

STATLIGT STÖD

Uppmaning enligt artikel 88.2 i EG-fördraget att inkomma med synpunkter på åtgärd C 18/2001 (ex N 123/2000) – Klimatförändringsskatt

(2001/C 185/03)

(Text av betydelse för EES)

Genom den skrivelse, daterad den 28 mars 2001, som återges på det giltiga språket på de sidor som följer på denna sammanfattning, underrättade kommissionen Förenade kungariket om sitt beslut att inleda det förfarande som anges i artikel 88.2 i EG-fördraget avseende en del av ovannämnda åtgärd.

Kommissionen har beslutat att inte göra invändningar mot vissa övriga åtgärder, i enlighet med vad som beskrivs i den skrivelse som följer på denna sammanfattning.

Berörda parter kan inom en månad från dagen för offentliggörandet av denna sammanfattning och den därpå följande skrivelsen inkomma med sina synpunkter på den åtgärd avseende vilken kommissionen inleder förfarandet. Synpunkterna skall sändas till följande adress:

Europeiska kommissionen
Generaldirektoratet för konkurrens
Direktorat G.2
Rue de la Loi/Wetstraat 200
B-1049 Bryssel
Fax (32-2) 296 12 42.

Synpunkterna kommer att meddelas Förenade kungariket. Den tredje part som inkommer med synpunkter kan skriftligen begära konfidentiell behandling av sin identitet, med angivande av skälen för begäran.

SAMMANFATTNING

1. Beskrivning av den åtgärd/det stöd avseende vilken/vilket kommissionen inleder förfarandet:

De brittiska myndigheterna hade för avsikt att den 1 april 2001 införa en klimatförändringsskatt (Climate Change Levy, CCL) på energikonsumtion utanför hushållen, vilket generellt sett omfattar uppvärmningsbränsle, belysning och drivmedel. Lagförslaget om klimatförändringsskatt är en del av regeringens miljöbeskattningspolitik och en central del i regeringens klimatförändringsprogram. Detta program innehåller regeringens förslag om hur Förenade kungariket skall kunna uppnå Kyotoprotokollets bindande mål att utsläppen av växthusgaser skall sänkas med ett snitt på 12,5 % över perioden 2008–2012. Programmet innehåller också förslag om hur man skall uppnå regeringens egen målsättning om att sänka koldioxidutsläppen med 20 % fram till 2010.

Den rättsliga grunden för skatten är finanslagen från 2000 (Finance Act 2000, nedan kallad finanslagen, Section 30 och Schedules 6 och 7).

Mineraloljor omfattas inte av skatten eftersom de redan är belagda med punktskatt i enlighet med rådets direktiv 92/81/EEG och 92/82/EEG ⁽¹⁾.

Skattesatserna för 2001–02 förväntas bli följande:

Energiprodukt	Skattesats (pence/kWh)
El	0,43
Gas	0,15
Kol och andra fasta bränslen	1,17 p/kg (motsvarande 0,15 p/kWh)
Gasol	0,07

Energiprodukter som levereras till personer som har för avsikt att använda dem för andra ändamål än som bränsle föreslås undantas från skatten, även om produkten som sådan omfattas av skatten. Begreppet bränsle definieras inte i finanslagen. Enligt de brittiska myndigheterna omfattar begreppet dock allmänt sett bränsle som används för att driva motorer eller till uppvärmning. Det föreslås att energiprodukter som delvis skall användas som bränsle och delvis till annat (blandad användning) skall undantas från skatten.

De brittiska myndigheterna ser bestämmelserna som en allmän åtgärd, och anser att den utgör en logisk följd av skattesystemet. Enligt Förenade kungariket gäller bestämmelsen om blandad användning stålsektorn, för produktion av aluminium, järn, bly, koppar, zink, batterier och vissa kemikalier.

⁽¹⁾ EGT L 316, 31.10.1992, s. 12 och 19.

2. Bedömning av åtgärden/stödet:

a) Bedömning av förekomsten av stöd i den mening som avses i artikel 87.1 i EG-fördraget

Förenade kungariket hävdar att undantaget för blandad användning är en allmän åtgärd som inte är statligt stöd. Man hävdar vidare att klimatförändringsskatten är en skatt på energiprodukter som används som bränsle, och undantaget är förenligt med rådets direktiv 92/81/EEG av den 19 oktober 1992 om harmonisering av strukturerna för punktskatter på mineraloljor⁽²⁾ (nedan kallat mineraloljedirektivet) och förslaget till rådets direktiv om en omstrukturering av gemenskapens regelverk för beskattning av energiprodukter⁽³⁾ (nedan kallat förslaget), eftersom bara energiprodukter som används för motorer och uppvärmning omfattas.

De brittiska myndigheterna hävdar att syftet med det utvidgade undantaget för blandad användning är att ge skattebetalarna (bränsleleverantörerna) tillförlitliga och klara besked om huruvida något användningsområde, på vetenskaplig grund, undantas från skatten. De brittiska myndigheterna anser att det inte är tekniskt genomförbart att närmare avgöra hur stor andel av energiprodukterna som används som bränsle eller för andra ändamål i vissa processer.

