



# Alert

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## EU, Competition & Trade



### Emission Trading Scheme: the European Commission considers aid to energy-intensive industries

**Under the auspices of the French Presidency, the EU institutions are considering the possibility of allowing State aid to help energy-intensive industries (such as chemical and aluminium producers) cope with increased electricity costs due to the EU Emission Trading Scheme (ETS). Although incentives for energy savings and energy efficiency must remain in place in order to achieve the EU's long-term environmental objectives, if the measures under discussion are finally adopted, Member States will be allowed to grant State aid to a number of industry sectors provided certain conditions are fulfilled.**

#### Background

The EU ETS was established by Directive 2003/87/EC and launched in January 2007 as a cornerstone in the EU's strategy for fighting climate change.

The EU ETS is usually described as a "cap and trade" system, ie a system which caps the overall level of emissions allowed but, within that limit, allows participants in the system to buy and sell allowances as they require. Under the current system, Member States draw up national allocation plans for each trading period under the scheme, determining their total level of ETS emissions and how many emission allowances each installation in their country receives.

#### Proposal to amend Directive 2003/87/EC

In January this year, the Commission issued a proposal to amend Directive 2003/87/EC, drawing from the experience of the first year of implementation of the ETS.

The main changes proposed by the Commission are:

- a single EU-wide cap will be imposed on the number of emission allowances (decreasing along a linear

trend line beyond the end of the third trading period, ie beyond 2020) instead of 27 national caps;

- a larger share of allowances will be auctioned instead of being allocated free of charge;
- a set of harmonised rules governing free allocation will be introduced;
- the rights to auction allowances will be redistributed from Member States with high per capita income to those with low per capita income;
- new industries (eg, aluminium and ammonia producers) will be included in the ETS, as well as two further gases (nitrous oxide and perfluorocarbons);
- Member States will be allowed to exclude small installations from the scope of the system, provided they are subject to equivalent emission reduction measures.

#### Current discussions

In its explanatory memorandum, the Proposal acknowledges, inter alia, that in the absence of comparable constraints for industry outside the EU, there may arise a risk of "carbon leakage", ie relocation of greenhouse gas emitting activities from the EU to third countries, thereby increasing global emissions. Such risk of carbon leakage has been the subject of recent discussions under the French Presidency. It appears as if the Commission is now considering the introduction of new State aid rules for those sectors which face higher electricity costs due to the pass-through of ETS-related costs by energy producers who participate in the ETS system.

The main features of the new State aid rules appear to be focused on the necessity and proportionality of the aid, as well as the attempt to maintain an incentive

to save energy and to move towards green electricity. Member States would have to make sure that all beneficiaries of the aid measures are covered by a list of sub-sectors which will have to be prepared by the Commission and which will include the industries most at risk of carbon leakage due to higher costs related to the ETS system.

Member States would also have to ensure that aid is granted only to those installations which actually suffer from the pass-on of ETS-related costs by energy suppliers. Also, the aid granted should be proportional to the increase in costs and at the same time ensure that incentives to achieve environmental objectives remain in place (eg, by not granting compensation for the full costs' increase).

The amount of aid which the beneficiary would be able to benefit from will have to be calculated on a case-by-case basis, using a formula which takes into account a number of factors, such as a percentage of the CO2 ETS-related costs, the average CO2 intensity in the EU's total electricity production, the average allowance price of the previous years and electricity use benchmarks for the sectors in question. A possible formula for the calculation of permitted aid could be as follows:

Maximum aid = x% \* EU wide CO2 content of electricity \* average price of CO2 allowances \* benchmark for efficient electricity use for the product \* historic production data

In any case, the aid measures would still have to be notified to the Commission.

A reference to the possibility of using State aid measures to help energy-intensive industries might therefore be included in the new Directive amending Directive 2003/87/EC, which is being discussed, and will have to be approved through the co-decision procedure (ie, it will have to be approved by both the Council of the EU and the EU Parliament).

## Comment

The above rules on State aid for energy-intensive industries, if adopted, will come as a third significant step in the field of environmental State aid, after the Commission's new Community Guidelines on State aid for environmental protection and the General Block Exemption Regulation of August 2008 which allow aid for energy saving measures high-efficiency cogeneration, renewable energy sources, relocation and waste management. The ETS measures are therefore part of a wider package allowing aid to industry to tackle energy costs.

A reaction to the risk of carbon leakage had to be expected, as the sectors in question face strong international competition from third countries that do not have strict environmental controls similar to the ETS system. Some feared that the EU might have combated this risk by introducing some sort of "border adjustment" in order to compensate for the competitive advantage enjoyed by those third country competitors who do not suffer cost increases equivalent to those incurred under the ETS system. Aid measures to help energy-intensive industries are certainly a more WTO-compliant solution and should be welcomed.

For more information on the developments related to State aid rules for energy-intensive industries and for any queries on State aid matters please do not hesitate to contact:

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