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LEGAL STUDY

on the Implementation of the Level Playing Field Principle

on behalf of

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PREAMBLE

The Industrial Gases Association (*Industriegasverband e.V.* – **IGV**) is a specialized association within the German Chemical Industry Association (*Verband der Chemischen Industrie*). Its members are companies specialized in the production of industrial gases for sale to third parties who use industrial gases as a required element in their commercial processes.

Manufacturing industrial gases requires a high level of energy input, which results in energy-intensive production processes. The prices for industrial gases are generally indexed to the price of electricity, resulting in a direct correlation between the price of electricity and product prices. Since the industrial gases sector, despite its energy intensity, cannot fully claim energy cost privileges in specific cases, the high energy costs are directly reflected in the product prices which may cause a problem for energy-intensive downstream processes especially for the primary industries.

State aid and relief measures are becoming increasingly important due to rising energy prices and the associated impact on the competitiveness of energy-cost-intensive industries.

Regarding the current discussion on new State aid measures (e.g. an Industrial Electricity Price), the IGV has taken the opportunity to take a closer look at the classification of the industrial gases sector in the context of the regulatory landscape of energy cost subsidies.

The aim of the study is to provide a comprehensive analysis of the legal framework for cost compensation for electricity consumption by energy-intensive industries as well as the underlying legal basis for State aid. On this basis, proposals are to be devised as to how the current and potential future options for relieving energy-intensive industries' costs can be further developed. [**Recommendations are intended for internal use of the IGV only and are therefore not published**. - **Empfehlungen sind nur für den internen Gebrauch des IGV bestimmt sind und werden daher nicht veröffentlicht.**] The development must reflect the actual economic conditions more accurately to protect endangered economic sectors from migrating and to achieve equality of interests.

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EXECUTIVE SUMMARY

The industrial gases sector is an industry amongst other energy-intensive industries for whom the high electricity prices have an impact on their competitiveness. The industrial gases sector has specific characteristics due to its manufacturing structure, which must be considered when addressing the compensation of high energy prices.

Energy cost privileges are a key element for supporting energy-intensive industries. They are state support measures in the context of State aid law. It is therefore important that all energy-intensive sectors can benefit from these privileges in the very same way. If equal treatment is not ensured, there is no level playing field between the energy-intensive industries.

Indeed, this level playing field does not currently exist for the industrial gases sector:

The inventory of national energy cost privileges shows that the industrial gases sector falls under the scope of those State aid measures that provide state support for electricity costs incurred directly by the affected companies. The sectors that are supplied by the industrial gases sector and have a comparable energy intensity can also benefit from these measures.

In the case of electricity price compensation[1], the divergence between the industrial gases sector and the comparative sectors arises due to the specific parameters of the Electricity Price Compensation Directive (SPK). The scope of application of the directive only includes two subsectors of the industrial gases sector. The comparative sectors, on the other hand, are fully covered by the scope of application of the privilege status. The industrial gases sector can therefore only claim compensation for indirect CO_2 costs incurred by the company to a very limited extent.

Thus, there is no level playing field between the industrial gases sector and the comparable sectors, at least not regarding the compensation of indirect CO_2 costs.

This disadvantageous situation would incidentally be exacerbated if the same standards as those applied to the Electricity Price Compensation Directive (SPK) were applied to new State aid measures to reduce high energy prices. It is therefore necessary that new State aid measures are not based on the narrow scope of applying existing privileges, but rather define their own scope of application, which is aligned with the requirements

[1] State aid to electricity-intensive companies to compensate for indirect CO_2 costs.

of EU law (e.g. Guidelines on State Aid for Climate, Environmental and Energy Protection 2022 – CEEAG).

State aid law and thus the requirements of EU law have an important function in shaping energy cost privileges. Besides the provisions of the Guidelines on State Aid for Climate, Environmental and Energy Protection 2022 (CEEAG), the EU Emission Trading Directive plays a crucial role. The latter, together with their ETS State Aid Guidelines 2021, is the European legal blueprint for the national Electricity Price Compensation Directive (SPK). The ETS State Aid Guidelines 2021 list those sectors that the European Commission considers to be genuinely at risk of carbon leakage and should therefore be compensated for indirect CO_2 costs. The industrial gases sector is not listed to full extent in the ETS State Aid Guidelines 2021, which leads to its partially exclusion from the scope of application of the national Electricity Price Compensation Directive (SPK). This leads to an unjustified disregard of the industrial gases sector and does not adequately reflect its role in international competition and energy-intensive value chains.

The products of the industrial gases sector are an essential part of the value chains of many primary industries. Competitive industrial gas prices are therefore a basic prerequisite for an internationally competitive primary industry. Consequently, cost reductions for the industrial gases sector are a requirement for a competitive primary industry. The future of the industrial gases sector and the downstream / supplied sectors (in particular the primary industry) are of significant importance to each other. The exclusion of industrial gases from relevant criteria for reduction restricts the competitiveness of downstream industries that offer their products internationally.

The identification of the unjustified disregard of the industrial gases sector shows the necessity to establish a level playing field in the classification of energy-intensive industries. To resolve the inconsistencies and establish a level playing field between the industrial gases sector and the downstream industries, it would be necessary to adapt the existing regulatory framework in such a way that the discrepancies identified between the privileges granted to the industrial gases sector and the comparative sectors are eliminated. The study identifies various approaches for action at both national and EU regulatory level to establish a level playing field.

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Part 1 Analysis of the Energy Cost Privileges for Energy-Intensive Industries

A. Outline: Existing Instances of Compensation

The first part of the study analyses provisions that contain energy cost privileges for energy-intensive industries. Regarding the objective of the study, the analysis focuses on the scope of application pertaining to respective regulations. In particular, the extent to which the industrial gases sector can rely on the respective regulatory regimes compared to other energy-intensive sectors it supplies (e.g. the manufacture of chemicals, the production of iron, steel and ferroalloys, or the processing of mineral oil) is emphasized.

I. Peak Compensation – Tax Law

With the peak compensation pursuant to Section 10 Electricity Tax Act (*Stromsteuergesetz* – StromStG) and Section 55 Energy Tax Act (*Energiesteuergesetz* – EnergieStG), manufacturing companies receive certain tax reductions. These tax reductions enable companies in the manufacturing sector to receive a refund of up to 90% of the energy and electricity tax on heating fuels and electricity remaining after deduction of the general tax reduction for all energy and electricity consumption in a year, based on the pension insurance contributions. In order to qualify a company as being part of the manufacturing sector, reference must be made to the 2003 edition of the Classification of Economic Activities, in accordance with Section 2, no. 2a, 3 of the Electricity Tax Act. By this definition, manufacturing companies include companies with the focus of activity in the areas of mining and quarrying, manufacturing, energy, and water supply or construction. The companies of the IGV are companies of the manufacturing industry and can generally benefit from the peak compensation. The scope of application of the regulations on peak compensation is broad, so that in addition to the industrial gases sector, comparative sectors are also covered. However, the temporal scope of the peak load compensation is limited until December 31, 2023 due to the current approval under State aid law.[2]

II. Section 19 (2) Electricity Network Charges Ordinance

The provisions of Section 19 (2) of the Electricity Network Charges Ordinance (*Stromnetzentgeltverordnung* – StromNEV) enable electricity-intensive companies to negotiate

[2] The prolongation of the peak compensation is subject of ongoing discussions on energy policy. When this study was finalised, the German government had drafted a proposal for an Electricity Tax Reduction as part of an Electricity Price Package dated 09.11.2023.

individual network charges with their respective transmission system operators. Companies in the industrial gases sector can claim relief from network charges if certain requirements are met.