Kommissionen gör bedömningen att undantaget ger de företag som kan utnyttja undantaget en fördel som finansieras av staten. För att bedöma om undantaget är en allmän åtgärd (vilket de brittiska myndigheterna uppger) eller statligt stöd måste det bedömas om effekterna gynnar vissa företag eller tillverkningen av vissa varor. Kommissionen noterar att undantaget enligt uppgifter från de brittiska myndigheterna kommer att gynna produktionen av vissa varor, nämligen vissa metaller (bland annat aluminium, järn, bly, koppar och koks), batterier och vissa kemikalier. Kommissionen betvivlar därför att undantaget kan betraktas som en allmän åtgärd.

Kommissionen noterar vidare att det måste bedömas huruvida undantaget är berättigat mot bakgrund av skattesystemets art och logik. Kommissionen noterar att de brittiska myndigheterna hävdar att det inte strider mot mineraloljedirektivet och förslaget till rådets direktiv om en omstrukturering av gemenskapens regelverk för beskattning av energiprodukter.

Kommissionen noterar att klimatförändringsskatten är en skatt på energikonsumtion utanför hushållen, vilket generellt sett omfattar uppvärmningsbränsle, belysning och drivmedel. Skatten kommer inte att tillämpas på bränslen som används för andra ändamål. En sådan definition av en energiskatts omfattning, där inte all bränsleanvändning beskattas, kan ingå i ett skattesystems logik som det som fastställts i mineraloljedirektivet och förslaget till rådets direktiv om en omstrukturering av gemenskapens regelverk för beskattning av energiprodukter.

Det undantag som föreslås för bränsle för blandad användning sträcker sig utöver en sådan definition av skattens omfattning.

⁽²⁾ EGT L 316, 31.10.1992, s. 12.

⁽³⁾ EGT C 139, 6.5.1997, s. 14.

För det första kan man inte genom undantaget behandla jämförbara situationer på ett likvärdigt sätt, i den utsträckning vissa processer för blandad användning undantas från skatten, medan andra processer, som också kan betraktas som blandad användning, inte undantas.

För det andra undantar Förenade kungariket bränslen helt från skatten, även om de bara delvis används för andra ändamål enligt definitionen ovan.

1. Kommissionen konstaterar att förslaget till rådets direktiv om en omstrukturering av gemenskapens regelverk för beskattning av energiprodukter inte är i kraft och därmed inte automatiskt kan hänvisas till för att fastställa skattesystemets logik och allmänna natur. Däremot kan det ge en indikation om huruvida bestämmelsen om blandad användning kan anses som en allmän åtgärd, även om det i artikel 13.1 hänvisas till bränslen som huvudsakligen används till kemisk reduktion. Kommissionen betvivlar dock att undantaget är helt förenligt med förslaget, eftersom det inte omfattar energi till alla metallurgiska processer, vilket krävs enligt artikel 13.1 a i förslaget. Kommissionen noterar att de brittiska myndigheterna hävdar att en metallurgisk process är en process som utmynnar i produktion av en metall, t.ex. från malm. Kommissionen betvivlar att denna tolkning är förenlig med vad som avses med metallurgisk process i förslaget. Energi till alla metallurgiska processer, dvs. all metallproduktion, borde undantas om skatten skall vara förenlig med förslaget.

2. Kommissionen noterar vidare Förenade kungarikets påstående att det inte går att närmare avgöra hur stor andel av energiprodukterna som används som bränsle eller för andra ändamål i vissa processer, och att blandad användning måste undantas av tillförlitlighets- och klarhetsskäl. Kommissionen betvivlar dock att de brittiska myndigheterna inte skulle kunna utforma en mekanism för uppskattning av förhållandet bränsle/annan användning för vissa processer, och sedan tillämpa denna för skatteuttaget.

Kommissionen konstaterar vidare att om energidelen i den blandade användningen helt undantogs, skulle det leda till ett resultat som inte är förenligt med syftet med skatten, dvs. att minska koldioxidutsläppen.

Av ovan angivna skäl betvivlar kommissionen att det undantag för energiprodukter som används för andra ändamål än bränsle kan betraktas som en allmän åtgärd och inte som statligt stöd.

b) Bedömning av stödets förenlighet

Om det antas att undantaget för bränsle för blandad användning utgör statligt stöd betvivlar kommissionen att det är förenligt med riktlinjerna för statligt stöd till skydd för miljön (EGT C 37, 3.2.2001, s. 3):

1. Undantaget omfattar energiförbrukning i processer som genererar stora koldioxidutsläpp, vilket därmed kan gå emot skattens syfte att sänka koldioxidutsläppen.

2. Undantaget är inte tillfälligt, och har inte införts för att ge företagen möjlighet att anpassa sig till den nya skattesituationen (punkt 48 i riktlinjerna).
3. Det är inte angivet som ett villkor för undantaget att avtal om att uppnå miljöskydds målen skall ingås eller andra motsvarande villkor uppfyllas (punkt 51.1 a i riktlinjerna).
4. Förenade kungariket har inte visat att de företag som kan komma i åtnjutande av undantaget likväl kommer att betala en betydande del av den nationella avgiften (punkt 51.1 b i riktlinjerna).

SKRIVELSEN

"The Commission wishes to inform the United Kingdom that, having examined the information supplied by your authorities on the measures referred to above, it has decided:

- not to raise objections on the tax exemptions from the climate change levy (CCL) for electricity from renewable sources, for CHP, for public transport and rail freight and on the tax reductions for companies entering into climate change agreements,
- to initiate the procedure laid down in Article 88(2) of the EC Treaty on the tax exemption for dual-use fuels.

