



EUROPEAN COMMISSION

Brussels, 21.05.2014
C(2014) 3136 final

PUBLIC VERSION

This document is made available for
information purposes only.

**Subject: State aid SA.35449 (2014/N) – United Kingdom
Aid for indirect Carbon Price Floor costs**

Sir,

I am pleased to inform you that the European Commission has assessed the scheme exempting certain energy-intensive sectors from part of the costs incurred as a result of the introduction of the Carbon Price Floor and decided that the aid can be considered to be compatible with Article 107(3)(c) of the Treaty on the Functioning of the European Union ('TFEU').

1. PROCEDURE

- (1) Following pre-notification contacts, the UK notified its proposed measure on 11 February 2014 by electronic notification, registered by the Commission on the same day. The UK provided additional information on 15 April 2014 as requested by the Commission on 11 April 2014.

2. DESCRIPTION OF THE MEASURE

2.1. Background and objective

- (2) As part of the Electricity Market Reform ('EMR'), the UK government intends to introduce a carbon price support mechanism to establish a carbon price floor ('CPF').

The Rt Hon William HAGUE
Secretary of State for Foreign Affairs
Foreign and Commonwealth Office
King Charles Street
London SW1A 2AH
UNITED KINGDOM

- (3) With the introduction of the CPF, the UK aims at incentivising low-carbon electricity generation. The UK believes that while the EU Emissions Trading Scheme ('ETS') should be the main policy instrument incentivising low-carbon generation in the EU, it does not currently provide the price incentives needed for significant investments in the UK. The UK government considers that carbon prices need to provide long-term price signals and need to enable investors to commit to make the investments.
- (4) The Carbon Price Floor will result from the removal of the exemptions from paying the Climate Change Levy ('CCL') relating to gas and coal used for electricity generation, as well as from a reduction in the amount of fuel duty that can be reclaimed when using oil.
- (5) Following the withdrawal of the exemptions mentioned in point (4), the UK authorities will introduce the carbon price support rates ('CPS') by applying new CCL rates and fuel duty rates to electricity generators. These support rates will be set at levels which are proportionate to the carbon content of the fuel used. This means that the CPS is effectively a tax on the level of carbon emissions of the fuels used in electricity generation.
- (6) The CPF is therefore the minimum price of carbon in the UK and consists of the sum of the ETS carbon price and the CPS. The CPS will complement the ETS carbon price, in that it will provide a price per tonne of carbon dioxide (tCO₂) to be paid when using high-carbon fuels on top and above the ETS price. The UK CPF started at around GBP 16 per tCO₂, equivalent to a CPS rate of about GBP 4 per tCO₂. The latter will increase to GBP 18 per tCO₂ in 2015-16 and remain at that level up to 2019-20.¹ The UK government has stated that it will review the trajectory of the CPS after that point in time in light of potential reforms to the ETS.
- (7) The UK however also expects the CPF to translate into higher energy prices. The increase in the wholesale cost of electricity caused by the CPF will lead to higher electricity prices. The UK believes that such increase will disproportionately affect large electricity users, many of which operate in internationally competitive markets and are exposed to the risk of carbon leakage.
- (8) In particular, the UK expects electricity prices to increase by about GBP 5 per MWh by 2015 as a result of the introduction of the CPF. Table 1 provides a break-down of the electricity price increase, which is based on the maximum regional emission factor for the UK.²

¹ Figures in 2009 prices. The latest CPS rates have been set in the government 2014 budget on 19 March 2014.

² See Annex IV of the Guidelines on certain State aid measures in the context of the greenhouse gas emission allowance trading scheme post-2012 ('the ETS Guidelines'), OJ C 158/4 of 5 June 2012, available at the following address:
<http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2012:158:0004:0022:EN:PDF>

Table 1 – Estimated impact of CPF on electricity prices

	2013/14	2014/15	2015/16
Carbon Price Support Mechanism Level (£/tCO ₂)	4.94	9.55	18.08
European Commission UK emission factor (tCO ₂ /MWh)	0.58	0.58	0.58
Electricity price impact (£/MWh)	2.87	5.54	10.49

Source: UK authorities

- (9) The UK therefore wishes to partly compensate certain energy-intensive users from the additional and indirect costs they will incur as a result of the imposition of the CPF. The UK has already exempted certain large electricity users from the ETS carbon price. This measure was approved by the Commission under the ETS Guidelines with decision of 2 May 2013.³
- (10) Under the notified scheme large electricity users are going to be compensated proportionally to the difference between the CPF and the ETS carbon price, which the UK defines as the CPS.