III. Special Compensation Scheme – BesAR

Under the Special Compensation Schemes (*Besondere Ausgleichsregelungen* – **BesAR**), companies with high electricity costs receive redistribution reductions. Under national law, the relevant legal basis is formed by the provisions of Sections 28 et seq. Energy Financing Act (*Energiefinanzierungsgesetz* – EnFG). The classification as a company belonging to an electricity-cost-intensive industry is based on the list of industries in Annex 2 of the Energy Financing Act. The production of industrial gases (WZ-2008 code: 2011) is listed as an industry with a significant risk of carbon leakage and thus an electricity-cost-intensive industry. The production of industrial gases is defined as an industry with significant carbon leakage risk. The comparison sectors are also listed in Annex 2 of the Energy Financing Act.

IV. Electricity Price Cap Act

Under the Electricity Price Cap Act (*Strompreisbremsengesetz* – StromPBG), final consumers receive subsidies in accordance with a specific relief mechanism to mitigate the increased energy costs resulting from the war of aggression on Ukraine. The maximum relief amounts are subject to certain limits, which are staggered according to the extent to which final consumers are affected by the increased energy costs. The industrial gases sector belongs to the group of final consumers that are privileged under the energy price brakes and can claim rebates of up to EUR 150 million, as the production of industrial gases (WZ-2008 code: 2011) is listed in Annex 2 to the Electricity Price Cap Act. However, the EBITDA (*Earnings before interest, tax, depreciation and amortization*) requirement, which must also be met to prove that the sector is particularly affected by high energy costs, is not sector-specific in nature and - in the experience of the authors - poses challenges for the sectors listed in Annex 2 in general. In the case of the industrial gases sector, there is the additional particularity that no possibility of a drop in the EBITDA exists due to the business model of passing on the electricity costs to customers. The price determining element for industrial gases is electricity. Therefore, it is intrinsic to the pricing of industrial gases that the companies in the industrial gases sector pass on energy costs to their supplied companies. An isolated view of the industrial gases sector thus fails to account for the fact that it is affected by high energy prices. This approach is immensely abbreviated and does not adequately reflect the significance of industrial gases in the value chain and thus their importance for the energy-intensive primary industries supplied by them. The contradictions resulting from this approach will be examined in depth at a later point.

V. Carbon Leakage Ordinance

Companies that are burdened with costs under the Fuel Emissions Trading Act (*Brennstoffemissionshandelsgesetz* – BEHG) receive financial compensation. The regulatory basis for this mechanism is the Ordinance on Measures to Prevent Carbon Leakage through National Fuel Emissions Trading (*Verordnung über Maßnahmen zur Vermeidung von Carbon Leakage durch den nationalen Brennstoffemissionshandel* – BECV). The prerequisite for receiving the subsidies is the assignment of companies to a sector eligible for subsidies in accordance with the annex to the before mentioned Ordinance. The production of industrial gases (20.11) is designated as an eligible sector. The comparative sectors are also listed as eligible sectors.

VI. Compensation of Electricity Prices

Under the national Electricity Price Compensation Directive[3] (*Strompreiskompensations-Förderrichtlinie* – **SPK**), sectors or subsectors that are assumed to be exposed to a significant risk of a shift in CO_2 emissions due to costs of greenhouse gas emissions being passed on to electricity prices are granted state aid to compensate for these costs. The eligibility for State aid according to the SPK results from the corresponding reference in no. 3 p. 1 SPK from the EU State Aid Guidelines[4]. Annex I of the State Aid Guidelines lists those sectors and subsectors for which, in view of the indirect CO_2 costs, it is assumed that there is an actual risk of carbon leakage (for more details, see Part 2 A. IV). By reference to the respective Statistical Classification of Economic Activities in the European Community (*Nomenclature statistique des activités économiques dans la Communauté européenne* - **NACE**), the sectors or subsectors are listed exhaustively. Within the industrial gases sector (NACE-code 20.11), the subsectors hydrogen (NACE-code 20.11.11.50) and inorganic oxygen compounds of non-metals (NACE-code 20.11.12.90) qualify as eligible sectors. The comparative sectors are listed in their entirety as eligible sectors; there is no breakdown into subsectors. Under the SPK, the products manufactured by a company are decisive for the eligibility to apply. Eligible products are identified by assigning them to a NACE / Prodcom code. The classification of a company within a certain branch of industry is not a determining factor. Aid can only be claimed for products - or more precisely, for the electricity used to manufacture the products - that are assigned to one of the sectors or subsectors listed, but not for further processing into products that are

[3] Directive on State Aid to companies in sectors or subsectors that have been established as being exposed to a significant risk of carbon leakage given the costs associated with EU ETS allowances that are passed on in electricity prices (State aid for indirect CO_2 costs).

[4] Communication from the Commission Guidelines on certain State aid measures in the context of the system for greenhouse gas emission allowance trading post-2021, (2020/C 317/04).

not eligible for aid. The required allocation prevents companies from applying for general compensation for all products which they manufacture.

VII. EU Allocation Regulation

Under the EU Allocation Regulation[5] (*EU-Zuteilungsverordnung*), the cost-free allocation of CO_2 certificates to industries at risk of carbon leakage builds a part of the privileged treatment of energy-intensive industries. The industrial gases sector is one of the industries at risk of carbon leakage under the EU Allocation Regulation and thus receives free CO_2 allowances.

VIII. Carbon Border Adjustment Mechanism – CBAM

The EU Commission (**COM**) has begun with the introduction of a Carbon Border Adjustment Mechanism (**CBAM**). For certain imported CO_2-intensive products (electricity, steel, cement, aluminium, fertilizers), certificates equivalent to the manufacturing-related, direct, product-based emissions ("specific embedded emissions") are to be purchased and passed from the year 2026 onward. These certificates are to be sold weekly by national authorities at the EUA price and will thus be linked to the emissions trading system. At the same time, the free allocation for the products in question is to be reduced by ten percentage points per year from the year 2026 onward, as the mechanism is intended to gradually replace the existing instruments for preventing carbon leakage. The industrial gases sector is currently not covered by the CBAM. Since the industrial gases sector does not import any CO_2-intensive (upstream) products, the CBAM's target does not affect the manufacturing model of the industrial gases sector.

B. Intermediate Result

Energy cost privileges are state support measures in the context of State aid law. The inventory of energy cost privileges shows that the industrial gases sector falls under the scope of those state aid measures that provide **state support for electricity costs incurred directly by the affected companies**. The comparative sectors under consideration can also benefit from these measures.

