operator". Whereas pursuing the objective to modernise, diversify and make sustainable (*note: add "decarbonise" in the objectives*) the energy sector is very welcome, aid is still granted, at the end of the day, to individual beneficiaries who shall deserve the said payments and meet the various requirements and conditions by themselves. The notion of "associated operator" is extremely vague and seems to encompass other undertakings from the same group as the operator as well as contractual partners. In this respect, the beneficiary of free allocations should not be allowed to avail itself from the decommissioning of fossil fuel assets by a supplier.³

4 Evaluation

In order to increase transparency of the schemes, ex-post evaluation reports should be made public.

5 Energy audits and management systems

We welcome the principle of a conditionality to the receipt of aid for indirect emissions costs. These conditions, if strong enough, could lead to State aid for indirect costs finally having environmental benefits and channelling resources towards renewable energy deployment. They can also reduce the dependency of companies on State aid over time in two ways.

Firstly, companies would need to buy less electricity from utilities by either improving energy efficiency or by increasing on-site renewable energy production. This would limit exposure to indirect costs.

Secondly, they will push electricity consumption efficiency benchmarks downwards, reducing the payouts of state aid over time.

However, this section should be strengthened in several respects - not only for ensuring that the conditions are really effective, but also to ensure that they reach the goal of increasing energy efficiency and decreasing greenhouse gas emissions of the aided installations in a concrete and ambitious manner.

³ Also because the supplier could avail itself from the decommissioning of those assets if it is eligible to free allowances and thus the same capacity could be counted twice.

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Firstly, there should be an **explicit obligation to use all State aid received** for indirect compensation costs towards achieving the various options. Any state aid that is not used for these purposes should be recovered.

Secondly, State aid should be used to **trigger additional investments**. Companies already have a strong financial incentive to do energy audits and following the recommendations - they will save energy and therefore reduce costs. State aid should not be crowding-out investments that companies would already make, but focus on pushing additional investments. In some countries energy audits and the implementation of the main findings are already mandatory. Therefore an additionality criteria should be added.

Thirdly, when the beneficiary is not covered by an obligation to conduct an energy audit, we believe that such audit shall be conducted and finalised **before** the first application for aid. Given that the conditionality of paragraph 54 is largely based on the implementation of the energy audits, conducting an audit only after the first application for aid (and thus in many cases, after the aid has been paid⁴) would risk exposing Member States to make payments without certainty of the investments the beneficiaries would make under paragraph 54.

On paragraph 54 in general: the lack of hierarchical order or prioritisation between options (a), (b) and (c) risks driving the beneficiaries of aid **towards the easiest, least costly measures rather than ensuring that the most concrete, effective and environmentally-desirable ones** are undertaken. Section 5 of the Draft Guidelines would be deprived of purpose if it did not tend towards reaching the 2030 climate and environment targets, which are all relevant in the EU industrial policy and ETS policy.

To this end, we recommend that investments in energy efficiency be prioritised, as per the principle of Energy Efficiency First and that the most concrete investments in flexibility, reduction of energy demand and investment in clean and sustainable generation capacity be prioritised over more vague projects (see comments under paragraph 54(c)).

On paragraph 54(a): implementation of energy audits is a legal obligation in some Member States or regions. When it is the case, the beneficiaries of aid should not be allowed to rely on option (a). It is crucial that the options under paragraph 54 have an incentive effect beyond the mere one of receiving aid for indirect emissions costs. When compliance with one of the options is mandatory or already planned by a beneficiary, it should explicitly not be a valid option for their receiving aid under the Draft Guidelines.

On paragraph 54(b):

- "carbon footprint" is not defined in the Draft Guidelines and should be replaced by "greenhouse gas emissions" in order to encompass other gases.
- "carbon-free power purchase agreements" should be replaced by "renewable energy power purchase agreements" with a particular focus on wind and solar energy.
- The conditions placed upon companies to receive State aid incentivise investments in on-site renewable electricity production. This means that companies will receive aid and invest

⁴ Given that the aid shall be paid either the same year or the following as per paragraph 24. See our recommendation above that aid cannot be paid in the same year.

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in zero-carbon electricity generation capacity - effectively shielding them from indirect costs. However, they will continue to receive State aid even though public funds have been invested in shielding them. This interaction between conditions for receiving state aid and eligibility of installations should be clarified in the final guidelines. The final guidelines should explicitly exclude state aid for indirect cost compensation when the electricity consumed is produced in-house and has no embedded carbon, even if it is the result of the conditions placed upon installations to get state aid in the first place.

On paragraph 54(c): the wording of this paragraph is extremely vague. What is a "*project*"? Carbon offsetting instruments or the like should not be covered: these projects do not directly nor effectively reduce the level of emissions or of energy consumption of the aided installations; rather, they preserve the status quo for the beneficiary and the aided installations. The direct effects of the investments undertaken under paragraph 54 must be internalised to tackle emissions and consumption at source. Besides, external projects make monitoring extremely uncertain. We therefore recommend to delete this paragraph.