PROCEDURE

By letter dated 14 February 2000, the UK authorities notified the 'climate change levy', following previous informal discussions on the subject in autumn 1999 and on 4 February 2000. The notification was discussed at a meeting on 8 March 2000 and additional information was subsequently submitted by letter of 26 April 2000 (registered A/33666, 3 May 2000). A second meeting was held on 4 May 2000, followed by additional information sent by letter of 14 July 2000 (registered A/36041, 19 July 2000) and of 8 September 2000 (registered A/31909, 14 September 2000). Further meetings were held on 20 October 2000 and 9 November (mainly on the agreements), and additional information was submitted by letter of 31 October (registered 6 November, A/39034), 14 November 2000 (registered on 17 November, A/39509) and by letter of 23 November (registered 27 November, A/39845). Preliminary sector targets were presented by the UK at a meeting on 1 December 2000. The letter by the Commission of 30 November was answered by letter of 13 December (A/40698, registered 18 December 2000). At a meeting on 14 December the exemption for double use fuels was discussed. Additional information on targets was sent on 15 January (registered A/30396, 16 January 2001). At a meeting on 29 January 2001 outstanding questions on CHP and renewables were discussed. Additional information on dual-use fuels was sent on 1 February

(A/30986, registered 2 February 2001). Additional information was sent on 7 February 2001, confirming several commitments made orally at meetings, giving additional information on double use fuels and modifying the scope of the exemption for electricity from renewable sources. Information on double use fuels was also sent on 1 and 9 February 2001 in the context of the examination of State aid N 197/2000.

Further clarification on the exemption for CHP was provided by e-mail on 14 February 2000 and confirmation of the facts was given by letter dated 21 February 2001 (registered on 22 February, A/31532). Detailed information on targets was last submitted on 5 March 2001. Additional information on CHP was provided on 7 March 2001.

CHARACTERISTICS OF THE CLIMATE CHANGE LEVY

The UK authorities intend to introduce from 1 April 2001 the climate change levy on the non-domestic use of energy, which is broadly the use as heating fuel, lighting or for motive power. The climate change levy package takes forward the government's policy on environmental taxation and is a central part of the government's climate change programme, which sets out the government's proposals for meeting the UK's legally binding target of a 12,5 % reduction in greenhouse gas emissions (Kyoto Protocol) averaged over 2008-2012 and for moving towards the government's domestic goal of a 20 % reduction in carbon dioxide emissions by 2010.

The levy is expected to raise GBP 1 billion in its first full year (2001/2002).

1. **Environmental impact of the CCL:** This new levy is introduced in order to help meet the UK's international greenhouse gas abatement obligations and to progress towards the domestic goal of reducing CO₂ emissions. This new environmental instrument is estimated to save around 5 M tonnes of carbon per year by 2010. Of this it is estimated that at least 2,5 M tonnes of carbon savings per year will be achieved through climate change levy agreements with energy-intensive sectors.

(estimates in MtC for the entire CC package)

Negotiated agreements		2,5
Levy package	Price effect of levy	1
	Renewables exemption	0,5
	CHP exemption	0,5
	Energy efficiency measures	0,5
Total		5

2. **The legal base** for the levy is the Finance Act 2000, Section 30 and Schedules 6 and 7, which received Royal Assent on 28 July 2000. The levy is scheduled to come into effect on 1 April 2001. If no Commission approval is given before 1 April 2001, the UK authorities have the option of amending their proposals in the Finance Bill before this.

3. Scope of the levy

The levy covers non-domestic use of primary and/or secondary fuel for lighting, heating, motive power and power for appliances by consumers in industry (including fuel industries), commerce, agriculture, public administration and other services.

The tax will be levied at the point of sale to the final consumer. In order to avoid double taxation the levy will not apply where a taxable commodity is used to produce another taxable commodity.

Mineral oils will not be brought within the scope of the tax because they are already subject to excise duty in accordance with Council Directives 92/81/EEC and 92/82/EEC⁽⁴⁾.

The levy will apply also to imported commodities when used in the UK. It will not be applied to commodities which are intended to be burnt outside the UK.

4. The rates of the levy

The rates of levy in 2001-2002 are expected to be:

Energy product	Levy rate (pence per kilowatt hour)
Electricity	0,43
Gas	0,15
Coal and other solid fuels	1,17 p/kg (equivalent to 0,15 p/kWh)
Liquified petroleum gas	0,07

DESCRIPTION OF THE AID

The UK Government notified several exemptions or reduced rates from the tax, for a period of **10 years**⁽⁵⁾. The duration of 10 years is meant to allow business to plan the necessary investments in energy savings and to gain legal certainty for their investment planning and actual decisions.

Subject of the notification in question are:

1. Exemption for electricity, gas and coal used in public transport and railfreight.
2. Exemption for input fuels and electricity generated by good quality CHP.
3. Exemption for electricity generated from some energy sources.
4. Reductions for facilities entering into climate change agreements.

The UK Government announced its intention of entering into climate change agreements with industry until 2013, that is a

⁽⁴⁾ OJ L 316, 31.10.1992, pp. 12 and 19.