In the case of electricity price compensation, the divergence between the industrial gases sector and the comparative sectors arises due to the SPK. In this case, the industrial gases sector is only covered by two subsectors. The comparative sectors, on the

[5] Commission delegated Regulation (EU) 2019/331 of 19 December 2018 determining transitional Union-wide rules for harmonised free allocation of emission allowances pursuant to Article 10a of Directive 2003/87/EC of the European Parliament and of the Council.

other hand, are fully covered by the scope of application of the privilege status. The industrial gases sector can therefore only claim **compensation for indirect electricity costs incurred by the company to a very limited extent**.

Thus, the linking criterion is the direction of the compensation. The causes for the limited scope of application for indirect CO_2 costs are examined under Part 2A.IV.

C. Proposed State Aid Measures in the Context of Energy Cost Privileges

In addition to the existing regulations on energy cost privileges, the introduction of new State aid measures (e.g. an Industrial Electricity Price) and their potential impact on the industrial gases sector is examined considering the constantly dynamic energy policy debate.

I. Outline: Regulatory Approaches

The necessity to reduce the burden on industries with high electricity costs has generated various models such as the Industrial Electricity Price.
The idea behind the Industrial Electricity Price is that energy-intensive industries would benefit from a medium-term bridge electricity price.[6] Who is to be included in the group of eligible energy-intensive industries depends primarily upon the decision of the competent regulatory authority. Although there is no legal obligation to do so, regulators often refer to pre-existing regulations for the scope of application of new State aid measures. The BesAR could be used as a basis, as it represents a model that has been tried and tested over many years and has been agreed at European level.[7] Since the EnFG, in which the BesAR is incorporated, is based on the Guidelines on State Aid for Climate, Environmental and Energy Protection 2022 (CEEAG), the selection of beneficiaries is in accordance with the requirements of the EU. They cover the industrial gases sector as well at its energy-intensive customers. Another model already recognized is the SPK. There were, hence, proposals for a regulation according to which the group of beneficiaries would be based on the eligibility for subsidies according to the SPK.

As an alternative to the introduction of an Industrial Electricity Price, there are plans to reduce the Electricity Tax and provide more compensation within the SPK.[8]

[6] Cf. *Wettbewerbsfähige Strompreise für die energieintensiven Unternehmen in Deutschland und Europa sicherstellen", Arbeitspapier des BMWK zum Industriestrompreis für das Treffen Bündnis Zukunft der Industrie,* Ministry for Economic Affairs and Climate Action (BMWK), 05.05.2023.

[7] This was also the proposal of the BMWK.

[8] Cf. draft proposal of an Electricity Price Package by the federal government dated 09.11.2023.

II. Expected Effects on the Industrial Gases Sector

How the introduction of new State aid measures will affect the industrial gases sector depends to a large extent on whether the scope of their application will be based on the existing regulatory framework, and if so, on which framework. Depending on which existing provisions are used as a reference, the sector can benefit from additional measures.

If the scope of beneficiaries of an Industrial Electricity Price would be chosen for industries due to their eligibility for aid under the BesAR, the industrial gases sector would be included.

If the group of recipients is based on the eligibility for subsidies under the SPK, the industrial gases sector could - at the present time at least - only partially benefit from the Industrial Electricity Price (see above under Part 1 A. VI). The narrower range of beneficiaries of the SPK only partially covers the industrial gas sector.

It is necessary to ensure a level playing field between the energy-intensive sectors when establishing new State aid measures - regardless of the form they may take. If regulatory authorities therefore choose the narrow scope of application of the SPK, they exclude a significant proportion of energy-intensive industries from the outset. The energy-intensive industries will not be served if the uneven level playing field is further reinforced by new measures.

D. Intermediate Result

Considering the ongoing debate on the design of supporting tools at the time of the finalisation of this study, it cannot be determined with certainty to what extent the industrial gases sector will benefit from new State aid measures, regardless of their design. The decisive factor will be whether the respective policymakers adequately consider the significance of the industrial gases sector within the context of the economy as a whole. To this end, it is crucial that the group of eligible applicants is defined accordingly. This consideration can be secured through appropriate preliminary action by the industrial gases sector (see **Fehler! Verweisquelle konnte nicht gefunden werden.**).

Part 2 Analysis of the State Aid Law Framework as a Basis for the Adjustment of the Energy Price Privilege Statutes

The connection between State Aid Law and energy prices privileges was made apparent in the first part of the study. The second part of the study will therefore analyse the underlying State Aid Law framework. The analysis of the European legal framework must therefore focus on those regulations that have an influence on the national regulations on energy price privileges.

A. Outline: Legal Framework for State Aid

According to the principle of Article 107 (1) of the Treaty on the Functioning of the European Union (**TFEU**), 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.[9] Under certain conditions, aid may be deemed compatible with the internal market, cf. Article 107 (3) TFEU. The prerequisite is that the aid be notified to and approved by the COM, Article 108 (3) TFEU. It is in addition possible, by adopting implementing regulations, to define groups of aid exempted from the notification requirement under Article 109 TFEU.

I. General Block Exemption Regulation – GBER

The General Block Exemption Regulation[10] (**GBER**) exempts certain state support measures of the Member States from the notification and approval requirement by the COM. An in-depth discussion of the regulatory framework of the GBER is not appropriate in the context of this study, as the exemptions are not helpful for the objective pursued by the IGV.

II. Guidelines on State Aid for Climate, Environmental Protection and Energy 2022 – CEEAG

The Guidelines on State Aid for Climate, Environmental and Energy Protection 2022[11] (**CEEAG**) define the conditions under which the COM considers State aid in the areas of

[9] The minimum volume of aid above which there is a presumption of an effect on trade is € 200.000 under the current de minimis regulation.

[10] Commission Regulation (EU) No 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty.

[11] Communication from the Commission Guidelines on State aid for climate, environmental protection and energy 2022.

climate, environmental protection and energy to be compatible with the internal market. They are the successor regulations to the Guidelines on State Aid for Environmental Protection and Energy 2014-2020[12] (**EEAG**). The CEEAG regulate, i.e., under which conditions the reductions of electricity levies for energy-intensive enterprises are permissible in the future, cf. Section 4.11.2, no. 403.[13] In the context of the eligibility for subsidies, the CEEAG distinguishes between sectors[14] that have a risk of relocation and those that have a significant risk of relocation. The relevant assessment criteria for the relocation risk are the trade intensity and the electricity intensity of the respective industry.

In this regard, it is decidedly stated under Section 4.11.3, 4.11.3.1, no. 405:

> *"For levies covered under Section 4.11.2, the risk at sectoral level of activities moving outside the European Union to locations where environmental disciplines are absent or less ambitious largely* ***depends on the electro-intensity of the sector in question and its openness to international trade****. Accordingly, aid can only be granted to undertakings from:*
>
> *(a) sectors at* ***significant risk****, for which* ***the multiplication of their trade intensity and electro-intensity at Union level reaches at least 2 %*** *and whose trade intensity and electro-intensity at Union level is at least 5 % for each indicator;*
>
> *(b)* ***sectors at risk****, for which the multiplication of their trade intensity and electro-intensity at Union level reaches at least 0,6 % and whose trade intensity and electro-intensity at Union level is at least 4 % and 5 % respectively.*
>
> *The sectors meeting these eligibility criteria are listed in Annex I."*
>
> (emphasis added)

On the list "Sectors at significant risk as referred to in Section 4.11.3.1" the manufacture of industrial gases (NACE-code 2011) is listed. The same applies to the comparative sectors.