ClientEarth calls for the insertion of a new paragraph 54a (or 55) **sanctioning the lack or late implementation of the measures undertaken by the beneficiary or its installations by the suspension or withdrawal of the aid**. To this end, paragraph 23 of the Draft Guidelines could provide that a percentage e.g. 50% of the aid would be liberated only when the measures undertaken under paragraph 54 are fully completed, or that part of the aid e.g. 50% would be liberated progressively when concrete stages of the investments are reached as per the energy audits.

6 Transparency

ClientEarth welcomes that a certain number of information on the schemes "must be available to the general public without restrictions". However more information should be added, that do not contravene the principles of protection of confidential information:

- (c): add "*and the aided installations under its ownership*";
- (e): add "*and the date [or year] on which it is being paid*";
- (f): information on the size must be updated when the beneficiary changes category;
- (g): add "*the beneficiary or the aided installation is located*";
- (h): sectors should be disclosed *at NACE-4 level*, not only at NACE group level. Moreover, they should be disclosed *for the aided installations* and not only at beneficiaries' level. NACE groups contain sectors which are not listed in Annex I to the Draft Guidelines and that information is thus insufficient to assess the eligibility of the beneficiary or of the beneficiary's installation - when it operates installations under different NACE-4 codes;
- (i) (*new*): add detailed information on *the implementation of the energy audits* as per paragraph 53 and 54 of the Draft Guidelines: measures or investments undertaken, amounts, disclosure on receipt of State aid in support of achieving the commitments (and text of the aid measure or a link to it)⁵, timeline for completion of the projects, **projected (and actualised) levels of CO2 emission reductions (to be) achieved and increased levels**

⁵ See our observations above on the grant of aid to achieve the commitments under paragraph 54 of the Draft Guidelines.

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of energy efficiency per installation etc. This is a matter of public interest given that commitments to undertake those projects condition the aid (financed by taxpayers' money) received by the beneficiaries. Therefore, these should not be considered as pure private investments - and even less so if they receive any State support to be achieved.

Paragraph 56 undermines the principle of transparency and should be removed. There is no reason why a limited amount of aid would be exempted from transparency obligations.⁶ At the very least, the threshold of EUR500,000 (or any other threshold that would be adopted - that should in any case not be higher) should apply for all aid received by an individual beneficiary under the Draft Guidelines **in a cumulative manner** i.e. as soon as the beneficiary receives a *cumulated amount* (also cumulating free allowances and aid for indirect emissions costs, where relevant) equal to the threshold, it should be included in the public register (including a retroactive reporting on all the amounts comprised between zero and the threshold).

Data from the national registers should also be centralized on a single EU website for better accessibility and transparency.

7 Reporting and monitoring

Reporting and monitoring on the implementation of requirements under paragraph 53 and 54 of the Draft Guidelines must be added to the list in paragraph 59. See our proposed new paragraph 55(i) above. It makes no sense to have a so-called conditionality and not control its achievement.

These data should also be included and made public in a centralised EU website.

Separately, some of the data contained in paragraph 59 should logically be decided at EU level - notably the EUA forward prices and CO2 factors - to avoid further distortion of the level playing field. This seems to be leaving an opening for Member States to move ahead with setting these variables themselves (which could spark a race to the bottom). It is important to specify that this data will be defined at the EU level, and communicated to all Member States to ensure the same relevant data is used throughout the various national schemes.

8 Period of application and revision

Paragraph 66 provides for a potential adaptation of the Guidelines in 2025. The drafting suggests that the adaptation process would start in 2025, but does not provide for an end / adaptation date. If the Guidelines are meant to expire in 2030, it is important that any adaptation be conducted in a timely manner and ends before 2026. Besides, it is crucial that the guidelines are not adapted in a more permissive manner.

The Guidelines should also be adapted as per the possible adoption of a carbon border adjustment mechanism.

⁶ Member States are still due to report these information, even more detailed ones, under section 8 "Reporting" of the Draft Guidelines for amounts of aid lower than 500,000. There is thus no reason to exempt them from publishing these informations to the general public as well.

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Adaptation of Member States' schemes to the adapted guidelines post-2025 may take some time and payments could have been promised or made in the meantime. To prevent payment of unlawful aid, we recommend to add a sentence at the end of paragraph 66: "All aid that would have been granted or payments made in excess to what would be allowed under the adapted guidelines would have to be repaid as from the date of entry into force of the adapted guidelines."

Moreover, we recommend that the Commission be pro-active in collecting the data necessary to review the methodology for calculating CO2 emission factors - and not merely passively waits to see if such data exists in 2025 ("the Commission will assess whether additional data is available"). Data must be collected progressively as from 1 January 2021 in order to be able to start the adaptation process in 2025 on this basis. This must be translated in the wording of paragraph 66 with commitments from the Commission to collect, and obligation on Member States to provide, the relevant data.

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ClientEarth is a non-profit environmental law organisation based in London, Brussels and Warsaw. We are activist lawyers working at the interface of law, science and policy. Using the power of the law, we develop legal strategies and tools to address major environmental issues.

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