2.2. Legal basis

- (11) The CPS is in effect since 1 April 2013 and is levied on supplies of fossil fuels to generators of electricity made on or after that date.⁴
- (12) Currently, Schedule 6 to the Finance Act 2000 contains the primary legislation for the CCL, while the Climate Change Levy (General) Regulations of 2001 govern its administration. In particular, paragraph 14 of Schedule 6 to the Finance Act 2000 exempts all supplies of solid fuels, liquefied petroleum gas and gas used for the generation of electricity from the levy.
- (13) Section 78 and Schedule 20 to the Finance Act 2011 remove this exemption and introduce the new CPS rates for coal, LPG and gas used in electricity generation, with effect from 1 April 2013.
- (14) Oil is subject to fuel duty in the UK under the Hydrocarbon Oil Duties Act 1979. The Hydrocarbon Oil Duties (Reliefs for Electricity Generation) Regulations 2005 (Statutory Instrument 2005/3320) provide relief from fuel duty for oils used to generate electricity in a generating station or CHP station.
- (15) Statutory Instrument 2005/3320 has been amended by secondary legislation to introduce the CPF provisions relating to oil with effect from 1 April 2013.

³ Case SA.35543 – Compensation for indirect EU ETS costs in the UK, OJ C 200/3 of 12 July 2013. Available at the following address:

http://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=3_SA_35543

⁴ While the CPF is in effect, compensatory measures which involve State aid have not yet been implemented. The UK committed to make any such measure conditional on Commission approval.

2.3. Scope of the notified measure

- (16) A two-step approach is taken to determine the eligibility of an undertaking for support under the CPS compensation scheme.
- (17) First, an undertaking must be operating in one of the sectors listed in Annex II to the ETS Guidelines. The UK considers that the same arguments supporting the possible existence of carbon leakage due to the indirect costs imposed by a carbon price which apply to the list of sectors included therein does apply also for the CPS scheme, given that both the ETS price and the CPS price are aimed at exactly the same objective, namely increasing the cost of using high-carbon fuels to generate electricity.
- (18) Second, as an additional filter for eligibility the UK will allow compensation only for such electricity-intensive businesses operating in one of the listed eligible sectors which can further demonstrate that their indirect emission costs, as a result of the combined effect of the EU ETS and the CPS, will be equal to at least 5 per cent of their gross value added ('GVA').
- (19) The same criteria have been used to select eligible undertakings in relation to exemptions from the ETS carbon price. Ultimately, the beneficiaries which are eligible for exemption from the CPS will therefore be a sub-set of those included in Annex II to the ETS Guidelines. The sectors are the following: Mining of chemical and fertilizer minerals; Preparation and spinning of cotton-type fibres; Manufacture of paper and paperboard; Manufacture of other inorganic basic chemicals; Manufacture of other organic basic chemicals; Manufacture of fertilizers and nitrogen compounds; Manufacture of man-made fibres; Manufacture of basic iron and steel and of ferro-alloys; Aluminium production; Lead, zinc and tin production; Copper production; and Manufacture of plastics in primary forms.

2.4. Beneficiaries

- (20) The scheme is open to all firms active in the sectors identified, provided that the individual companies can demonstrate that their indirect emission costs are at least 5 per cent of their GVA.
- (21) The aid will be granted on non-discriminatory terms. It does not involve any discretion on the part of the public authorities.

2.5. Budget and duration

- (22) The overall amount of funds available for compensations has been set at GBP 100 million over the current spending review period, i.e. until 2015/16.
- (23) While the amount of funds available in the subsequent periods has not yet been decided upon, the UK is seeking approval of the exemption for the entire duration of the CPF, i.e. until 31.12.2020.

