Euro Chlor
representing the chlor-alkali industry

EUROFER
European Confederation of Iron and Steel Industries

ESTA

EUROMETAUX
EUROPEAN ASSOCIATION OF METALS

EURO ALLIAGES
COMITÉ DE LIAISON DES INDUSTRIES DE FERRO-ALLIAGES

Mr Joaquin Almunia
Vice President and Commissioner for Competition
European Commission
Rue de La Loi 200
B- 1049 Brussels

15 October 2010

Dear Commissioner Almunia,

Re: The need to act now on financial compensation under ETS Directive 2009/29/EC

The electricity intensive industry sectors, represented by Euro Chlor, Eurometaux, Eurofer, Euroalliages and ESTA, call on the Commission to develop the provisions to effect financial compensation for indirect CO_2 costs, as provided for by ETS Directive Article 10a6. If the delay in establishing state aid rules were to be prolonged, there would be insufficient time to develop national aid schemes, for 2013, taking into account notification and approval procedures.

The Community's unilateral climate change policies threaten the international competitiveness of energy-intensive industries, and thereby create carbon leakage, which undermines the environmental objectives of the Community's climate change policies. These industries are essential to the competitiveness of the EU economy and the control of carbon leakage risks is important not only for our industries but also for the Community, as such, and its environmental goals.

It is important to set out a clear timetable for modifying the state aid rules to give the businesses concerned the regulatory certainty required for them to continue to maintain and invest in their operations between now and 2013.

We believe that the construction of this framework can and must proceed independently of any quantitative leakage risk assessment for potential beneficiaries and that it should, in fact, antedate such assessments. The state aid rules must be modified, as provided for in the amended Emissions Trading Directive (2009/29/EC), to prevent carbon leakage and distortion of competition between EU-based producers and non-EU based producers. While the rules will provide a common framework for the granting of state aid, they cannot be expected to solve all possible inequities inherent to the autonomy given by the legislator to Member States. This, however, must not serve as a justification for delaying the establishment of the regulatory framework or to deny compensation to the energy-intensive industries.

The granting of compensation for indirect CO_2 costs for some installations in certain sectors will not require increased abatement contributions from other operators. Compensation on the basis of a benchmark provides the incentive for inefficient operations to improve their electricity consumption performance to the level of the benchmark that will be set according to the most efficient available technologies. Furthermore, the necessity and proportionality requirements applicable for state aid cases will ensure that only those installations that have suffered an actual cost increase due to CO_2 costs will receive aid.

As both the competitiveness of our industries and the integrity of the Community's climate policies depend on compensation for the CO_2 cost in electricity, we appeal to you to encourage your services to publish a proposal to amend the state aid rules, in the short term. Our industry experts and representations are ready to discuss with your services any supportive activities needed from our side.

Yours sincerely,

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J. TARGHETTA
President of Eurometaux

W. EDER
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P. MARTINACHE
Secretary General of ESTA

CC:

President Barroso
Vice-President Tajani
Commissioner Oettinger
Commissioner Hedegaard
Commissioner Rehn

15 October 2010

The need to act now on financial compensation under ETS Directive 2009/29/EC

Explanatory paper accompanying a call from key impacted industry sectors to Commissioner Almunia

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Introduction

The Community's unilateral climate change policies threaten the international competitiveness of the EU's energy intensive industries, creating carbon leakage that will undermine the environmental objectives of the Community's climate change policies. Control of these risks is important not only for our industries but also for the Community, as such, since energy-intensive industries are essential to the competitiveness of the EU economy as a whole.

This issue was addressed in the amended Emissions Trading Directive (2009/29/EC), where free allowances and state aid provisions to limit exposure to indirect CO2 costs were introduced as a means of mitigating carbon leakage, for sectors found to be prone to such risk. These provisions were framed to preserve the environmental objectives of climate change policies.