[12] Communication from the Commission Guidelines on State aid for environmental protection and energy 2014-2020 (2014/C 200/01).

[13] Section 4.11.2, no. 403: „Member States may grant reductions from levies on electricity consumption which finance energy and environmental policy objectives. This includes levies financing support to renewable sources or to combined heat and power and levies financing social tariffs or energy prices in isolated regions. (...)".

[14] The point of reference is NACE.

III. EU Emission Trading Directive – Directive (EU) 2003/87/EG

An important element of EU law in the context of state aid for energy-intensive companies is Directive (EU) 2003/87/EC, the Emissions Trading Directive[15] (**ETS Directive**). The Directive implements a system for trading greenhouse gas emission allowances in the EU to achieve a reduction in greenhouse gas emissions in a cost-effective and economically efficient manner. The regulations of the ETS Directive also consider the special features of energy-intensive companies within the EU.

In 2009, the Directive was amended[16] to introduce Articles 10a and 10b, which formed the basis for the free allocation of allowances to energy-intensive companies and electricity price compensation.

1) Electricity Price Compensation from 2009 to 2020

The introduction of electricity price compensation was enabled by Article 10a (6) ETS Directive[17]:

> *„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 CO_2 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 CO_2 emissions of the relevant European electricity production mix."*
>
> (emphasis added)

Based on the enabling provision in Article 10a (6) of the ETS Directive, the Member States could enact regulations that provide for State aid to reduce the indirect CO_2 costs of the member state's energy-intensive companies. Indirect CO_2 costs arise from the fact that electricity producers pass on the costs of emission allowances to their customers via

[15] Directive 2003/87/EC of the European Parliament and of the Council of 13 October 2003 establishing a scheme for greenhouse gas emission allowance trading within the Community and amending Council Directive 96/61/EC.

[16] Directive 2009/29/EC of the European Parliament and of the Council of 23 April 2009 amending Directive 2003/87/EC so as to improve and extend the greenhouse gas emission allowance trading system of the Community; hereinafter Directive 2009/29/EC.

[17] Directive 2009/29/EC.

the electricity price. Energy-intensive companies are particularly affected by the passing-on of CO_2 costs. The criteria for determining whether there is a significant risk of CO_2 emissions being passed on were initially determined on the basis of quantitative assessment criteria.

In this context, Article 10a (15) ETS Directive[18] stipulates:

> *"A sector or subsector shall be deemed to be exposed to a significant risk of carbon leakage if:*
>
> *(a) the sum of direct and indirect additional costs induced by the implementation of this Directive would lead to a substantial increase of production costs, calculated as a proportion of the gross value added, of at least 5 %; and*
>
> *(b) the intensity of trade with third countries, defined as the ratio between the total value of exports to third countries plus the value of imports from third countries and the total market size for the Community (annual turnover plus total imports from third countries), is above 10 %."*

According to the first quantitative evaluation parameter, the cost intensity and the trade intensity of the respective sector must be evaluated.

Furthermore, Article 10a (16) ETS Directive[19] regulated in the context of quantitative assessment:

> *"Notwithstanding paragraph 15, a sector or subsector is also deemed to be exposed to a significant risk of carbon leakage if:*
>
> *(a) the sum of direct and indirect additional costs induced by the implementation of this Directive would lead to a particularly high increase of production costs, calculated as a proportion of the gross value added, of at least 30 %; or*
>
> *(b) the intensity of trade with third countries, defined as the ratio between the total value of exports to third countries plus the value of imports from third countries and the total market size for the Community (annual turnover plus total imports from third countries), is above 30 %."*

In addition to the quantitative assessments, qualitative assessment criteria could also be applied, see Article 10a (17) of the ETS Directive[20]:

[18] Directive 2009/29/EC.

[19] Directive 2009/29/EC.

[20] Directive 2009/29/EC.

The list referred to in paragraph 13 may be supplemented after completion of a qualitative assessment, taking into account, where the relevant data are available, the following criteria:

(a) the extent to which it is possible for individual installations in the sector or subsector concerned to reduce emission levels or electricity consumption, including, as appropriate, the increase in production costs that the related investment may entail, for instance on the basis of the most efficient techniques;

(b) current and projected market characteristics, including when trade exposure or direct and indirect cost increase rates are close to one of the thresholds mentioned in paragraph 16;

(c) profit margins as a potential indicator of long-run investment or relocation decisions.

2) Carbon Leakage List

The affected sectors were listed by the COM in a directory, which was to be updated every five years, cf. Article 10a (13) ETS Directive.

Subsequently, on December 24, 2009, the COM issued the first decision[21] establishing the directory of sectors (**Carbon Leakage List**) for the period 2010 to 2014. The sectors were assessed considering the requirements as described in Part 2 A. III. 1 of Article 10a (15) to (17) of the amended ETS Directive. The COM based its assessment on a CO_2 price of EUR 30 per tonne of Co_2 equivalent. The assessment of indirect costs was based on the average emission factor for electricity in the Union of 0.465 tons of CO_2 per MWh.

In the first determination and the amendment of 18.12.2013[22], the industrial gases sector was listed with the subsectors hydrogen (including production of hydrogen in combination with synthesis gas) (NACE-code 24111150), nitrogen (NACE-code 24111160) and oxygen (NACE-code 24111170).

In 2014, the COM adopted the second decision[23] establishing the Carbon Leakage List for the period 2015-2019. The sectors were assessed considering the requirements as

[21] Commission Decision of 24 December 2009 determining, pursuant to Directive 2003/87/EC of the European Parliament and of the Council, a list of sectors and subsectors which are deemed to be exposed to a significant risk of carbon leakage (notified under document C(2009) 10251).

[22] Commission Decision of 18 December 2013 amending Decisions 2010/2/EU and 2011/278/EU as regards the sectors and subsectors which are deemed to be exposed to a significant risk of carbon leakage (notified under document C(2013) 9186).