⁽⁵⁾ The notification does not cover tax exemptions and reductions for Annex I products and for the ECSC sector, which will be dealt with as separate notifications (Annex I products: State aid N 9/2001 (intensive pig and poultry rearing) N 10/2001 (food, drinks and fisheries), N 44/2001 (horticulture), ECSC: State aid N 197/2000). An exemption for natural gas used in Northern Ireland was notified separately (State aid N 660/2000) and will also be subject of a separate decision.

period for tax benefits of 12 years. However, the UK Government seeks approval of the tax reduction linked to climate change agreements for an initial period of 10 years. Also the legal provisions for the other exemptions are by nature unlimited, but notified for a period of 10 years.

The UK authorities confirmed that although the entitlement to reductions and exemptions is contained in legislation, they will review their policy before the end of the 10-year approval and either renotify or amend the legislation and/or agreements as necessary so as to respect State aid obligations.

5. Exemption for dual-use fuels

The tax law exempts dual-use fuels from the levy. The UK authorities consider this exemption to be a general measure and in the nature of the tax scheme.

The levy exemption for dual-use fuels amounts to around 0,1 % of the turnover for each sector.

BUDGET OF THE SCHEME

Expenditure on the scheme is not expected to exceed GBP 420 million in the first year 2001/2002 against a net yield of GBP 1 billion of the levy. The cost and benefit is expected to fall in subsequent years as the impact of measures taken to meet the targets in the agreements are taken. The amount of revenue forgone will depend on future rates of levy; the success of the policy in encouraging more environmentally friendly forms of electricity generation; the scale of reduction in energy consumption by energy intensive users; and the development of rail transport.

The total costs for the exemption for public transport will be GBP 15 million, the exemption for railfreight will cost about GBP 1 million.

The exemption for CHP will cost GBP 40 million at current take-up. Part of this benefit will accrue to customers drawing electricity or heat directly from these plants.

The cost for exemption for renewable sources depends on the success of the policy in encouraging the development of new capacity. At current capacity an exemption will cost GBP 15 million.

The cost of the reduced rate for companies entering into climate change agreements has been calculated at GBP 350 million in the first full year.

1. Exemption for electricity, gas and coal used in public transport and railfreight

The UK Government is proposing to exempt energy used in public transport and rail freight from the CCL. Because diesel and petrol are not within the scope of the tax (being subject to excise duties) this means the main beneficiaries would be mainline railways, light railways, London Underground and rail freight companies using electricity.

In July 2000, the UK published its integrated transport White Paper 'A new deal for transport: better for everyone'. The plan aims to transform the UK transport system by helping reduce road congestion and pollution, providing better and more reliable public transport and significantly improving transport in London. Key targets of this plan are:

- to increase rail use by 50 %, measured in passenger kilometres, by 2010 from 2000 levels,
- to increase rail freight by 80 % by 2010, increasing its share of the freight market to 10 %,
- to double light rail use in England by 2010 from 2000 levels,
- to reduce road congestion on the inter-urban network and in large urban areas in England to below current levels by 2010,
- to cut journey times on London Underground services by increasing capacity and reducing delays.

Without the exemption for 10 years, the costs of the levy could be passed on to the government through the franchise renegotiations. This would create an additional support requirement that would consequently reduce the amount of support available for the new enhancements envisaged in the 10-year plan. Alternatively, the cost of the levy could be passed on to the customer in the form of higher fares/charges; this would also run counter to the objectives of the 10-year plan.

Meeting the targets in the plan will require increased investment in infrastructure and rolling stock which may be jeopardised if rail operators have to meet the costs of the CCL. It is estimated that these could add approximately GBP 15 million a year to rail operators' costs.

Securing the exemption from the climate change levy for 10 years will provide the certainty needed by industry to make the necessary investment to meet the plan targets, and is consistent with the introduction of the 10-year plan as a long-term strategy.

In addition, the exemption of rail freight from the levy would be consistent with the Commission's proposal, adopted on 26 July, regarding regulation concerning the granting of aid for the coordination of transport by rail, road and inland waterways. This proposes a comprehensive exception for State aid in the freight sector benefiting users of rail, inland waterways and combined transport infrastructure on the grounds — in the interests of sustainable mobility and to overcome existing distortions between modes — that it compensates them for the unpaid external costs (environmental, congestion, etc.) of road transport.

Of course, the levy exemption would be just one of many policies put in place to help achieve the targets in the 10-year plan. Other measures include a substantial increase in investment, both private and public, with an emphasis on promoting private and public partnerships. Total private and public investment in transport over the next 10 years will be

GBP 180 billion. A number of multi-modal studies will be undertaken, which aim to identify solutions to problems on key transport corridors by looking at the contribution that all modes of transport might make, moving away from a one-dimensional approach. On railways, the Strategic Rail Authority (SRA) will take the targets in the 10-year plan into account when considering replacement of the current train operator franchises.

The plan sets out the government's commitment to monitor and evaluate progress towards the targets, including those mentioned above. The UK will be reporting regularly on the results, together with other key indicators.

The UK will be monitoring closely how this package of policies is contributing to the expansion of rail travel as an alternative to road travel, and its role in promoting more sustainable transport practices.

