Subject: State aid SA.35543 (2013/N) – United Kingdom
Compensation for indirect EU ETS costs in the UK

Sir,

1. Procedure

(1) By electronic notification dated 7 March 2013, the UK authorities notified to the Commission, in accordance with Article 108(3) of the Treaty on the Functioning of the European Union (TFEU), a scheme to compensate undertakings for a share of their indirect emission costs, that is to say the costs resulting from the EU Emission Trading System (ETS) passed on in electricity prices. The notification followed pre-notification contacts, initiated by the UK in October 2012.

2. Description of the measure

(2) The UK intends to grant State aid to compensate electro-intensive industries that are most at risk of carbon leakage due to the indirect emission costs resulting from the implementation of the ETS. The UK expects electricity costs for these...
companies to rise significantly as a result of the implementation of the third phase of the ETS as from January 2013, especially as a large proportion of ETS allowances will be auctioned, rather than allocated free of charge.

(3) The UK authorities have indicated that the scheme is related to another compensation scheme which they intend to set up and which will be notified to the Commission separately, namely the compensation for costs stemming from the Carbon Price Floor (CPF) mechanism.¹

2.1 Legal basis

(4) The scheme referred to in this decision will be based on section 8 of the Industrial Development Act 1982.

2.2 Budget and duration

(5) The scheme will have a total budget of GBP 113 million. The budget shall cover a period from April 2013 to March 2015, the annual budget being GBP 13 million in 2013 and GBP 50 million in 2014 and 2015 respectively.

(6) The duration of the scheme, however, shall extend beyond 2015 and cover a period from 2013 to 2020.

2.3 Eligibility

(7) A two-step approach is taken in order to determine which undertakings will be eligible for support.

(8) First, the scheme provides that, in order to be considered for indirect EU ETS compensation, a company must be in one of the sectors listed in Table 1 below, which corresponds to Annex II to the Commission’s Guidelines on certain State aid measures in the context of the greenhouse gas emission allowance trading scheme post-2012 (ETS Guidelines):²

¹ The CPF is a national measure comparable to an energy tax. The CPF compensation scheme is outside the scope of this decision.
² OJ C 158, 05.06.2012, p. 4.
<table>
<thead>
<tr>
<th><strong>NACE code</strong></th>
<th><strong>Description</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>2742</td>
<td>Aluminium production</td>
</tr>
<tr>
<td>1430</td>
<td>Mining of chemical and fertiliser minerals</td>
</tr>
<tr>
<td>2413</td>
<td>Manufacture of other inorganic basic chemicals</td>
</tr>
<tr>
<td>2743</td>
<td>Lead, zinc and tin production</td>
</tr>
<tr>
<td>1810</td>
<td>Manufacture of leather clothes</td>
</tr>
<tr>
<td>2710</td>
<td>Manufacture of basic iron and steel and of ferro-alloys</td>
</tr>
<tr>
<td>272210</td>
<td>Seamless steel pipes</td>
</tr>
<tr>
<td>2112</td>
<td>Manufacture of paper and paperboard</td>
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<tr>
<td>2415</td>
<td>Manufacture of fertilisers and nitrogen compounds</td>
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<tr>
<td>2744</td>
<td>Copper production</td>
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<tr>
<td>2414</td>
<td>Manufacture of other organic basic chemicals</td>
</tr>
<tr>
<td>1711</td>
<td>Preparation and spinning of cotton-type fibres</td>
</tr>
<tr>
<td>2470</td>
<td>Manufacture of man-made fibres</td>
</tr>
<tr>
<td>1310</td>
<td>Mining of iron ores</td>
</tr>
<tr>
<td>2416</td>
<td>The following sub-sectors within the manufacture of plastics in primary forms</td>
</tr>
<tr>
<td>24161039</td>
<td>Low-density polyethylene</td>
</tr>
<tr>
<td>24161035</td>
<td>Linear low-density polyethylene</td>
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<tr>
<td>24161050</td>
<td>High-density polyethylene</td>
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<tr>
<td>24165130</td>
<td>Polypropylene</td>
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<td>24163010</td>
<td>Polyvinyl chloride</td>
</tr>
<tr>
<td>24164040</td>
<td>Polycarbonate</td>
</tr>
<tr>
<td>2111</td>
<td>The following sub-sectors within the manufacture of pulp</td>
</tr>
<tr>
<td>21111400</td>
<td>Mechanical pulp</td>
</tr>
</tbody>
</table>