2.6. Compensation levels

- (24) The UK authorities intend for the level of compensation to be directly linked to the level of the CPS (and therefore the CPF). According to this approach, the level of compensation will

be calculated by making use of the formula included in the ETS Guidelines to calculate the maximum amount of aid for undertakings exposed to a significant risk of carbon leakage.⁵

- (25) In particular, the UK will use exactly the same formula to calculate the amount of compensation as in the ETS Guidelines except for the fact that the EUA price, i.e. the forward price of EU carbon allowances, will be replaced with the rate of the CPS for the relevant year. This implies that the level of compensation granted by the UK will be *de facto* the same as that which would be granted if the ETS carbon price were to be equal to the CPF.
- (26) In terms of the formula used, and where electricity consumption efficiency benchmarks listed in the amended Annex III to the ETS Guidelines⁶ are applicable, the UK proposes to calculate the eligible costs, i.e. the level of potential maximum compensation, as follows:

$$A_{max,t} = A_{i,t} \times C_t \times P_t \times E \times BO$$

Where $A_{i,t}$ is the aid intensity at year t , expressed as a fraction; C_t is the applicable UK regional CO₂ emission factor (i.e. 0.58) at year t ; P_t is the CPS rate in GBP per tCO₂ at year t ; E is the applicable product-specific electricity consumption efficiency benchmark; and BO is the baseline output.

- (27) Where the electricity consumption efficiency benchmarks are not applicable, the UK proposes to calculate the eligible costs as follows:

$$A_{max,t} = A_{i,t} \times C_t \times P_t \times EF \times BEC$$

Where $A_{i,t}$ is the aid intensity at year t , expressed as a fraction; C_t is the applicable UK regional CO₂ emission factor (i.e. 0.58) at year t ; P_t is the CPS rate in GBP per tCO₂ at year t ; EF is the fall-back electricity consumption efficiency benchmark; and BEC is the baseline electricity consumption in MWh.

3. ASSESSMENT OF THE AID

3.1. State aid within the meaning of Article 107(1) TFEU

- (28) Article 107(1) TFEU provides that "[s]ave as otherwise provided in the Treaty, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market". The application of these cumulative conditions is examined below.
- (29) The aid is based on decisions imputable to the UK and funded from the budget of the UK, thereby involving State resources.

⁵ ETS Guidelines, paragraph 27 (a).

⁶ Communication from the Commission amending the Communication from the Commission Guidelines on certain State aid measures in the context of the greenhouse gas emission allowance trading scheme post-2012, OJ C 387/5 of 15 December 2012.

- (30) The scheme is by its nature selective, as it only applies to certain sectors and to certain undertakings within those sectors.
- (31) The scheme has the potential to distort competition and trade between Member States, as beneficiaries compete with companies operating in the same sectors in other Member States.
- (32) As the measure relieves a selective group of beneficiaries from a national tax burden, the Commission considers that the notified measure grants a selective economic advantage to the beneficiaries. Therefore the Commission regards the notified measure as constituting State aid within the meaning of Article 107(1) TFEU. The United Kingdom has not provided any reason to conclude otherwise, and has explicitly indicated that it does not maintain that the measure does not constitute aid.
- (33) It is therefore necessary to consider whether the aid measure can be found to be compatible with the internal market.

