

The Hague, 6 March 2020

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**Response of the Dutch authorities on the COMMUNICATION FROM THE COMMISSION, draft Guidelines on certain State aid measures in the context of the system for greenhouse gas emission allowance trading post 2021**

HT.582

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This response reflects the views of the Dutch 'Interdepartementaal Steun Overleg (ISO)'. The ISO is a national State aid committee composed of all Dutch ministries and representatives of the regional and local authorities.

### **1. General points**

In Europe, following the introduction of the ETS, industrial sectors deemed at a risk of carbon leakage are compensated for direct emission costs with free ETS allowances. On top of the compensation for direct emission costs, the 2012 ETS Guidelines allowed Member States to compensate some energy-intensive industries for the higher electricity costs resulting from the EU ETS, also called indirect emission costs.

The purpose of the draft Guidelines is to address the risk of carbon leakage due to indirect ETS costs while minimizing competition distortions and maintaining the incentives for a cost-effective decarbonisation of the economy. The draft Guidelines take into account the new provisions of the ETS Directive 2018, the evolution of market conditions and the previous practices of Member States.

The Netherlands advocates 55% EU emissions reduction in 2030 (compared to 1990) to reach the EU target to become climate neutral by 2050 cost effectively. The Netherlands welcomes the green deal as an important framework to reach these targets. However we do acknowledge that as long as there is no international shared approach with international partners, there is a risk of carbon leakage. Therefore, we acknowledge that the draft Guidelines need to address three specific objectives: minimising the risk of carbon leakage, preserving the EU ETS objective to achieve cost-efficient decarbonisation and minimising competition distortions in the internal market.

We welcome the approach proposed by the Commission, with stricter rules on how EU Member States can compensate companies for indirect costs such as rising electricity prices due to higher carbon prices. We support that targeted aid should only be possible for the most exposed sectors and that compensation is conditional upon decarbonisation efforts. However it is key that the compensation - allowed by this proposal - should not result in distortions of competition in the internal market. In view of this the Netherlands doesn't support the introduction of a so called super cap. The Netherlands supports the new geographical division of the relevant markets in order to determine the accurate CO<sub>2</sub> emission factor because it suggests that the Commission uses a low estimate for the emission factor to stimulate the further decarbonisation of the electricity sectors.

Finally, we would like to signal that future developments such as a foreseen revision of the ETS Directive and a possible Carbon Border Adjustment Mechanism can make it necessary to revise the proposed guidelines or even the indirect cost compensation as such.

In the light of this context we have the following feedback.

## 2. The Dutch comments

### 2.1. Eligible sectors

First, compared to the 2012 ETS Guidelines, the proposal provides an updated and more limited list of sectors eligible for compensation. This list includes eight sectors, which have been identified as the sectors most exposed to an actual risk of carbon leakage. The methodology used to establish the list of eligible sectors relies on the carbon leakage indicator as defined in Article 10b of the revised ETS Directive, calculated based on indirect cost only. The indirect carbon leakage indicator required for eligibility is 0.2. In addition, eligible sectors need to have a trade intensity of at least 20% and an indirect emission intensity of at least 1 kgCO<sub>2</sub>/EUR. These values are calculated at NACE code 4 level using the dataset also used for establishing the Carbon Leakage List used for the allocation of free ETS allowances.

The Dutch authorities are in favour of the proposal of the European Commission for a more limited list of sectors that are eligible for compensation. According to the Netherlands, the Commission has accurately found that state aid should only be given to those sectors that are actually exposed to carbon leakage. We believe that the European Commission has identified the relevant variables to test this in the carbon emissions associated with the industrial production and the exposure of sectors to global trade.

We do worry about the statement of the Commission that 'The Commission may decide to include additional sectors, in light of the feedback and evidence received in the public consultation, based on qualitative considerations provided the sectors concerned have at least an indirect carbon leakage indicator of 0.2 and that their carbon leakage risk as evaluated by the consultant in the study is at least medium.' The Netherlands is concerned that this will lead to an undue increase in the amount of sectors eligible for compensation. We support the idea of an evaluation during Phase 4. The Netherlands suggests to take developments like a Carbon Border Adjustment Mechanism into account in the evaluation.

### 2.2. Aid intensity and degressivity

The draft Guidelines also establish the aid intensity, i.e. the maximum share of indirect ETS costs that Member States can compensate. The proposal maintains this aid intensity at 75%. This value is in line with the aid intensity applied at the end of the third ETS trading period under the previous guidelines.

The draft Guidelines also introduce the possibility for Member States to further limit the exposure of beneficiaries to indirect ETS cost as a function of their gross value added ("GVA"). This new possibility is aimed at limiting the exposure to indirect ETS cost of certain sectors for whom these costs, even after applying the 75% compensation, can make up a disproportionate amount of their GVA. Stakeholders are invited to present their views on this new possibility.

The Netherlands are not in favour of introducing this possibility, as it presents an undue exception to the other criteria which are well-considered. In addition, the Netherlands is concerned that this introduces a scope for discussion on how to determine the exact gross value added at the level of the individual beneficiary. The Commission may have been precise in outlining which factors to include in determining the GVA, but the Netherlands is concerned that not all of these factors can be established on a wholly objective basis.