[23] Commission Decision of 27 October 2014 determining, pursuant to Directive 2003/87/EC of the European Parliament and of the Council, a list of sectors and subsectors which are deemed to be

described in Part 2 A. III. 1 of Article 10a (15) to (17) of the amended ETS Directive. For the compilation of the list of sectors and subsectors, the assessments were based on an assumed CO_2 price of EUR 30 per tonne of CO_2 equivalent - whereas the current order of magnitude is EUR 85 per tonne of CO2 - as in the previous decision. In the context of indirect CO_2 costs, reference was also made to the previous resolution:

> *"(...) To determine the emissions related to the production of electricity consumed by the different sectors for the list of sectors and subsectors in Decision 2010/2/EU, the Commission used the average emission factor derived from the total fuel mix for electricity production as it was considered to be based on the most accurate data. The same average emission factor has been used for the assessments underlying this Decision."*

In the second decision, the subsectors hydrogen (2111150), nitrogen (2111160), and oxygen (2111170) were qualified as having a significant risk of carbon leakage. The validity period of this determination was extended until December 31, 2020.[24]

3) ETS State Aid Guidelines 2012

Accompanying the regulations of the ETS Directive, the COM issued the first State Aid Guidelines in 2012[25] (**ETS State Aid Guidelines 2012**). To ensure transparency and legal certainty, the ETS State Aid Guidelines 2012 specified the criteria for the compatibility of this state aid with the internal market in connection with the greenhouse gas emission allowance trading system. The ETS State Aid Guidelines 2012 were thus also applicable only to the latter.

Annex II to the ETS State Aid Guidelines 2012 lists sectors or subsectors that are considered ex ante to pose a significant risk of carbon leakage given the indirect costs of CO_2. The methodology for determining eligible sectors is based on quantitative and qualitative assessments. In the first quantitative assessment stage, the regulation on trade intensity and cost intensity was used. Indirect costs were calculated on the basis of the COM decision of December 24, 2009. The same data on trade, production and value added were assumed for the individual sectors and subsectors as in the COM decision of

exposed to a significant risk of carbon leakage, for the period 2015 to 2019 (notified under document C(2014) 7809).

[24] Directive (EU) 2018/410 of the European Parliament and of the Council of 14 March 2018 amending Directive 2003/87/EC to enhance cost-effective emission reductions and low-carbon investments, and Decision (EU) 2015/1814.

[25] Communication from the Commission Guidelines on certain State aid measures in the context of the greenhouse gas emission allowance trading scheme post-2012.

December 24, 2009. In the context of the qualitative assessment, the COM made use of the provisions of Article 10a (17) of the ETS Directive:

> *„3. Similar with the provisions in Article 10a (17) of the ETS Directive, in determining the eligible sectors and subsectors listed in the table above, the assessment of sectors on the basis of quantitative criteria set out in paragraph 1 above has been supplemented with a qualitative assessment, where relevant data are available and industry representatives or Member States have made sufficiently plausible and substantiated claims in favour of eligibility. The qualitative assessment was applied, firstly, to borderline sectors, i.e. NACE-4 sectors which face increased indirect emission costs in the range of 3-5 % and a trade intensity of at least 10 %; secondly, to sectors and subsectors (including at Prodcom level (2)) for which official data are missing or are of poor quality; and, thirdly, to sectors and subsectors (including at Prodcom level) that can be considered to have been insufficiently represented by the quantitative assessment. Sectors or subsectors with less than 1 % indirect CO_2 costs have not been considered.*
>
> *4. The qualitative eligibility assessment focused, firstly, on the size of the asymmetric indirect CO_2 cost impact as a share of the sector's gross value added. The asymmetric cost impact must be sufficiently large to entail a significant risk of carbon leakage due to indirect CO_2 costs. Indirect CO_2 costs of more than 2,5 % were considered to fulfil this criterion. Secondly, in addition, account was taken of available market related evidence indicating that the (sub)sector cannot pass on the increased indirect emission costs to its clients without losing significant market share in favour of its third country competitors. As an objective proxy to that end, a sufficiently high trade intensity of at least 25 % was deemed necessary for that second criterion to be fulfilled. In addition, the second criterion required substantiated information indicating that the EU sector concerned is on the whole likely to be price-taker (e.g. prices set at commodity exchanges or evidence of price correlations across macro-regions); such evidence was supported by further information where available, on the international demand and supply situation, transport costs, profit margins and CO_2 abatement potential. Thirdly, fuel and electricity exchangeability for products in the sector, as established by the Commission Decision 2011/278/EU (3) was also taken into account."*

The industrial gases sector and its respective subsectors are not listed in Annex II to the ETS State Aid Guidelines 2012. The precise assessment of the COM has not been fully disclosed. It can however be assumed, that the industrial gases sector did not meet the assessment criteria set out in the ETS State Aid Guidelines 2012.

4) Implementation in Germany from 2013 to 2020

As previously described, the national legislator has made use of the option provided by Article 10a (6) of the ETS Directive and introduced the SPK in 2013[26]. The SPK 2013 were approved by the COM in July 2013. The legal basis for the SPK were the ETS State Aid Guidelines 2012 authorised by the COM.[27] The explanatory memorandum of the COM[28] therefore refers to the following in the context of eligibility[29]:

> *"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)1: (...)"*

Neither the 2013 SPK nor the authorization under State aid law make any reference to the sector directories adopted by the COM. For the scope of application of the SPK, reference has been made to the scope of application of the ETS State Aid Guidelines 2012.

IV. Amended Emissions Trading Directive – Directive (EU) 2018/410

In 2019, a paradigm shift took place with the amendment of the ETS Directive by Directive (EU) 2018/410 of the European Parliament and of the Council[30] (**amended ETS Directive**). The background to the amendment of the Emissions Trading Directive was, among other things, also to restrict the range of sectors eligible for aid.

1) Outline of the changes made by Directive (EU) 2018/410

The provisions of Article 10a (12) to (18) ETS Directive have been eliminated in its entirety. In the amended ETS Directive, there is therefore no longer a provision according to which the particular risk of carbon leakage can be determined.

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[26] Directive on State aid to companies in sectors or subsectors that have been established as being exposed to a significant risk of carbon leakage given the costs associated with EU ETS allowances that are passed on in electricity prices (State aid for indirect CO_2 costs) of January 30, 2013.

[27] Authorisation for State aid pursuant to Articles 107 and 108 of the TFEU, SA.36103, OJ 2013/C 353/01.

[28] Letter to the Member State of 17.07.2013, published on 14.11.2013.

[29] Letter to the Member State of 17.07.2013, published on 14.11.2013, Sector 2.3.

[30] Directive (EU) 2018/410 of the European Parliament and of the Council of 14 March 2018 amending Directive 2003/87/EC to enhance cost-effective emission reductions and low-carbon investments, and Decision (EU) 2015/1814.