3.2. Compatibility of the aid measure

- (34) In derogation from the general prohibition of State aid laid down in Art 107(1) TFEU, aid may be declared compatible if it can benefit from one of the derogations enumerated in the Treaty.
- (35) In the present case, Art 107(3)(c) TFEU could provide a basis for compatibility. Article 107(3)(c) TFEU states that "aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest," may be declared compatible under certain circumstances.
- (36) In particular, the 2008 Guidelines on State Aid for Environmental Protection ('EAG')⁷ lay down compatibility criteria for measures which are aimed at increasing the level of environmental protection. Among others, they provide for compatibility criteria for aid in the form of reductions in, or exemptions from, environmental taxes. The EAG do not specify whether a measure to partly compensate certain *electricity users* from additional and indirect costs incurred as a result of the imposition of an environmental tax on *electricity generators* can be regarded as an exemption from an environmental tax.
- (37) On 9 April 2014, the Commission (in principle) adopted the Guidelines on Environmental and Energy State Aid ('EEAG').⁸ Section 3.7.1 of the EEAG provides compatibility criteria for aid measures in the form of reductions in, or exemptions from, environmental taxes which have the same design as the proposed UK measure. According to their point 247, the EEAG will be applicable as of 1 July 2014 and until 31 December 2020.
- (38) While the EEAG are thus not yet directly applicable, they reflect the Commission's current policy approach and interpretation with regard to environmental and energy aid. Therefore, for the purposes of this case the Commission will apply Article 107(3)(c) TFEU in line with the compatibility criteria set out in the EEAG. Therefore, there is no need to assess whether

⁷ 'EAG', OJ C 82 of 1 April 2008. The EAG will apply until 30 June 2014; according to point 247 of the EEAG (see following footnote), they will be replaced as of 1 July 2014 by those new guidelines.

⁸ Communication from the Commission on Guidelines on State aid for environmental protection and energy 2014-2020, C(2014)2322, adopted with Commission decision of 9 April 2014 ('EEAG').

the EAG would be applicable or whether the measure would need to be assessed directly on the basis of Article 107(3)(c) of the Treaty.

- (39) The UK submits that the purpose of introducing the CPS, and increasing the price of carbon up to the CPF level, is to generate a price signal strong enough to drive production and investment decisions towards low-carbon energy generation. Further, the UK believes that there is a compelling environmental case for taxing the use of fossil fuels in electricity generation, particularly given the relatively high proportion of fossil fuels used to generate electricity in the UK, which the UK submits account for about 75 per cent of electricity generation, of which natural gas represents 46 per cent and coal 28 per cent.⁹
- (40) The CPS cannot be considered as a tax harmonised by Directive 2003/96/EC (the Energy Taxation Directive), but it is a non-harmonised tax covered by Directive 2008/118/EC. The exemptions from the CPS can therefore be assessed in light of Section 3.7.1 of the EEAG and more specifically the compatibility criteria referred to as "Situation 2" in Section 3.7.1.
- (41) In order to guarantee that it meets an objective of common interest, aid in the form of reductions in, or exemptions from, environmental taxes needs to contribute at least indirectly to an improvement of the level of environmental protection, in line with point 151 of the EAG and point 171 of the EEAG. The latter requires that the reductions are well targeted to undertakings being mostly affected by a higher tax and that a higher tax rate is generally applicable than would be the case without the exemption.
- (42) The CPF, and the CPS rate in particular, are aimed at increasing the level of environmental protection by making it more expensive to use, hence discouraging the use of, high-carbon fuels in the production of electricity and limiting the aid to a targeted group of beneficiaries mostly affected by the tax. The eligible sectors are clearly described by reference to Annex II of the ETS Guidelines and the additional criterion of indirect CPS costs of at least 5% of GVA. Therefore, the Commission considers that the aid is aimed at a well-defined objective of common interest.
- (43) In order to demonstrate that the aid is well designed to advance the objective of common interest, both the EAG and EEAG include specific criteria to assess the necessity and proportionality of the aid. In particular, points 180 and 181 of the EEAG explicitly provide compatibility criteria for the compensation of indirect costs of a non-harmonised carbon tax levied on energy products used for electricity production which is directly linked to the ETS allowance price. This is the case with the CPS given that both the ETS and the CPS price are aimed at the same objective and the CPS constitutes the difference between the CPF and the ETS carbon price (see above paragraphs 6, 17).
- (44) Point 181 of the EEAG furthermore requires that:
- (a) The aid is only granted to sectors and subsectors listed in Annex II of the ETS Guidelines to compensate for additional indirect cost resulting from the tax; and

