EU Commission Launches Public Consultation on Revised EU ETS State Aid Guidelines

20 January 2020

Introduction

On 14 January 2020, the European Commission (the Commission) launched a public consultation on proposed revisions to EU State aid guidelines which set out the conditions under which EU Member States may compensate industrial companies for certain costs incurred due to the EU's Emission Trading System (ETS). The proposed amendments must be seen in the context of the EU's climate policy goals: the Commission suggests tightening the conditions for compensation of indirect emission costs, including by reducing the number of eligible sectors from fifteen to eight, lowering the compensation level from 85% to 75% and making compensation conditional upon decarbonization efforts by the companies concerned. Stakeholders are now invited to make their views known on the proposed changes, in particular as regards their impact on the risk of carbon leakage, the effectiveness of the ETS, and possible distortions of competition. The consultation runs until **10 March 2020**.

What is the consultation about?

The ETS is part of the EU's policy to combat climate change and seeks to reduce greenhouse gas emissions in a cost-effective way. Companies incur two types of costs due to the ETS: (i) **direct costs**, which arise because companies need to buy allowances corresponding to their own actual emission level (direct ETS costs); and (ii) **indirect costs**, which arise because electricity producers pass direct ETS costs on to their customers, with the result that companies pay higher electricity prices (indirect ETS costs).

EU rules allow companies to receive compensation for both types of costs, subject to certain conditions. In particular, the EU acknowledges that, in the absence of global standards equivalent to the ETS, indirect ETS costs may cause companies to transfer their production outside the EU to countries with less stringent emission regulations. Such a scenario, referred to as "carbon leakage", would result in less economic activity in the EU but no reduction in global emissions. Therefore, the EU permits its Member States to partly compensate companies for indirect ETS costs. As this type of compensation is considered State aid, it requires approval by the Commission, which may only be granted subject to the conditions set out in the ETS State aid guidelines. These guidelines seek to minimize the risk of carbon leakage, but also to preserve the ETS objective to achieve cost-efficient decarbonization and to minimize competition distortions in the EU internal market.

Given that the current ETS State aid guidelines will expire on 31 December 2020, the Commission published a proposal for revised guidelines on 14 January 2020. The new guidelines are due to be adopted in the course of 2020 and will cover the period from 2021 to 2030. It is these draft revised guidelines that are subject to the public consultation.

Comprehensive information on the public consultation as well as the consultation reference documents (including the draft revised guidelines, an explanatory note, a consultant report, and a factsheet) are available on a dedicated webpage of the Commission (https://ec.europa.eu/competition/consultations/2020_ets_stateaid_guidelines/index_en.html)

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What are the main proposed revisions to the guidelines?

The consultation takes place in a context where addressing climate change is high on the EU's political agenda. According to the Commission, the draft revised guidelines reflect the objectives of the European Green Deal, whereby the EU seeks to limit global greenhouse gas emissions and achieve climate neutrality by 2050. It does therefore not come as a surprise that the draft revised guidelines generally make compensation for indirect ETS costs subject to stricter conditions. The proposed revisions include, in particular, the following:

- **Reduced number of eligible sectors**: The number of sectors/sub-sectors eligible for compensation is reduced from fifteen to eight,[i] reflecting a focus on the sectors identified as most exposed to a genuine risk of carbon leakage. In order to establish the updated list of eligible sectors, the Commission relied on certain quantitative criteria, which are specified in the consultation documents. The explanatory note states that, depending on the feedback and evidence it receives as part of the public consultation, the Commission may decide to include additional sectors based on qualitative considerations, provided that those sectors have at least an indirect carbon leakage indicator of 0.2 and that their carbon leakage risk is evaluated as at least medium.

  The following sectors are proposed to be eligible in the draft revised guidelines:

	NACE code	Description
1.	14.11	Manufacture of leather clothes
2.	24.42	Aluminium production
3.	20.13	Manufacture of other inorganic basic chemicals
4.	24.43	Lead, zinc and tin production
5.	17.11	Manufacture of pulp
6.	17.12	Manufacture of paper and paperboard
7.	24.10	Manufacture of basic iron and steel and ferro-alloys
8.	19.20	Manufacture of refined petroleum products

  The following sectors/sub-sectors are eligible under the current guidelines but are no longer included among the eligible sectors in the draft revised guidelines:[ii]

	NACE code	Description
1.	1430	Mining of chemical and fertilizer minerals
2.	2415	Manufacture of fertilizers and nitrogen compounds
3.	2744	Copper production
4.	2414	Manufacture of other organic basic chemicals
5.	1711	Spinning of cotton-type fibres
6.	2470	Manufacture of man-made fibres
7.	1310	Mining of iron ores
8.	2416	Manufacture of plastics in primary forms (certain sub-sectors)

- **Lower compensation level**: In the previous trading period (2013 to 2020), the maximum share of indirect ETS costs that EU Member States could compensate (the so-called maximum aid intensity) amounted to 85% in 2013-2015, 80% in 2016-2018 and 75% in 2019-2020. In the draft revised guidelines, the maximum aid intensity is set at 75% and remains stable throughout the entire ETS trading period of 2021-2030. At the same time, the draft revised guidelines introduce the possibility for Member States to further limit the exposure of companies to indirect ETS costs where those costs represent, even after applying the 75% compensation, a disproportionate amount of their gross added value.

- **Strengthened conditionality**: The draft revised guidelines introduce a new conditionality requirement which goes beyond current EU law. Specifically, compensation is made conditional upon decarbonization efforts by the companies concerned, such as conducting energy audits, implementing energy audit recommendations, facilitating an increase in sustainable and private investment, and reducing the carbon footprint in their electricity consumption.

How can stakeholders get involved in the consultation process?

Stakeholders are invited to submit their comments on the draft revised ETS State aid guidelines by **10 March 2020**. The Commission seeks, in particular, feedback on the following points:

- **Impact on carbon leakage risk**: Are the draft revised guidelines well designed to address the risk of carbon leakage due to indirect emission costs (notably as regards the sectors that are eligible for compensation)?
- **Effectiveness of the ETS**: Do the draft revised guidelines preserve the incentive of the ETS for a cost-effective decarbonization of the economy?
- **Possible distortions of competition**: Do the draft revised guidelines minimize competition distortions in the EU internal market?

All citizens, Member States, organizations and any other interested parties may contribute to this consultation. Contributions to the consultation will, in principle, be published on the Commission's dedicated webpage. However, it is possible to mark submissions as confidential and to provide a non-confidential version, in which case only the non-confidential version will be published.

How can Baker Botts assist you?

If you have any questions or require assistance in connection with this public consultation, please do not hesitate to reach out to any of the Baker Botts lawyers listed below.

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[i] While the Commission's press release (available at https://ec.europa.eu/commission/presscorner/detail/en/IP_20_53) refers to a reduction from fourteen to eight sectors, the text of the current guidelines refers to fifteen eligible sectors/sub-sectors.

[ii] The NACE codes and descriptions are those referred to in the current guidelines.