Revision of the ETS State Aid Guidelines

AFEP POSITION

General comments

French companies are strongly committed to combating climate change. They believe that a reinforced and structurally reformed ETS is the cornerstone of the EU energy and climate policy, to reduce greenhouse gas emissions while preserving the competitiveness of energy-intensive companies exposed to international competition.

The 2050 climate neutrality objective will transform the whole economy and society. It will lead to a massive electrification of industrial processes, thus increasing energy costs for energy-intensive companies. This key industrial challenge needs to be anticipated and addressed, especially in the context of the ETS State Aid Guidelines.

Large French companies first stress that the proposed draft Guidelines include some positive features. In particular, **AFEP supports the following provisions**:

- The **degressivity** principle of the aid intensity is **removed**;
- A sector can be considered eligible through a **qualitative assessment**;
- Electricity consumption efficiency **benchmarks** will be **updated** at the beginning of Phase 4 and in 2025;
- Similar to Phase 3, the proxy of the CO_2 price is the **forward price of the European Union Allowances (EUA) in the year t-1**;
- **Actual output levels** replace baseline output levels used in phase 3, thus making the system more dynamic and avoiding overcompensation;
- The provision on the **interaction with renewable energy sources**, laying down that no state aid can be granted 'in case of electricity supply contracts that do not include any CO2 costs' is **removed.**

However, **AFEP is very much concerned by the following issues**:

- It is **essential to maintain a CO_2 emission factor at the regional level**, in particular for the **Central Western Europe** area (see the specific comment 1. below).
- Eligible sectors should be considered **not only at NACE level, but also at the PRODCOM codes level**. In that sense, the qualitative approach should **not be only limited to the four additional sectors identified** by the consultant mandated by the European Commission (see the specific comment 2. below).
- **The update of** the list of sectors **should be possible continuously** throughout the period 2021-2030 to take into account in particular the electrification of the industrial processes (see the specific comment 2. below).
- The European Commission should **specify, as from now, the calculation rules** governing the eligibility of sectors and **applicable in the context of the specific update planned for 2025**; for the sake of investment predictability, it is not acceptable to have to wait for the applicable rules the year preceding the update (see the specific comment 3. below).

- Finally, the draft Guidelines should **better define** the way in which **"early actions" in energy efficiency are integrated**.

Specific comments on AFEP's main concerns

1. CO_2 emission factor: maintaining of a single factor for the Central Western Europe area

AFEP supports the definition of a CO_2 emission factor based on a regional approach and market coupling. It is important to maintain a regional CO_2 emission factor where submarkets are coupled through power exchanges and where no significant congestion exists (see Compass Lexecon study made for Uniden: "Analysis of the CO2 power emission factor for indirect compensation related to the EU ETS"). It is also important to maintain the notion of market coupling as it enables to define zones with no physical congestion.

AFEP opposes the draft Guidelines as they remove the single CO_2 emission factor for the Central Western Europe (CWE) area of the current State Aid Guidelines. The Commission proposes instead different national emission factors for Germany, France, Austria, Belgium, the Netherlands and Luxembourg, although electricity markets are strongly correlated in this area. This is unacceptable: firstly, it would paradoxically introduce a **competitive distortion** inside the EU between energy intensive companies from those countries, and, secondly, it would **favour companies from countries whom energy mix is more carbon intensive**, granting them a **higher aid amount**.

Furthermore, the **calculations concluding that there is no price convergence in the CWE area are not transparent**. The definition of the CO2 emission factor in the current Guidelines (Annex I) lays down that there is a price convergence when hourly day-ahead power exchange prices within the zones shows price divergence in euros (using daily ECB exchange rates) of maximum 1 % in significant number of all hours in a year. However, **neither the Guidelines nor the consultant report in view of the revision of the Guidelines describe what a "significant number of all hours in a year" means**. AFEP therefore asks the European Commission to **further explain its assumptions and to clarify the criteria** it has taken into account to conclude that there is no price convergence in the CWE area.