⁹ Data from the International Energy Agency reported by the UK authorities. See in particular International Energy Agency, *Energy Policies of IEA Countries – The United Kingdom 2012 Review*, 2012. Available at the following address:
http://www.iea.org/publications/freepublications/publication/name_46278.en.html

- (b) The aid intensity and maximum aid intensities are calculated as defined in point 27 – 30 of the ETS Guidelines, with the forward price of allowances being replaced by the level of the national tax. Aid should be granted as a lump sum amount that can be paid to the beneficiary in the year in which the costs are incurred or in the following year. If the aid is paid in the year in which the costs are incurred an *ex post* monitoring mechanism needs to be in place to ensure that any over-payment of aid will be repaid before 1 July of the following year.
- (45) Point (a) of point 181 of the EEAG is clearly met, as the UK committed to provide aid only to the sectors included in Annex II to the ETS Guidelines.
- (46) Point (b) of point 181 of the EEAG is also clearly met. The UK uses the same formula to calculate the compensation as the one used in the ETS Guidelines, as explained in Section 2.6 above.
- (47) Moreover, the UK authorities have committed to compensate beneficiaries not for the full indirect costs due to the CPS, but in line with the maximum aid intensities allowed under the ETS Guidelines. In particular, the UK authorities commit to compensate eligible beneficiaries for 85 per cent of the eligible costs incurred in 2014 and 2015; 80 per cent of the eligible costs incurred in 2016, 2017 and 2018; and 75 per cent of the eligible costs incurred in 2019 and 2020.
- (48) In order to further increase the effectiveness of the measure in terms of the impact of the price signal on the behaviour of the beneficiaries, the UK confirmed that compensation for the indirect costs due to the CPS will be paid quarterly *ex post* to beneficiaries (while being based on *ex ante* or historical data).
- (49) The UK also commits to putting in place an *ex post* correction mechanism in case the use of unverified data leads to overcompensation, similarly to what is required under the ETS Guidelines.¹⁰ This further ensures that any excess payment in a given year will be recouped before 1 July of the following year.
- (50) Finally, the UK will put in place a mechanism for keeping detailed records for the duration of the CPS compensation scheme, including all information required to demonstrate that the terms of the proposed scheme have been complied with.
- (51) In view of these conditions, the Commission considers that, taking into account the contribution to the objective of common interest, on the one hand, and the potential distortions of competition, on the other hand, the positive effects of the measure outweigh the potential negative effects and the overall balance is positive, in line with both the EAG and EEAG.
- (52) The UK scheme has been notified for a period until 31.12.2020. The Commission can approve the measure for this length as it remains within the maximum 10 year period for which the Commission approves aid measures.

¹⁰ See paragraph 30 of the ETS Guidelines.

3.2.1. *Conclusions on the assessment*

- (53) It follows from the assessment carried out above that the notified scheme fulfils the conditions for the application of Art 107(3)(c) TFEU when applied in light of the compatibility criteria stipulated in both the EAG and EEAG (in particular Section 3.7.1 thereof).
- (54) These conclusions are in line with the current legal framework, and in particular the provisions laid down in the Energy Taxation Directive. The Commission notes, however, that non-harmonised taxes risk having a negative impact on the internal market and should therefore in principle be avoided. Hence, this decision merely reflects the Commission's specific assessment for the present case and shall not be understood as prejudging any future review of that Directive.

4. CONCLUSION

The Commission has accordingly decided to consider the aid to be compatible with the internal market pursuant to Article 107(3)(c) TFEU.

If this letter contains confidential information which should not be disclosed to third parties, please inform the Commission within fifteen working days of the date of receipt. If the Commission does not receive a reasoned request by that deadline, you will be deemed to agree to the disclosure to third parties and to the publication of the full text of the letter in the authentic language on the Internet site:

<http://ec.europa.eu/competition/elojade/isef/index.cfm>

Your request should be sent by registered letter or fax to:

European Commission
Directorate-General for Competition
State Aid Registry
B-1049 Brussels
Belgium
Fax No: +32-2-296 12 42

Yours faithfully,

For the Commission

Joaquín ALMUNIA
Vice-president