*Table 1 – Sectors and subsectors eligible for aid under the UK scheme*
(9) Secondly, the UK authorities argue that even within the electro-intensive sectors, there may be some processes which use much less electricity and will be less exposed to electricity price increases. Therefore, in order to ensure that compensation is appropriately targeted, they propose to apply an additional filter to identify the eligible beneficiaries: those applicants that pass the first eligibility test, described above in paragraph (8), must, in addition, demonstrate that their carbon costs (EU ETS and CPF costs taken together) in 2020 will amount to 5% of their gross value added (GVA). Only those undertakings that fulfil both criteria will be considered eligible.

(10) When applying this additional filter, the calculation shall be based on the following formula and values: the carbon cost share will equal the undertaking’s past average electricity consumption multiplied with the future carbon price and divided by the undertaking’s past average GVA. GVA is defined as earnings before interest, taxes, depreciation, amortisation and staff costs including employers’ pension and national insurance contributions (averaged over the period 2005-2011). Electricity consumption is defined as the consumption average of the same period. The carbon price to be applied when calculating the proportion of carbon costs out of GVA shall be GBP 33.14 per tonne of CO₂ equivalent, which is equal to GBP 19.22 per MWh. This is the adjusted price forecasted for 2020 in the context of the CPF. In addition, the UK authorities intend to rely on the regional emission factor set out in the ETS Guidelines, i.e. 0.58 tCO₂/MWh for the UK.

2.4 Aid amount calculation

(11) The maximum aid amount payable per installation will be calculated according to the following two formulae, which correspond to the ones mentioned in point 27 of the ETS Guidelines:

(a) Where electricity consumption efficiency benchmarks have been published for a given product manufactured by the beneficiary, the following formula will apply:

\[ A_{\text{max}} = A_i \times C_t \times P_{t-1} \times E \times BO \]

In this formula, \(A_i\) is the aid intensity in year \(t\). \(C_t\) is the applicable CO₂ emission factor at year \(t\). \(P_{t-1}\) is the EU ETS allowance forward price at year \(t-1\). \(E\) is the applicable product-specific electricity consumption efficiency benchmark. \(BO\) is the installation’s baseline output.
Where no product-related electricity consumption efficiency benchmarks have been published for those products manufactured by the beneficiary, the following formula will apply:

$$A_{\text{max}} = A_i \times C_t \times P_{t-1} \times EF \times BEC$$

Here, the concepts are the same as defined above under subparagraph (a), except for $EF$, which is the applicable fall-back electricity consumption efficiency benchmark, and for $BEC$, which is the installation’s baseline electricity consumption.

(12) The UK has provided a commitment that all the elements of the two formulae mentioned above will correspond to the definitions set out in Annex I of the ETS Guidelines.

(13) Moreover, the UK proposes to apply the aid intensity levels set out in the ETS Guidelines, i.e. 85% of eligible costs in 2013, 2014 and 2015, 80% in 2016, 2017 and 2018 and 75% in 2019 and 2020.

(14) The UK has also committed to applying the electricity consumption efficiency benchmarks defined by the Commission in Annex III of the ETS Guidelines, as well as the maximum regional emission factor of 0.58 tCO$_2$/MWh, which is the one found in Annex IV of the Guidelines.

### 2.5 Proportionality

(15) The UK authorities take the view that, overall, the proposed ETS compensation scheme is proportional, in that the aid is limited to the minimum amount necessary. First, in view of the aid intensities of less than 100% and the efficiency benchmarks, a beneficiary will never be fully compensated for its indirect ETS costs, thereby maintaining an incentive to further reduce its electricity consumption. Secondly, the additional filter will target the aid at those undertakings that are most at risk of carbon leakage.