2. Exemption for outputs of good quality combined heat and power plants (CHP)

CHP makes significant fuel and emissions savings over conventional, separate forms of power generation and heat-only boilers. The generation and supply of electricity from power stations is generally at an efficiency in the range 25-50 %, based on the gross calorific value (GCV) of the fuel and including transmission and distribution losses. This means that 50-75 % of the energy content of the fuel is not usefully employed. This unutilised energy content is rejected as heat directly to the atmosphere or into seas or rivers. The generation of electricity and the recovery of heat in CHP schemes typically achieve overall efficiencies of 60-80 % and sometimes more.

Unlike conventional methods of electricity generation, some of the heat cogenerated in a CHP scheme is used typically in industrial processes or for heating and hot water in buildings. The heat used in this way displaces heat that would otherwise have to be supplied by burning additional fuel and so leads directly to a reduction in emissions. The development of CHP provides a particularly environmentally-effective approach for reducing CO₂ emissions.

The UK Government has a target of increasing the installed capacity of CHP from its current level of 4,5 GW to at least 10 GW by 2010. This will lead to additional reductions in carbon dioxide emissions of about 4 million tonnes per annum.

However, in the absence of any incentives to promote the development of CHP, it is estimated that CHP capacity will only increase to 7 GW or possibly less by 2010.

The economic viability of CHP is critically dependent on the differential between electricity and gas prices. Over the last five years, electricity prices have fallen by 3 % in real terms, while gas prices have increased by 30 %. These factors together have resulted in an extremely adverse effect on CHP economics. Without any exemption for CHP, the climate change levy (CCL) will exacerbate this problem, as it will increase gas prices proportionately more than electricity prices.

It is important to recognise that the cost-effectiveness of CHP is marginal in many instances. The proposed CHP exemption will help to tip the balance in favour of investment of CHP in many of these cases. The exemption will address market imperfections and help to counteract the effect of the trend in energy prices over recent years, which has reduced the cost-effectiveness of many CHP schemes. These issues apply just as much in the business sector as within any other sector of the economy.

The government has therefore proposed that good quality CHP should be exempt from the climate change levy. The definition of good quality CHP⁽⁶⁾ is based on threshold criteria, which must be met or exceeded in order for the whole of the scheme to qualify as 'good quality'.

The CHPQA programme provides for a rigorous assessment of the energy efficiency and environmental performance of CHP schemes. It is much more rigorous in this respect than simply assessing the overall efficiency of a CHP scheme. In particular, the weighting given to the efficiency of power generation in the assessment procedures recognises the environmental benefits of using CHP rather than conventional energy generation technologies. In comparison, a conventional boiler system with a small amount of electrical power generation could achieve relatively high 'headline' energy conversion efficiencies, but offers much reduced environmental benefit compared to good quality CHP.

Threshold criteria are set for quality index and power efficiency.

Power efficiency (η_{power}) is the proportion of input energy which is converted to electrical or mechanical power (total annual power output divided by the total annual fuel input).

The quality index (QI) is a measure of the overall efficiency of a CHP scheme, taking account of the efficiency of production of both heat and power. In the definition of the quality index, the quantity of power produced is weighted relative to the quantity of heat, given the greater energy and environmental cost involved in generating power.

The general definition for $QI = (X \times \eta_{power}) + (Y \times \eta_{heat})$ ⁽⁷⁾

Quality index (QI) definitions for various sizes and types of CHP schemes:

Size of scheme	QI definition
≤ 1 MW _e	$QI = 230 \times \eta_{power} + 125 \times \eta_{heat}$
> 1 to ≤ 10 MW _e	$QI = 220 \times \eta_{power} + 125 \times \eta_{heat}$
> 10 to ≤ 25 MW _e	$QI = 205 \times \eta_{power} + 125 \times \eta_{heat}$
> 25 to ≤ 50 MW _e	$QI = 190 \times \eta_{power} + 125 \times \eta_{heat}$
> 50 to ≤ 100 MW _e	$QI = 185 \times \eta_{power} + 125 \times \eta_{heat}$
> 100 to ≤ 200 MW _e	$QI = 180 \times \eta_{power} + 125 \times \eta_{heat}$
> 200 to ≤ 500 MW _e	$QI = 170 \times \eta_{power} + 125 \times \eta_{heat}$
> 500 MW _e	$QI = 160 \times \eta_{power} + 125 \times \eta_{heat}$

⁽⁶⁾ Established by the UK's CHP quality assurance programme (CHPQA).

⁽⁷⁾ X is a coefficient related to alternative power supply options. Similarly Y is a coefficient for heat generation, related to alternative heat supply options. The values for X and Y vary for different sizes and types of scheme.

Special cases	QI definition
Fuel cell schemes	$QI = 180 \times \eta_{power} + 125 \times \eta_{heat}$
Reciprocating engine schemes (including those in combined cycle applications) ≤ 25 MW _e	$QI = 200 \times \eta_{power} + 125 \times \eta_{heat}$
Transitional arrangements for existing steam turbine and reciprocating steam engine schemes to April 2005	$QI = 240 \times \eta_{power} + 125 \times \eta_{heat}$
Alternative fuel schemes	
Alternative fuel gases	$QI = 240 \times \eta_{power} + 125 \times \eta_{heat}$
Biogas, waste gas or waste heat	$QI = 300 \times \eta_{power} + 140 \times \eta_{heat}$
Biomass or solid or liquid waste	$QI = 400 \times \eta_{power} + 140 \times \eta_{heat}$

Threshold criteria for good quality CHP

For fuel inputs under annual and initial operation:

Normally, a scheme that qualifies as good quality CHP for its entire energy inputs is one where the power efficiency equals or exceeds 20 %.