The aid intensity would not be degressive but stable throughout the entire ETS trading period. With a non degressive aid intensity however, it is key to conduct a mid-term update of the electricity consumption efficiency benchmarks, based on the most electricity-efficient methods of production for the product considered, to take into account most recent data and production processes. We can follow the Commission in its reasoning that that this update of the efficiency benchmarks is better suited to capture any potential efficiency gains in the sectors concerned than a per-se reduction of the aid intensity.

The Commission is considering aligning the methodology for updating the electricity consumption efficiency benchmarks for the purposes of these Guidelines with the methodology specified in Article 10a(2) of the EU ETS Directive (see point 14(13) of the draft Guidelines proposed for consultation). Under this methodology, the Commission would extrapolate an annual reduction rate for each benchmark based on past efficiency improvements. Stakeholders are invited to present their views on the use of such methodology in the future Guidelines. Member States should amend, where necessary, their respective schemes in order to bring them into line of these updates.

The Netherlands supports this methodology as an effective way of limiting the state aid given only to the actual expected additional costs for those sectors that run the risk of carbon leakage.

### *2.3. Aid amount calculation formula*

The Commission proposes the estimated amount of indirect ETS costs and consequently the maximum aid amount to be calculated on the basis of parameters comparable to those used under the 2012 ETS Guidelines.

- Differentiated regional "CO<sub>2</sub> emission factors", which reflect the CO<sub>2</sub> intensity of electricity produced from fossils fuels in a given geographic area, will continue to apply. For this purpose, the relevant geographical zones have been defined according to the same methodology as was used under the 2012 ETS Guidelines, i.e. the development of market coupling and the degree of actual price convergence, using updated economic data.

- The baseline output used for the purposes of the calculation corresponds to the actual production in the year preceding the granting of the aid. The impact assessment of the 2012 ETS Guidelines stated that such option would risk undoing the price signals and incentives from the ETS to become more efficient in terms of electricity consumption. However, as compensation of indirect ETS costs is only a partial compensation, an increase of production leading to an increase of electricity consumption will always result into increased electricity costs for the undertaking. Therefore, the Commission considers that the reliance on actual output figures most accurately reflects the level of indirect cost incurred by each beneficiary and maintains the incentive for energy efficiency. On the contrary, as the historical output does not allow to calculate the actual indirect costs faced by an individual undertaking, it does not fully maintain the incentive for the undertaking to become more efficient. Indeed, in a situation where the historical output value is higher than the actual output, using the historical output as the reference parameter would reduce the price signal from the ETS and therefore undermine the incentive to improve energy efficiency.

It is important that the reference output is determined as accurately as possible in order to prevent competition distortions. Therefore the Netherlands supports the Commission proposal to determine the reference output dynamically.

The CO<sub>2</sub> emission factor should reflect the ambition to decarbonise the electricity sectors. As a result of this regions will be encouraged to fasten their developments in more sustainable electricity production. Also in the next years the amount of sustainable

energy will grow and therefore the average CO<sub>2</sub>-emission factor will decrease. Therefore the emission factor should be determined year-by-year and based on actual carbon intensity.

Several parameters used to calculate the aid amounts have not been set in the attached draft Guidelines proposed for consultation and will be established at a later stage. This concerns the electricity consumption efficiency benchmarks, the actual level of the above GVA cap and the actual regional CO<sub>2</sub>-factors. The CO<sub>2</sub>-emissions factors will be set on the basis of the most recent Eurostat data (2019), and will be updated once in the middle of the next trading period. In 2025, the Commission will also assess whether additional data is available allowing to improve and revise the methodology used to calculate the CO<sub>2</sub> emission factors, i.e. to take into account the increasingly important price-setting role of low-carbon technologies in EU electricity markets.

#### *2.4. Conditionality*

Finally, the draft Guidelines propose to strengthen the conditionality of the compensation of indirect ETS costs by going beyond the obligations already set by the Energy Efficiency Directive 2012/27/EU. Stakeholders are invited to present their views on this new conditionality requirement. Member States would have to verify that beneficiaries, irrespective of their size, have conducted or commit to conduct an energy audit or have an energy or environmental management system in place. Member States would also have to monitor the implementation of the resulting recommendations by large undertakings. Member States would have to monitor compliance with this requirement. Also, the Commission as part of its monitoring efforts for approved schemes can check compliance with this requirement.

We support the introduction of conditionality in order to incentivize beneficiaries to reduce their carbon footprint. It is important that these Guidelines will be consistent with the European Green Deal as well as the EU's broader climate goals.

#### *3. Modernisation of Electricity Generation*

The new provisions related to aid involved in optional transitional free allowances for the modernisation of electricity generation, are largely pre-determined by Article 10c of the revised ETS Directive. The objective of this type of aid is the modernisation, diversification and sustainable transformation of the energy sector. For projects involving a total amount of investment exceeding EUR 12,5 million, aid would be granted on the basis of a competitive bidding process which complies with the requirements of the draft Guidelines proposed for consultation. For projects below EUR 12,5 million, State aid measures would also be subject to State aid assessment.

In view of a fair competition on the internal market, we would like to underline the importance of granting the aid on the basis of a competitive bidding process in order to comply with principles of transparency, non-discrimination and financial management. In line with this we would like to point out that a state aid assessment for projects below EUR 12.5 million is necessary.