### 2.6 Cumulation and impact of the CPF compensation scheme

(16) It will not be possible to cumulate compensation under the present scheme with aid received from other schemes to cover the same eligible costs.

(17) In particular, without prejudging the outcome of the State aid assessment on the CPF compensation scheme, the UK authorities have highlighted that both schemes are entirely separate and will not overlap.

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4 See above paragraph (3).
2.7 Granting modalities

(18) The aid will be paid out in arrears, i.e. after the costs have been incurred, on a quarterly basis.

2.8 Annual reports, transparency and monitoring

(19) The UK authorities have committed to following the requirements set out in points 52 to 54 of the Guidelines on transparency and monitoring.

3. Assessment of the measure

3.1 Existence of aid

(20) Article 107(1) TFEU defines State aid as ‘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 […], in so far as it affects trade between Member States’.

(21) Under the scheme, certain undertakings that belong to a limited number of sectors and subsectors will receive direct grants from the State budget. It can be assumed that the sectors and subsectors targeted are characterised by competition between undertakings established in various EU Member States. The support granted under the scheme therefore constitutes State aid in the sense of Article 107(1) TFEU.

3.2 Lawfulness of aid

(22) By notifying the scheme before its implementation, the UK authorities have fulfilled their obligation according to Article 108(3) TFEU.

3.3 Compatibility with the internal market

(23) According to Article 107(3) TFEU, State aid may in some cases be considered to be compatible with the internal market, including where, according to lit. c), the aid is intended ‘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’.
(24) In Article 10a(6) of the ETS Directive, as amended by Directive 2009/29/EC, it is said that

‘Member States may also adopt financial measures in favour of sectors or subsectors determined to be exposed to a significant risk of carbon leakage due to costs relating to greenhouse gas emissions passed on in electricity prices, in order to compensate for those costs and where such financial measures are in accordance with state aid rules applicable and to be adopted in this area.

Those measures shall be based on ex-ante benchmarks of the indirect emissions of CO₂ per unit of production. The ex-ante benchmarks shall be calculated for a given sector or subsector as the product of the electricity consumption per unit of production corresponding to the most efficient available technologies and of the CO₂ emissions of the relevant European electricity production mix.’

(25) In 2012, the Commission adopted the ETS Guidelines, which spell out the conditions under which State aid that is granted with regard to the effects of the ETS may be deemed compatible with the internal market.

(26) The Commission has assessed the compatibility of the scheme notified by the UK with the internal market on the basis of Section 3.1 of the Guidelines, which sets out the conditions for aid to undertakings in sectors and subsectors deemed to be exposed to a significant risk of carbon leakage due to EU ETS allowance costs passed on in electricity prices (aid for indirect emission costs).

3.3.1 Objective of the aid

(27) According to point 24 of the Guidelines, aid may be granted ‘to prevent a significant risk of carbon leakage due to EUA costs [i.e. costs of ETS allowances] passed on in electricity prices supported by the beneficiary, if its competitors from third countries do not face similar CO₂ costs in their electricity prices and the beneficiary is unable to pass on those costs to product prices without losing significant market share’.

(28) The UK’s scheme is directed to this objective, given that the scheme shall support the competitiveness of electro-intensive industries that are most at risk of carbon leakage.

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3.3.2 Necessity of the aid

(29) According to point 25 of the Guidelines, ‘a significant risk of carbon leakage is considered to exist only if the beneficiary is active in a sector or subsector listed in Annex II’ of the Guidelines.

(30) The UK has defined a number of eligible sectors and subsectors, listed in the table in paragraph (8) above, which correspond to the ones found in Annex II of the Guidelines.

(31) The UK authorities also apply an additional filter, based on the individual applicant’s carbon costs and described above in paragraphs (9) and (10).

(32) In that respect, the Commission notes that according to Annex II of the ETS Guidelines, an installation may receive aid only if it is active in one of the sectors or subsectors listed. A Member State is not obliged to grant aid to all sectors, subsectors or even installations belonging to these sectors or subsectors. Rather, the Member State’s authorities may decide to further restrict the scope of eligible applicants.