The trend over the period 2013-2019 clearly shows an increase of the price convergence (as a % hourly day-ahead power exchange prices), close to 48% in 2019. Like the other competition rules, State Aid Guidelines should thus **consider market changes in the near future**. ETS State Aid Guidelines should not only be governed by historical considerations, but also **embed impact assessments of the EU legislation itself on the energy internal market**. In particular, they should take into account the effects of the newly adopted Regulation (EU) N° 2019/943 on the internal market for electricity (in force as from 1/1/2020), which will increase cross-zonal capacity allocation, then leading to a higher price convergence.

In order to comply with the generally recognized necessity, especially in the present crisis circumstances, to have, within the EU general legal framework, **a significantly increased consistency between the EU Energy policy and the EU Competition policy**, it is proposed, without changing the methodology adopted by the Commission **but changing only the reference**, to retain, as of January 1st 2021, as the right criterium of convergence, **the extrapolated values for the entire ETS Phase IV of the 2013-2019 historical trend** and **to set the convergence threshold which triggers the zonal approach of the emission factor <u>at 50%</u> of the time on a yearly basis where there is a <u>price convergence</u>** (as a percentage of hourly day-ahead power exchange prices).

2. Eligibility criteria: dynamic update of the list throughout the Phase 4 and consideration of sectors at PRODCOM level for the qualitative assessment

Considering the growing electrification of industrial processes and the higher impact of the ETS on electricity prices over the phase 4 (2021-2030), it should be made possible to **include new sectors and continuously update the list throughout the Phase 4** of the EU ETS.

Furthermore, AFEP strongly supports a **greater consistency between free allocations (direct emissions) and the compensation of indirect emissions**. Direct and indirect emission carbon costs are **treated differently without any reasonable grounds, although they are equally harmful for competitiveness and investments**. According to the Commission, the proposed list of sectors has been established on the basis of the same methodology as the one applied for the definition of the carbon leakage list under the revised EU ETS Directive, subject to 100% free allocations up to the benchmark. However, unlike the EU ETS Directive, the draft State Aid Guidelines does not allow for an assessment and **qualification at sub-sector level (PRODCOM)** and therefore penalises some industries that could demonstrate substantial and adequate risk. To be coherent with the Commission initial approach, eligible sectors should thus be considered not only at NACE level, but also at the PRODCOM codes level. Consequently, the **qualitative approach should not be only limited to the four additional sectors** identified by the consultant mandated by the European Commission.

3. Revision and update of the State Aid Guidelines: legal predictability to generate investments

Companies need legal predictability and transparency to plan the necessary investments. They need a clear vision of the future rules few years in advance to adapt themselves, in particular if they will no longer benefit from any compensation for indirect costs. Contrary to the present situation, they should be **informed much sooner than one year in advance**.

Therefore, the European Commission should **specify**, **as from now, the calculation rules governing the eligibility of sectors and applicable in the context of the specific update planned for 2025**.

Last, but not least, a **review clause** should be introduced to clarify that the State Aid Guidelines will be reviewed **after June 2021, should the Commission revise the ETS Directive**, as announced in the Green Deal for Europe.

About AFEP

Since 1982, AFEP brings together large companies operating in France. The Association, based in Paris and Brussels, aims to foster a business-friendly environment and to present the company members' vision to French public authorities, European institutions and international organisations. Restoring business competitiveness to achieve growth and sustainable employment in Europe and tackle the challenges of globalisation is AFEP's core priority. Afep has around 113 members. More than 8 million people are employed by AFEP companies and their annual combined turnover amounts to €2,600 billion.

AFEP is involved in drafting cross-sectoral legislation, at French and European level, in the following areas: economy, taxation, company law and corporate governance, corporate finance and financial markets, competition, intellectual property and consumer affairs, labour law and social protection, environment and energy, corporate social responsibility and trade.

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