We call on the Commission to modify the state aid rules as mandated by the amended ETS Directive, as soon as possible. This will give the businesses affected the regulatory certainty required for them to continue to maintain and invest in their operations between now and 2013. If the delay in establishing necessary changes to the state aid rules were to be prolonged further, there would be insufficient time to develop the implementing national aid schemes, by 2013, taking into account notification and approval procedures. The fact that the Member States will also benefit from swift action is evident, for example, by Germany's recent notification and its national energy concept in which the need for compensation is clearly stated. **We therefore request DG Competition to present a proposal in the short term (by the end of 2010 at the latest).**

State aid rules as a common framework for compensation

In modifying the state aid rules, the Commission must address the environmental objectives of the Community and the competitiveness of EU-based enterprises subject to CO_2 costs, compared to non EU-based enterprises. The Commission must also address the equal treatment of operators subject to the Directive but characterised by different exposures to indirect CO_2 costs. As, however, **Member States are free to decide on implementation** of compensation for indirect CO_2 costs, it is not possible to construct a system guaranteeing equal treatment within and among sectors.

The state aid **rules must set a common framework for compensation**. Possible internal EU competitiveness concerns inherent to the autonomous granting of compensation by Member States are not a legitimate reason for refusing compensation to energy-intensive industries. Consequently, the risk of possible unequal intra- or inter-sector treatment should not govern the review of the rules. Instead, the certainty of competition distortion between EU-based producers and non-EU-based producers - particularly when sectors have a global pricing regime, must be the governing consideration.

To recap, the distortion of international competition is not a purely economic issue: it will also undermine the environmental objectives of the Directive. Therefore, as determined by the legislator, it is essential for the Commission to establish state aid rules that will enable compensation measures to be implemented. The necessity and proportionality requirements applicable for state aid cases will ensure that only those installations that have suffered an actual cost increase of electricity due to CO_2 costs will receive aid.

Sectors exposed to a significant risk of carbon leakage

The process that identified 164 sectors as being at risk of carbon leakage was conducted by taking into account the combined cost effect of direct CO_2 emissions and indirect CO_2 cost effects. If an additional eligibility assessment at sector level is considered, it should follow the structure of quantitative and qualitative assessments, as defined in the Directive (Article 10a 14-17). Since **NACE and PRODCOM codes are not suitable in all cases for identifying electricity-intensive sub-sectors,** it is important to identify parameters and definitions that are able to do so. An example is the operation of Electric Arc Furnaces in the steel and ferro-alloys industry, for which a suitable identification scheme must be found. The same applies for the chlor-alkali and zinc industries, whose exposure is not correctly reflected at NACE 4 level.

The emphasis of leakage assessment is on the aspect of risk. This approach looks at the structural competitiveness susceptibility of sectors to CO_2 costs. The legislators decided to apply two criteria, namely the impact of CO_2 prices on the Gross Value Added, coupled with an indicator of a sector's ability to pass through such CO_2 costs. The inability of a sector to pass through costs (due, for example, to its prices being set on a global trading exchange, as is the case for non-ferrous metals traded on the London Metal Exchange) is indeed an obvious criterion to qualify for compensation of indirect costs.

Leakage risk assessment should not be an exercise to identify historic and actual leakage events. This would constitute an inherent contradiction, as it would only make compensation available when it is already too late, i.e. for those production volumes that have already ceased to be produced in the Community. It runs counter to the objectives of the Directive. Consequently, investigations of production shifts in the past are not a valid approach for identifying or quantifying leakage risk. Historic long-term power contracts for the energy-intensive industry did not include CO_2 costs. Today, most of these contracts have disappeared and, generally, **industries are and will be exposed to the CO_2 costs in electricity prices**.

Leakage risk assessment cannot be designed as a snapshot of the economy - past, present or future. Instead, leakage risk assessment ideally covers a range of prices, costs and returns over one full economic cycle at least. A ''kick in'' of leakage mechanisms can be considered as likely, if it can be demonstrated that, for a range of CO_2 costs and economic scenarios, the investment capability of a sector is significantly impaired.

Support measures cannot be linked to international agreements and economic situations

For the assessment of **leakage risk due to indirect CO_2 costs, it is of no practical importance whether or not certain developments have taken place**. This pertains, especially, to final decisions on the eventual form of EU climate change policies, the content of any international agreements or the actual economic situation. As a definitive settlement is unlikely, over the coming years, this approach would withhold compensation, indefinitely. It will not be the signing of an international agreement *per se* that will influence the impact of EU climate change policies on our international competitiveness but the policy measures that are then implemented.

Moreover, a possible international climate agreement on direct emissions cannot create a level playing field on indirect impacts worldwide. The reason for this is the different pricing systems for electricity in the world. It is widely recognised that in the EU electricity markets, industry generally has to pay marginal fossil fuel based power prices, including CO2 costs, with substantial additional renewable levies, while in most other regions long-term bilateral power contracts and/or regulated prices exist.