However, it is still possible for Member States to adopt compensation measures for indirect CO_2 costs, Article 10a (6) amended ETS Directive:

> *"Member States should adopt **financial measures** in accordance with the second and fourth subparagraphs **in favour of sectors or subsectors which are exposed to a genuine risk of carbon leakage due to significant indirect costs that are actually incurred from greenhouse gas emission costs passed on in electricity prices**, provided that such financial measures are in accordance with State aid rules, and in particular do not cause undue distortions of competition in the internal market. Where the amount available for such financial measures exceeds 25 % of the revenues generated from the auctioning of allowances, the Member State concerned shall set out the reasons for exceeding that amount."*

(emphasis added)

In order for Member States to continue to provide State aid to energy-intensive companies to reduce indirect CO_2 costs, these energy-intensive companies must be exposed to a **genuine risk of carbon leakage**. The relevant criterion of genuine risk of carbon leakage is not defined in the amended ETS Directive. The recitals to the amended ETS Directive state in this context, among other things[31]:

> *"To preserve the environmental benefit of emission reductions in the Union while actions by third countries do not provide comparable incentives to industry to reduce emissions, transitional free allocation should continue to installations in sectors and subsectors at genuine risk of carbon leakage. Experience gathered during the operation of the EU ETS has confirmed that sectors and subsectors are at risk of carbon leakage to varying degrees, and that free allocation has prevented carbon leakage. **While some sectors and subsectors can be deemed to be at a higher risk of carbon leakage, others are able to pass on a considerable share of the costs of allowances to cover their emissions in product prices without losing market share, and only bear the remaining part of the costs so that they are at a low risk of carbon leakage.** The Commission should determine and differentiate the relevant sectors based on their trade intensity and their emissions intensity to better identify sectors at genuine risk of carbon leakage. (...)"*

(emphasis added)

The relevant parameters thereafter remain the trading and emission intensity of the respective subsectors. This is also in line with the rules on the fundamental risk of carbon

[31] Directive (EU) 2018/410, recital 10.

leakage in Article 10b (1) to (3) of the amended ETS Directive. In addition, it must be determined whether the indirect CO_2 costs can be passed on via product prices.

Significant amendments were also made to Article 10b ETS Directive. The provision of Article 10b amended ETS Directive ("Transitional measures to support certain energy intensive industries in the event of carbon leakage") now defines the characteristics of a carbon leakage risk.

Thus, Article 10b (1) amended ETS Directive states:

> *"Sectors and subsectors in relation to which the product resulting from multiplying their intensity of trade with third countries, defined as the ratio between the total value of exports to third countries plus the value of imports from third countries and the total market size for the European Economic Area (annual turnover plus total imports from third countries), by their emission intensity, measured in kgCO_2, divided by their gross value added (in euros), exceeds 0,2, shall be deemed to be at risk of carbon leakage. Such sectors and subsectors shall be allocated allowances free of charge for the period until 2030 at 100 % of the quantity determined pursuant to Article 10a. (...)*"

2) Carbon Leakage List

The delegated decision of the COM of 15.02.2019[32] established the Carbon Leakage List for the period 2021 to 2030. The Carbon Leakage List determines the (sub-)sectors with a risk of carbon leakage, considering the provisions of Article 10b (5) of the ETS Directive. The annex to the decision lists the sectors and subsectors that are considered to be at risk of carbon leakage in accordance with Article 10b of the amended ETS Directive.

The criteria for determining the sectors and subsectors are the intensity of trade with third countries and the sector's emission intensity. To compile the Carbon Leakage List for the period 2021 to 2030, the COM assessed the risk of carbon leakage in sectors and subsectors at the NACE 4 level. Carbon leakage was assessed in two steps. For the **quantitative assessment** at the first stage at NACE-4 level, a sector is considered to be at risk of carbon leakage if the carbon leakage indicator exceeds the threshold of 0.2 according to Article 10b (1) amended ETS Directive. In a few cases that met the listing criteria clearly specified in Article 10b (2) and (3) of Directive 2003/87/EC, a second step assessment was performed either as a **qualitative assessment** based on established criteria or

[32] Commission Delegated Decision (EU) 2019/708 of 15 February 2019 supplementing Directive 2003/87/EC of the European Parliament and of the Council concerning the determination of sectors and subsectors deemed at risk of carbon leakage for the period 2021 to 2030.

as a quantitative assessment on a disaggregated level. Based on the criteria of Article 10b (1) ETS Directive, **the industrial gases sector (NACE code 2011) is listed.**

3) ETS State Aid Guidelines 2021

In 2020, the COM issued new State Aid Guidelines[33] (**ETS State Aid Guidelines 2021**), which replace the ETS State Aid Guidelines 2012. The principles set out in the ETS State Aid Guidelines 2021 are only applicable to the specific aid measures under Article 10a (6) and Article 10b of the amended ETS Directive. The ETS State Aid Guidelines 2021 have limited the scope of Article 10a (6) of the amended ETS Directive to those sectors that are deemed to pose a genuine risk of carbon leakage. In order to limit the risk of competition distortions within the internal market, the ETS State Aid Guidelines 2021 require that aid must be limited to sectors that are assumed to face a genuine risk of carbon leakage due to significant indirect costs that are actually incurred as a consequence of greenhouse gas emission costs being passed on in electricity prices by passing on the costs of greenhouse gas emissions through electricity prices.[34] Annex I of the ETS State Aid Guidelines 2021 therefore lists those sectors that are considered to have a genuine risk of carbon leakage given the indirect costs of CO_2. Section 3, 3.1, no. 21 ETS State Aid Guidelines 2021 states:

> *"(...) For the purpose of these Guidelines, a genuine risk of carbon leakage is considered to exist only if the beneficiary is active in a sector listed in Annex I."*

The assessment of the genuine risk of carbon leakage in the context of the State Aid Guidelines sets higher requirements for the sectors than the Carbon Leakage List. The methodological procedure of the COM has not been made fully transparent at this point. No explanation of the methodological procedure is offered - as in the context of Annex II of the ETS State Aid Guidelines 2012.

Considering the above depiction of the amended ETS Directive, it seems reasonable to presume that the industrial gases sector is not fully covered by the ETS State Aid Guidelines 2021 since the indirect CO_2 costs could be passed on to the downstream sectors in

[33] Communication from the Commission Guidelines on certain State aid measures in the context of the system for greenhouse gas emission allowance trading post-2021, (2020/C 317/04); The State Aid Guidelines were complemented on 30.12.2021 by Commission Communication supplementing the guidelines for certain State aid measures in connection with the scheme for greenhouse gas emission allowance trading after 2021 (2021/C 528/01). The complement is not relevant for the subject of this study.

[34] Communication from the Commission Guidelines on certain State aid measures in the context of the system for greenhouse gas emission allowance trading post-2021, (2020/C 317/04), Section 3, 3.1, no. 21.

the framework of product prices. By allowing electricity costs to be passed on, it has presumably been assumed that the indirect CO_2 costs will not be significant for the industrial gases sector itself. A genuine risk of relocating the production sites of the industrial gases sector to places with lower energy costs but also lower emission standards seem to be ruled out from the COM's point of view. Furthermore, the industrial gases sector is exposed to international competition to the degree and extent required by the COM due to its production infrastructure.

The COM has conducted a study to evaluate and assess the impact of the ETS State Aid Guidelines.[35] The study was complemented by sector-specific studies, including a study on the industrial gases sector.[36]

The sector study states that[37]:

> *„The competitive advantage for an IG producer is therefore to be located close to its customers, which maintains the competition low and especially limits the competition from producers outside the EU ETS area. The IG sector is therefore not at risk of direct competition with import products and this trade pattern will remain the same for the future trading phase of ETS. Thus the sector is considered at low risk of carbon leakage on the existing and future trading patterns parameters.*"

Within the industrial gases sector (NACE-code 20.11), only the subsectors hydrogen (NACE-code 20.11.11.50) and inorganic oxygen compounds of non-metals (NACE-code 20.11.12.90) are qualified as eligible sectors. The COM does not provide any explanation as to why these subsectors are considered to be subject to a genuine risk of relocation.

