Brussels, 28 November 2018

To: Ms. Margrethe Vestager, Commissioner for Competition

Cc: Mr. Jean-Claude Juncker, President of the European Commission
Mr. Miguel Arias Cañete, Commissioner for Climate Action and Energy
Ms. Elżbieta Bieńkowska, Commissioner for Internal Market, Industry, Entrepreneurship & SMEs

RE: Reform of the State Aid Guidelines for Compensation for the Indirect Costs of the EU Emissions Trading System

Dear Commissioner Margrethe Vestager,

We are writing to you to emphasise the importance of the European Commission coming forward with an improved scheme for compensation for the indirect costs of the EU Emissions Trading System (ETS) for Phase IV, and to request a meeting to discuss this topic in more detail.

We, the non-ferrous metals industry, representing the whole value chain, are concerned that the current compensation measures will not be enough to prevent carbon leakage of Europe's most-electro intensive industries. We would like to request a meeting with you to discuss our proposals for updating and improving the State Aid Regime for the indirect costs in Phase IV.

The non-ferrous metals industry has long supported the EU ETS as the best instrument to reach our stated GHG reduction targets. We've advocated for the EU ETS to be strengthened during recent reform discussions, under the understanding that corresponding carbon leakage provisions would also be put in place. Such provisions have been adopted to protect carbon-intensive industries fully from the direct costs of the EU ETS. We're now looking forward to reciprocal measures being integrated into the upcoming State Aid Guidelines to protect electro-intensive industries from EU ETS indirect costs.

Looking ahead, a continuation of the current State Aid Guidelines in Phase IV will not be enough to reduce the risk of carbon leakage for the non-ferrous metals sector, given the high costs we face even after maximum permitted compensation is granted.

The current system of partial, degressive and voluntary indirects compensation is not "fit for purpose" in light of the European Commission's industrial and climate change objectives, and should be improved. A more proportional approach, integrating elements from the Energy and Environment Guidelines (EEAG), would take into account that not all companies have similar indirect cost burdens and thus create a fairer level playing field. In Annex I we outline in more detail how the updated guidelines can be made more effective.

Short timeframe

Finally, we would like to conclude by flagging that the remaining timeframe to put in place the new State Aid Guidelines remains relatively short. Indeed, the Guidelines need to be put in place well in advance of the beginning of Phase IV on 1st January 2021 in order to give Member States an adequate timeframe to come forward with, and get approved, their own compensation schemes.

We trust that our comments and concerns will be given due consideration, and hope to discuss them further in a meeting with you. We remain open to answering any questions you may have and look forward to continuing the good, open dialogue which we have already established with your colleagues.

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Sincerely,

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Annex I

Why indirect costs compensation is essential for the non-ferrous metals industry and 2050 pathways

We are the front-runners in industry electrification having switched from fossil-fuel based CO2 emitting to more energy efficient electric processes (With full decarbonisation potential of the power sector). Electricity now represents 30-45% of the primary production costs of many metals. Further industry electrification will also be essential for the 2050 decarbonisation pathways of several other energy-intensive industries, as concluded in **a recent study** by the Institute of European Studies. However, the current system of partial, degressive and voluntary indirect costs compensation will punish those sectors that have already electrified their production processes, and disincentivise further electrification across energy-intensive industries.

Given our electro-intensive nature, the indirect costs of the EU ETS have a major impact on production costs of non-ferrous metals. For example, for primary aluminium production, if the EU ETS carbon price increases to €30 a tonne, indirect costs will be around 20% of production costs. Even at a level of 75% compensation (Maximum level allowed by 2020 under the Guidelines) the indirect costs will exceed 5% of production costs after compensation. Similar figures can be seen for the primary production of other non-ferrous metals such as copper, nickel, silicon and zinc (in alphabetical order).

To compound matters, non-ferrous metals are 'price-taker' commodities operating at global markets, with price setting at global exchanges. This means they are not in a position to pass any unilateral regulatory costs, such as the EU ETS indirect costs, to their customers. Inability to pass on cost is best reflected in a very high value of the price elasticity of demand. However, due to a lack of data, the ETS relies on the second best indicator of trade intensity. As a result of using this non-optimal indicator, a purely quantitative approach significantly underestimates the carbon leakage exposure of the non-ferrous metals sector. Therefore, in order to have an accurate determination of a sector's exposure, a qualitative approach where sectors which are verified to be 'price-takers' are de facto set at the highest level of trade intensity (100%) is needed.

How to improve the State Aid Guidelines for Compensation for the Indirect Costs in Phase IV

It's crucial that the current guidelines be improved to allow for differentiation between companies [also referred to as "undertakings"] eligible for compensation. This will help to ensure that all are commensurately protected from carbon leakage. In particular, the relative significance of indirect costs for a company should be decisive for the level of compensation available. Such an approach would build upon the Commission's approved methodology in the Energy and Environment Guidelines (EEAG) of 2014-2020 and would be more effective in achieving the objectives of the indirect compensation scheme.

Paragraph 189 of the EEAG notes that the regulatory charge incurred [in this case renewable energy surcharges] "might go beyond what an undertaking particularly affected by the burden can bear". In order to address this, the Guidelines give Member States the opportunity to further limit the amount of the costs for undertakings having an electro-intensity of 20% to 0.5% of gross value added. The same reasoning applies to the exposure of Europe's most electro-intensive industries to indirect ETS costs; indirect costs are not inherent to the operation of energy-intensive industries, yet they add an unbearable burden. Thus, a similar provision should be integrated into the upcoming State Aid Guidelines for the Indirect Costs of the EU ETS.

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