Economic development follows a totally uncertain regime, as demonstrated by the current crisis. Therefore, the compensation mechanism will be able adequately to respond to the economic situation only if it is granted for actual CO_2 costs incurred. The modified state aid rules must provide a framework independent of any actual economic or political situation.

Environmental legislative impact on competitiveness

Manufacturing industries are well aware **competitiveness is not linked solely to CO_2 cost**. Production relocation can be triggered by causes other than just environmental cost effects. It is the daily business of industry managers to maintain and increase competitiveness. Independently of environmental aspects, such efforts sometimes succeed while others fail. A shield from indirect CO_2 cost would be insufficient, in itself, to perpetuate uncompetitive operations but it would avert the failure of highly competitive enterprises, owing to CO2 cost burdens not borne by competitors outside the EU. .

Benchmarks: an effective incentive to reduce electricity consumption

The granting of compensation for CO_2 costs in electricity for certain installations in some sectors will not impose an increased abatement burden on other operators. **Compensation does not reduce the recipients' obligation to reduce indirect emissions** because it will be based on electricity consumption efficiency benchmarks, similar to the benchmarks for direct emissions. They will provide the incentive for relatively inefficient operations to improve their performance to the level of the benchmark, set according to the most efficient available technologies.

In fact high electricity prices in Europe have been a continuous incentive for industries to be electricity-efficient. Indeed, for many operations, the sheer laws of physics prevent further electrical efficiency improvements with current technology. Another factor is that electricity intensive users do not control the carbon footprint of the electricity-mix supplied by the market. **Pressure to reduce the CO_2 footprint is and should be on the electricity sector, which can control this – not industry.**

This is also why it is so **important to provide full cost compensation up to the benchmark** for all CO_2 costs in electricity prices. Anything less would both lead to carbon leakage and miss the extra incentive given by the benchmark in addition to the electricity price signal. A potential reduction factor or cap (in the level of aid intensity) applied to the national compensation measure would come in addition to the benchmarks already incorporated and would not be in accordance with the provisions of the Directive. The benchmarks will be established according to the most efficient technologies and will deliver the necessary incentives to reduce electricity consumption.

Need to establish state aid rules now

The Commission has received a binding mandate to establish the framework that will allow the filing of claims for state aid support and their assessment by the national authorities and the Commission. We understand that the **construction of this framework can and must proceed independently of any quantitative leakage risk assessment** for potential beneficiaries and, in fact, should antedate such assessments.

Already, companies are exposed to CO_2 cost pass-through effects from electricity generators, and are in urgent need of a compensation mechanism not yet in existence. This dangerous and unfortunate situation will deteriorate with the significant tightening of the CO_2 cap from 2013 onwards.

It is **necessary to have the state aid rules in place now**, so that Member State compensation schemes can be developed in good time before the entry into force of the amended ETS Directive. To ensure that the CO_2 costs in the electricity prices do not result in unnecessary carbon leakage, the aid must be of such duration that new and necessary investments do not move from the EU to other regions.

Conclusion

It is necessary to establish a clear timetable for modifying the state aid rules according to Article 10a6, to give the businesses affected **regulatory certainty** in order to continue to maintain and make planned investments in their operations between now and 2013.

We call on DG Competition to propose amendments to the state aid rules in the short term and for them to be developed according to the following legal requirements:

- The necessity (and proportionality), duration and related incentive effect of any state compensation measures designed to address indirect costs of carbon leakage must be assessed in the light of the **overriding objective of minimising the risk of carbon leakage** and as such of raising the overall level of environmental protection;

- To meet the proportionality test, **compensation levels should be based on the actual costs** arising from the pass-through of CO_2 costs in electricity prices;

- To satisfy the suitability test, the proposed measures only need to consider the condition that **aid must be granted in principle in the same way for all competitors** in the same sector (or sub-sector) if they are in a similar factual situation – in other words that there is no discrimination;

- The choice of **potential beneficiaries to receive national state aid is based on objective and transparent criteria**. No state aid would be permissible for a recipient company that was not within a sector or sub-sector included in the lists drawn up in accordance with Article 10A (14 to 17).

- **Benchmarks fully reflect necessary incentives**. Any additional cap on aid intensity is neither justified nor warranted and must not be included in the proposals.

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