For power outputs under annual operation:

A scheme that qualifies as good quality CHP for its entire annual energy output is one where the quality index equals or exceeds 100.

For power outputs under initial operation:

A scheme that qualifies as good quality CHP for its entire annual energy output is one where the quality index equals or exceeds 95.

For power generation capacity under annual operation:

The threshold criterion for existing good quality CHP capacity is that the CHP scheme achieves a QI of at least 100 at its maximum heat output under normal operating conditions.

For proposed new power generation capacity, threshold criteria for proposed new good quality CHP scheme capacity, at design, specification, tendering and approval stages, are:

either $QI \geq 105$ and power efficiency ≥ 20 %, both under annual operation,

or $QI \geq 110$ at max heat and power efficiency ≥ 35 % under annual operation.

The QI definitions shall be subject to periodic review to ensure that the values of X and Y remain applicable and appropriate for each size and type of CHP scheme, that certified good quality CHP will continue to provide significant environmental benefits compared with conventional energy supply alternatives and that the QI definitions provide a challenging threshold for all CHP schemes and promote continuous improvement of CHP plant.

Simplified arrangements will operate for small-scale CHPs (less than 2 MWe) as regards metering, monitoring and reporting.

The extent of the exemption on fuel input and energy output depends on the proportion of good quality CHP

A scheme meeting or exceeding the threshold quality index and power efficiency criteria will qualify as good quality CHP for its entire capacity, annual energy inputs and annual energy outputs.

A CHP scheme that does not meet the threshold criteria for good quality CHP will not be eligible for CCL exemption on its entire fuel input or power output, but only for a part of it, corresponding to good quality portion of the overall CHP scheme ⁽⁸⁾.

Regular monitoring

It is a requirement of CHPQA that CHP schemes are assessed against the standard each year to ensure continued performance in relation to the good quality CHP threshold criteria. If there is a change in the level of performance, eligibility for exemption from the climate change levy shall be adjusted appropriately.

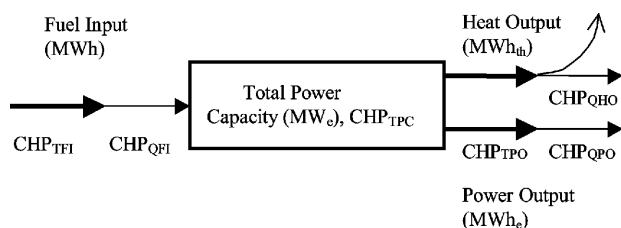
3. Exemption for electricity generated from some energy sources

The government proposes to exempt from the levy electricity sold by electricity suppliers which can be matched with

⁽⁸⁾ For such schemes, if the power efficiency is less than the threshold power efficiency criterion, the qualifying fuel input must be calculated. The qualifying fuel input (CHP_{QFI}) is the portion of total fuel input that would achieve the threshold power efficiency, given actual annual average power output. In this way, the fuel input to the good quality CHP power output is recognised and the threshold criterion does not represent a 'cliff-edge'.

If the quality index is less than the threshold quality index criterion, the qualifying power output (CHP_{QPO}) must be calculated. The qualifying power output is the portion of total power output that would achieve the threshold quality index, given actual annual average heat utilisation. In this way, the good quality CHP power output is identified and recognised whilst any additional power output is regarded as conventional power generation.

It is the qualifying fuel input and qualifying power output, as the fuel input and power output meeting the threshold criteria, that are used to determine CCL exemption for schemes that do not meet the threshold criteria for their total fuel inputs and outputs. In this way, benefits are only ever given to the good quality portion of any overall CHP scheme.



CHP scheme

purchases from an eligible generator. The technologies eligible for exemption will be: wind energy, hydro power up to 10 MW, tidal power, wave energy, photovoltaics, photoconversion, geothermal hot dry rock, geothermal aquifers, the biodegradable fraction of municipal and industrial wastes, landfill gas, agriculture and forestry wastes, energy crops and sewage gas.

Suppliers will be able to exempt sales of electricity from the levy if the supplier has contracted with a generator or generators of eligible electricity from the defined sources to purchase such electricity; the supplier agrees to independent audit by the authorities; and the generator(s) agree to the same conditions.

This exemption is also applicable to imported electricity from the same energy sources.

4. Reductions for facilities entering into climate change agreements

The government also recognises the need for special consideration to be given to the position of energy intensive industries given their energy usage, the requirements of the integrated pollution prevention and control regime and their exposure to international competition. Consequently, the government will provide an **80 % discount from the levy** for those sectors that can agree targets for improving their energy efficiency or reducing carbon emissions ('agreements').

Beneficiaries: The government defines an 'energy intensive' sector as one which operates processes which will be covered by Annex I of Council Directive 96/61/EC concerning integrated pollution prevention and control ⁽⁹⁾. This criterion applies throughout the UK and has been chosen because sites operating such processes will be subject to a legal requirement to use energy efficiently — other sites are not subject to this requirement. Small sites which fall below IPPC size thresholds (with the exception of thresholds relating to combustion plant), but which would otherwise be covered by the proposed regulations, will also be eligible for the relevant sector agreement.