In conclusion, it can be observed that the procedure of defining the list of sectors in Annex I to the ETS State Aid Guidelines 2021 is characterized by a lack of transparency.

4) Implementation in Germany from 2021 to 2030

The national legislator further implements Article 10a (6) amended ETS Directive by the SPK[38]. The legal basis for the current SPK is the ETS State Aid Guidelines 2021 adopted

[35] *ADE, Compass Lexecon*: „Combined retrospective evaluation and prospective impact assessment support study on Emission Trading System (ETS) State Aid Guidelines - Final report", 2020.

[36] *ADE, Compass Lexecon*: Sector Fiche - Manufacture of industrial gases, 2020.

[37] *ADE, Compass Lexecon*: Sector Fiche - Manufacture of industrial gases, 2020, p. 6.

[38] Authorisation for State aid pursuant to Articles 107 and 108 of the TFEU, SA.100559, OJ 2022/C 387/01.

by the COM, which limits the scope of application to the sectors and subsectors listed in Annex I to the ETS State Aid Guidelines 2021.

Therefore, the scope of the SPK is limited to the restricted sectoral scope of the ETS State Aid Guidelines 2021 and not the wider sectoral scope of the Carbon Leakage List.

V. Future Amendment of the Emissions Trading Directive

A proposal for a new amendment to the Emissions Trading Directive was published at the beginning of this year.[39] Among other things, the amendment is intended to pursue a new approach in the carbon leakage sector. The current system of carbon leakage prevention through the free allocation of allowances and electricity price compensation will be gradually eliminated through the introduction of the CBAM. It can be assumed that the burdening of imports of goods from the covered sectors (aluminium, cement, electricity, fertilizers, iron and steel) with a CO_2 price will be reflected by an end to free allocation in 2034 and probably also by an end to electricity price compensation.[40] Currently, however, the future of electricity price compensation cannot be feasibly predicted.

VI. Temporary Crisis Framework – TCF

The Temporary Crisis Framework[41] (**TCF**) serves as the basis under European law for the limited aid measures in the national regulation on energy price brakes. Annex I to the TCF lists the sectors and subsectors for which the risk of a loss of competitiveness due to the energy crisis is particularly high. Objective indicators are the sector's intensity of trade with third countries and their emission intensity.[42] The sectors and sub-sectors, listed based on their emission and trade intensity, correspond to those listed on the Carbon Leakage List according to Decision (EU) 2019/708 of the COM of February 15, 2019[43], and thus also **include the manufacturing of industrial gases**. The TCF therefore illustrates once again the energy intensity of the industrial gases sector and the urgent need

[39] Proposal for a Directive of the European Parliament and of the Council amending Directive 2003/87/EC establishing a system for greenhouse gas emission allowance trading within the Union, Decision (EU) 2015/1814 concerning the establishment and operation of a market stability reserve for the Union greenhouse gas emission trading scheme and Regulation (EU) 2015/757, dated 08.02.2023.

[40] Detailed information on the proposed revisions in *Telschow/Grebe*, *Reform des Europäischen Emissionshandels - Wichtigste Neuerungen im Überblick*, IR 2023, p. 98 ff.

[41] Temporary Crisis Framework for State aid measures to support the economy following the aggression against Ukraine by Russia (2022/C 426/01).

[42] Temporary Crisis Framework for State aid measures to support the economy following the aggression against Ukraine by Russia (2022/C 426/01), n. 97.

[43] *Ibid*.

to mitigate its high energy costs through state aid. However, due to the reference to the Carbon Leakage List and the time-limited nature of the TCF, an in-depth discussion of the regulatory content is not expedient in view of the purpose of the study. The TCF does not establish any new criteria of its own for the requirement for energy-intensive industries. The recourse to the Carbon Leakage List implies that the responses to the issue of privileging the industrial gases sector are the same as those in the Carbon Leakage List. The TCF nevertheless underlines the multiplicity of regulatory instruments for energy-intensive sectors in the context of a quantitative argument.

B. Identification and Evaluation of the Shortcomings in the Applicability of the Energy Price Privileges to the Industrial Gases Sector

As previously outlined under Part 1 B, there is an application void in the area of energy price privilege for indirect CO_2 costs. For measures concerning direct carbon leakage, the industrial gases sector can rely on energy cost privileges, as can the comparative sectors. For indirect carbon leakage measures, the industrial gases sector, unlike the comparative sectors, cannot fully rely on aid.

This inequality in the treatment of energy-intensive industries creates an unlevel playing field. The industrial gases sector cannot invoke the SPK like the comparative sectors and cannot receive compensation for its indirect CO_2 costs. There is no existing level playing field.

I. Unjustified Neglection – Significance of the Industrial Gases Sector Misjudged

The unequal conditions of competition cannot be justified.

The products of the industrial gases sector, especially the air gases oxygen, nitrogen and argon, are an essential part of the value chains of many primary industries (chemicals, steel, glass, etc.). Competitive industrial gas prices are therefore a basic prerequisite for an internationally competitive primary industry. Consequently, cost reductions for the industrial gases sector are a requirement for a competitive primary industry.

The argument, that the industrial gases sector is not lastingly affected by indirect costs that are in reality incurred from greenhouse gas emission costs passed on in electricity prices due to the prevailing production and distribution structure, is misguided. The role of the industrial gases sector within the value chain of the primary industries has been misunderstood in this context. This has led to extensive consequences.

The primary industry itself is exposed to carbon leakage according to the ETS State Aid Guidelines 2021 to the extent that all the associated sectors receive compensation for

indirect CO_2 costs. The unrestricted passing on of indirect CO_2 costs from the industrial gases sector to the primary industries it supplies, undermines the relief effect and thus the declared aim of preventing carbon leakage. Passing on the indirect CO_2 costs from the industrial gases sector without limitation creates incentives for supplied industries to relocate to regions where the industrial gases are not burdened with (indirect) CO_2 costs.

The unrestricted passing-on of indirect CO_2 costs also results in disincentives for the downstream sectors. There is an increased risk that hitherto supplied sectors will insource the production of industrial gases. By insourcing, the downstream sectors absorb the industrial gases sector. As a result, it is exposed to the same carbon leakage risk as the sector that now produces the industrial gases itself. Insourcing would allow a downstream sector to claim the indirect CO_2 costs that the industrial gases sector has been precluded from claiming. The energy-intensive sectors, which were already highly energy-intensive, would become even more energy-intensive and thus be able to claim higher compensations. It would thus appear to be more efficient to provide direct compensation to the industrial gases sector, and thereby preserve the benefits of the division of labour process (e.g., consolidated know-how).

The downstream sectors have limited resources for investment. If these sectors must invest in industrial gas assets, they will be less capable of investing in their core businesses, which currently require substantial investments to achieve the transition to carbon-neutral processes.

The future of the industrial gases sector and the downstream/supplied sectors (in particular the primary industry) are of significant importance to each other. The exclusion of industrial gases from relevant criteria for reduction restricts the competitiveness of downstream industries that offer their products internationally.