(33) As long as such a restriction does not contradict or run counter to the ETS Guidelines, nor results in the breaching of any provision of EU law, and in particular as long as it is based on objective criteria, the Member State may opt for such a restriction.

(34) In the case at hand, the additional filter requires the undertakings that apply for compensation to demonstrate that their total carbon costs in 2020 will amount to 5% of their GVA.

(35) This is similar to the methodology used for the purpose of defining the eligible sectors and subsectors in the ETS Guidelines: According to Annex II of the Guidelines, and in particular no. 1 of the Explanatory note, eligibility has been conditional, inter alia, on ‘the sum of additional indirect costs induced by the implementation of the ETS Directive [leading] to a substantial increase in production costs, calculated as a proportion of gross value added, amounting to at least 5%’.

(36) Accordingly, the additional filter chosen by the UK authorities is based on an objective criterion which is consistent with the underlying objective of section 3.1 of the ETS Guidelines on the prevention of a significant risk of carbon leakage.

(37) Hence, the aid is necessary to realise the scheme’s objective of common interest.
3.3.3 *Maximum aid intensity*

(38) The ETS Guidelines do not provide for full compensation, as this could remove the incentive for the undertakings concerned to further reduce their consumption of electricity. Point 26 of the Guidelines sets out the maximum aid intensities: For the years 2013 to 2015, the aid may not exceed 85% of the eligible costs. The aid intensity is then gradually reduced to 80% (for the years 2016 to 2018) and to 75% (for 2019 and 2020).

(39) The aid intensities applied in the UK scheme are identical to those in the Guidelines.

3.3.4 *Maximum aid amount calculation*

(40) The maximum aid amount payable per installation is determined on the basis of the formulae spelled out in point 27 of the Guidelines.

(41) The maximum aid amount payable per installation for costs incurred in a given year $t$ is a product of the aid intensity, of the applicable CO$_2$ emission factor, of the EUA forward price at year $t-1$, of the relevant electricity consumption efficiency benchmark and of the baseline output or baseline electricity consumption. Depending on the product, a product-related electricity consumption efficiency benchmark, listed in Annex III of the Guidelines, may exist. Otherwise, a fall-back electricity consumption benchmark needs to be used.

(42) The UK scheme uses these formulae, and the UK authorities have made a commitment that the formulae’s elements will be equivalent to the definitions in Annex I of the Guidelines and to the values in Annex III and IV.

3.3.5 *Incentive effect*

(43) According to point 31 of the Guidelines, if all the conditions set out in sections 3.3.1 to 3.3.4 above are fulfilled, which is the case here, the aid is presumed to have an incentive effect.
3.3.6 Proportionality

(44) Member States are required to demonstrate that the aid granted to the beneficiary is limited to the minimum necessary (point 45 of the Guidelines).

(45) The UK has committed to applying the aid intensities and the efficiency benchmarks provided for in the Guidelines. This ensures that the compensation does not cover the totality of indirect ETS costs and maintains an incentive for the beneficiaries to further reduce their electricity consumption. Moreover, due to the benchmarks, only the most efficient beneficiaries will receive an optimal level of compensation, i.e. representing the highest proportion of their indirect ETS costs.

(46) In addition, the UK authorities intend to apply an additional filter which, in comparison to the eligibility criteria of the Guidelines, is likely to reduce the number of eligible undertakings and to target the aid at those who are most at risk of carbon leakage.

(47) Therefore, the ETS compensation scheme is proportional.

3.3.7 Cumulation

(48) The UK authorities have provided a commitment that cumulation with aid from other schemes regarding the same eligible costs will not be possible.

3.3.8 Annual reporting, transparency and monitoring

(49) With regard to reporting, transparency and monitoring of the proposed scheme, the UK authorities have committed to following the requirements set out in points 52 to 54 of the Guidelines.

4. Conclusion

The Commission has accordingly decided:

to consider the aid to be compatible with the Treaty on the Functioning of the European Union.
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Belgium

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Stateaidgreffe@ec.europa.eu

Yours faithfully,  
For the Commission

Joaquín ALMUNIA  
Vice-President