Duration: The agreements cover a period of 12 years (2001-2013). The UK Government seeks Commission approval for a period of 10 years and confirmed that it would terminate the agreements with sectors after 10 years if no Commission decision allows their prolongation (commitment see above).

⁽⁹⁾ These sites and installations will, in due course, be subject to a regulatory requirement, in terms of having to operate in an energy efficient manner. The activities in question include activities of energy industries, production and processing of metals, mineral industry, chemical industry, waste management and some other activities.

Form of agreements: Two options are envisaged for these agreements

1. Sector level agreements ('umbrella agreements') between the industrial sector associations⁽¹⁰⁾ and the relevant Secretary of State under which sector targets would be set. Individual entities participating in the scheme would additionally agree individual targets and would enter into separate agreements with the Secretary of State ('participation agreements'). The reduction in levy would be available either if the sector as a whole met its target or, failing that, if an individual entity met its target (in which case, only that individual entity would qualify for a levy reduction).

Most eligible sectors and participants are choosing to use these forms of agreements.

2. In this option, the sector level agreement is also between the government and the sector association. But the participant level agreement is between the sector association and each participant in respect of their facility or facilities. The UK Government has to agree the model agreement used by the sector and will also approve each individual agreement before they will be permitted to come into effect.

The levy is only payable by those operators carrying out economic activity in the UK. All of those are equally eligible to enter climate change agreements, no matter what their origin. Any business setting up a new establishment in the UK will be eligible to enter an agreement on equivalent terms to those agreed with their sector in existing agreements. Provided an equivalent target can be agreed for qualifying activities, DETR will include the establishment within the relevant sector agreement and the establishment will become eligible for the 80 % discount.

Targets: The targets consist of quantitative energy use and carbon emissions reductions outcomes, defined in absolute terms or per unit output. Milestone targets are set for two-year periods.

Targets are reviewed twice, in 2004 and 2008 in order to ensure that they continue to represent the potential for cost effective energy savings taking into account any changes in technical or market circumstances.

The UK Government will make sector targets transparent by reporting to the UK Parliament, and as appropriate, to the devolved legislatures.

Tolerance bands allow small overshoots of the milestone target to be accepted for those participants who otherwise demonstrated satisfactory performance in view of additional qualitative criteria (such as good environmental management). The tolerance band facility will not be available after the third milestone.

Over the period envisaged for the agreements participants will wish to be free to choose whether to respond to market demand for new products or a different mix of products from that on which their original energy/CO₂ savings targets were based. This may lead to an increase or decrease of energy per unit of production. The scheme foresees an adjustment procedure in order to adapt the targets to a change in the

product mix until 2006. A potential extension of this possibility will depend on the successful introduction of a carbon emission trading scheme. Participants with absolute targets would not be permitted to use this procedure. The product mix approach is not available for those participants who choose a tolerance band approach.

If the beneficiary is unable to meet a milestone target due to a relevant constraint or requirement, progress made towards meeting the targets is taken as being satisfactory. These constraints or requirements are:

- constraint or requirements imposed by or under town and country planning, environmental, health and safety or food hygiene legislation,
- certain constraints or requirements imposed on the construction or operation of a CHP plant under the Energy Act 1976 or Electricity Act 1989,
- unforeseen major disruptions to a dedicated energy supply of more than 240 consecutive hours.

The scheme foresees the possibility to meet agreed targets by carbon emission trading among entities committed to a climate change agreement. Emission trading should later on be possible also with participants in a wider emission trading scheme subject to approval of such a linkage by the Commission. Details of such a scheme are not yet available. The UK authorities undertake that unless the Commission agrees otherwise, carbon trading will only be allowed between participants in climate change agreements, and then only where the selling party has verified surplus carbon to sell. This restriction is contained in the climate change agreements.

Recuperation: A beneficiary who does not meet a milestone target will lose the levy reduction for the next two years. If he then meets the next milestone target, he will be allowed the levy reduction for the following two years.

While the mechanism of such a 'forward penalty' is different from a clawback provision for levy rebates received over the past years, the UK Government claims that the risk of losing the levy reduction for the future is a stronger incentive for beneficiaries to meet their targets than a proportionate clawback mechanism would provide⁽¹¹⁾.

⁽¹¹⁾ An example for a beneficiary not meeting the target in year 2 and is back on target thereafter:

	Year 2	Year 4
Energy target agreed	900	800
Energy use	925	800
Levy to be paid:		
Forward penalty	$100 \times 20 \% = 20$	$90 \times 100 \% = 90$
Proportionate clawback	$100 \times 20 \% = 20$	Clawback $\frac{1}{4}$ of 80 previous rebate = 20 + $90 \times 20 \% = 18$ = 38

⁽¹⁰⁾ Or an organisation especially set up by the sector association for this purpose.

For the last milestone target, for which the prospective loss of levy reduction may not create a sufficient incentive, the UK authorities undertook that they will introduce a provision to recover levy reduction granted to participants for the last two years of a 10-year State aid approval in proportion to the extent, if any, to which their last milestone targets were not met. The UK authorities consider it probable that this provision will require a change to the legislation, which will be brought forward at the appropriate time. As yet the framework for recovery has not been settled, but will be considered in the prevailing circumstances.