II. Legal Obligation to Consider the Industrial Gases Sector in Entirety

The preceding observations demonstrate that not considering the industrial gases sector is not reasonable, both from an economic point of view and, more importantly, regarding the prevention of carbon leakage.

It is therefore necessary to clarify whether the inequitable assessment of the COM is predicated on the violation of mandatory legal requirements, which could under certain circumstances also be challenged in judicial proceedings.

1) Criterion "Genuine Carbon Leakage Risk"

The legal basis for the compensation of indirect CO_2 costs is the enabling provision of Article 10a (6) of the amended ETS Directive. However, the factual criterion of "genuine" carbon leakage risk is neither legally defined, nor are the requirements that must be fulfilled specified. It is an indeterminate legal term. Indeterminate legal terms are generally open to interpretation. Considering the statements under Part 2 A. IV, it can be assumed that the COM, through its administrative practice, reads the element of the possibility of passing on indirect CO_2 costs into the term. If the COM's administrative practice is characterized by this understanding of the term, then the COM's subsumption would not have been legally incorrect, since the companies in the industrial gases sector do in fact regularly pass on the indirect CO_2 costs to the downstream sectors. On the inadequate assessment of the pass-on option, see below. Part 2 B. III. 3).

2) Constitution and application of the ETS State Aid Guidelines 2021

State Aid Guidelines issued by the Commission do not have a formal legal status. Therefore, unlike the implementing regulation under Article 109 TFEU, there is no defined legal basis for the issuance of State Aid Guidelines. Due to the absence of an enabling act for the State Aid Guidelines, there is no standard of review that can be used to verify whether the Commission already acted within the framework of legal requirements when it issued the ETS State Aid Guidelines 2021.

Regarding the application of the ETS State Aid Guidelines 2021, reference can be made to the aforementioned non-transparent procedure for the compilation of the list in Annex I of the ETS State Aid Guidelines 2021.

3) Adaptation of the Methodology

Despite the omission of specific legal criteria, the COM is generally bound by the principles of lawful administrative action when issuing and applying the ETS State Aid Guidelines 2021. These include adherence to the principle of equal treatment and the self-binding obligation of the administration. These principles can, under certain circumstances, be used to justify an obligation on the part of the Commission to adapt the assessment methodology when compiling the list in Annex 1 of the ETS State Aid Guidelines 2021.

III. Approaches for Resolving the Discriminatory Assessment of the Industrial Gases Sector

The non-existent level playing field is a consequence of the European legal provisions. This discrimination should be diminished by further developing the current provisions.

1) NACE as a Delimitation Criterion

The NACE[44] serves as a reference for defining and classifying the various sectors. NACE is a four-digit statistical classification of economic activities in the EU. It is used for the collection, transmission, and publication of comparable national and community statistical data. NACE thus provides the framework for the collection and presentation of a wide range of statistical data broken down by economic activity from the economic domain (e.g. production, employment, national accounts) and from other domains within the European Statistical System (**ESS**).

Given the significant importance of value chains, the question arises whether and to what extent NACE is a suitable means of determining the beneficiaries of electricity price compensation. The use of NACE necessarily leads to a sector-specific assessment. The isolated sector evaluation is not a suitable means to prevent vertical distortions of competition.

As a recognized statistical classification, NACE is fundamentally suitable for providing a uniform scale for the energy-intensive sectors of the EU. The implementation of alternative methods can only be successful if they have an equally objective and proven status. A complete substitution of NACE does not seem to be expedient – especially because of its firm anchoring in a multitude of regulations. It is conceivable, however, that the reference to NACE could be made in a broader scope. Thus, not only the companies that are covered by the respective NACE codes themselves should benefit from the compensation of indirect CO_2 costs, but also those that supply these industries as a compulsory part of value chains. The requirement to be a "compulsory" part of value chains prevents an overstretching of the application scope that is not compatible with the objectives of electricity price compensation.

2) Specifications Regarding the Superordinate Criterion of "International Competition"

Since the amended ETS Directive aims to prevent carbon leakage from energy-intensive companies, particular consideration must be given to sectors that are in international competition and for which there is a risk that their international competitiveness will be impaired by the emissions trading standards that prevail within the EU.

[44] Statistical Classification of Economic Activities in the European Community (*Nomenclature statistique des activités économiques dans la Communauté européenne*).

The industrial gases sector is not directly exposed to international competition due to its production infrastructure. **However, indirect participation in international competition must not be disregarded**. As an enabler in the value chain of the primary industries, industrial gases play an important role - at least indirectly - in international competition. To avoid repetition, reference can be made to the explanations in Part 2 B. I for the illustration of the indirect influence of the industrial gases sector on international competition.

3) Evaluating the passing on of indirect CO_2 costs

The issue of passed on costs and their impact on the downstream sectors was observed in the sector study:[45]

> *"However, downstream customers of IG may relocate if IG were to entirely pass-on ETS indirect costs since this product is an essential input, e.g. in steel production. Since IG firms are very often by necessity located close to their customers, we consider this element to strongly mitigate the ability to pass on ETS indirect costs."*

Nevertheless, in terms of market characteristics, the sector study found that the possibility of passing-on would not disadvantage the industrial gases sector pertaining to market characteristics and profit margins:[46]

> *"The sector presents a low-medium risk on the market characteristics criteria based on the ability of the sector to pass on higher electricity costs to its downstream customers. This pass through will be constrained by the ability of the downstream sectors to absorb additional costs without relocating. The IG sector also benefits from a low international competition and good bargaining position over its customers.*
>
> *The sector presents a medium risk on the profit margin criteria based on the mitigated current situation of the sector which presents high and stable profit margins but declining business demography and production. The future demand of the IG sector which is correlated to the downstream customers demand growth is expected to be moderate based on the slow demand growth for the steel and chemical industries due to declining competitiveness of the European producers compared to Asian competitors in those industries."*

Hence, even though the link to the supplied sectors was seen, it was not sufficiently included in the assessment. The study focuses exclusively on a possible disadvantage of the industrial gases sector. The necessary integrated view has been omitted.

[45] ADE, Compass Lexecon: Sector Fiche - Manufacture of industrial gases, 2020, p.8.

[46] ADE, Compass Lexecon: Sector Fiche - Manufacture of industrial gases, 2020, p.4.

C. Intermediate Result

The analysis of the regulatory framework under State aid law illustrates that the particular position of the industrial gases sector in the compensation of indirect CO_2 costs has not been sufficiently appreciated.

Part 3 Proposals for the Inclusion of the Industrial Gases Sector in Compensation Facts

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Part 4 Summary Result

The analysis of the existing provisions on energy cost privileges and the examination of potential new provisions shows the enhanced need for a level playing field between the industrial gases sector and other energy-intensive sectors. The sector's significance in international competition must no longer be underestimated and thus the sector's industries need to be adequately compensated for their high energy prices. Actual competitiveness can only be guaranteed in the long term if all energy-intensive sectors operate on a level playing field.

Berlin, 23. November 2023

Rechtsanwalt Rechtsanwalt Rechtsanwältin