Level of the targets: When negotiating the targets with the sectors concerned, the principal benchmark used by the UK authorities to assess whether these targets are demanding is the UK's study of the potential for savings achievable

through the implementation of all energy saving measures which are cost effective ⁽¹²⁾.

During the negotiations, several assumptions of the study were corrected or refined. Agreements are being finalised with most of the sectors concerned. While all negotiations are not yet finalised, the UK authorities informed the Commission on the likely outcome of the negotiations. The UK informed the Commission that they do not intend to weaken the targets in the final phase of the negotiations, but may on the contrary even enforce them for some sectors. The latest estimates being reviewed with the sector associations are:

⁽¹²⁾ The study has been published as 'Industrial sector CO₂ emissions: projections and indicators for the UK 1990-2020, April 1999 (EPSC 20616001/Z/1)'. The assessment of the potential savings, sector by sector, has assumed unlimited availability of capital and management time and therefore is an upper potential limit with known technologies.

First wave climate change levy: Target as agreed and carbon savings as estimated by sector associations (as of 5 March 2001)

Sector association	Type of target relative/absolute carbon/energy	Base year	Target (change from base year to 2010)	Additional carbon savings (in 1 000 t above BAU between 2000 and 2010)	Status of agreements
Non-Ferrous Alliance	Relative energy	1990	- 22,0 %	50	Agreed
Chemical Industries Association	Relative energy	1990	- 34,0 %	790	Agreed
Aluminium Federation	Relative carbon equivalent	1990	- 32,1 %	150	Agreed
Food and Drink Federation ⁽¹³⁾	Relative energy	1995	- 13,8 %	420 (including estimate for CHP)	Agreed
Paper Federation of Great Britain	Relative energy	1990	- 40,0 %	430	Agreed
British Cement Association	Relative energy	1990	- 25,6 %	170	Agreed
British Glass Manufacturers Association	Relative energy	1999	- 9,2 %	20	Agreed
British Ceramics Confederation	Relative energy	2000	Pottery - 12,4 % Heavy clay - 10,22 % Fletton bricks - 8,1 % Refractories - 10,33 % Cer. materials - 10,1 %	44	Agreed
Foundries: target 2010	Relative energy	2000	- 11,0 %	20	Agreed

⁽¹³⁾ Partly Annex I products.

Second wave climate change levy: Carbon savings estimated by sector associations (as of 5 March 2001)

Sector association	Type of target relative/absolute carbon/energy	Base year	Target (change from base year to 2010)	Carbon savings (1 000 t) from target	Status of agreements
British Rubber Manufacturers Association	Relative energy	1999	- 10,0 %	23,0	Provisionally agreed
Slag Grinders Association	Relative energy	1999	- 10,0 %	2,0	Agreed
Gypsum Products Development Association	Relative energy	2000	- 7,16 %	7,2	Agreed
British Lime Association	Relative energy	1998	- 7,9 %	6,0	Agreed
Wallcovering Manufacturing Association of GB Ltd	Relative energy	1999	- 9,0 %	2,0	Agreed
Brewers and Licensed Retailers Association	Relative energy	1999	- 11,6 %	16,0	Agreed
Maltsters Association of Great Britain	Relative energy	1999	- 7,8 %	5,0	Agreed
National Association of Master Bakers	Relative energy	1999	Scratch bakeries - 9 % Bake-off facilities - 4,5 %	2,0	Provisionally agreed
Scotch Whisky Association Gin and Vodka Association	Relative energy	1999	- 4,5 %	6,5	Agreed
UK Agricultural Supply Trade Association	Relative energy	1999	- 7,1 %	7,9	Agreed
UK Renderers Association	Relative energy	1999	- 9,0 %	4,5	Agreed
British Apparel & Textile Confederation	Relative energy	1999	- 9,0 %	Finalising data	
British Leather Confederation	Relative energy	1999	- 9,68 %	0,6	Agreed
Confederation of British Metalforming	Relative energy	2000	- 7,0 %	Finalising data	
Eurisol	Relative energy	1999	- 14,9 %	6,7	Agreed
Metal Packaging Manufacturers Association	Relative carbon	1999	- 9,0 %	2,5	Agreed
National Microelectronics Institute (Semiconductors)	Relative energy	2000	- 59,0 %	220,0	Agreed
National Microelectronics Institute (CRTs)	Relative energy	2000	- 21,0 %	7,4	Agreed
Society of British Aerospace Companies	Absolute energy	2000	- 8,5 %	0,5	Agreed
Society of Motor Manufacturers and Traders	Relative energy	1995	- 15,3 %	19,2	Agreed
Surface Engineering Association	Relative energy	1999	- 12,01 %	2,5	Agreed
Vehicle Builders and Repairers Association	Relative energy	2000	- 10,0 %	Finalising data	
British Printing Industry Federation	Relative energy	2000	- 12,0 %	4,2	Agreed
Wood Panel Industries Federation	Relative energy	1999	- 7,34 %	1,9	Agreed
Boat Builders	—	—	—	Late entrant	
Supermarkets					
Environmental Service Association (incineration)	—	—	—	Late entrant	

The UK authorities will send final versions of the agreements to the European Commission.

The UK authorities assume that the cost of meeting the milestone targets will be around GBP 2 500 million over the period 2000-2010. The diversity of investment cycle across the various industries means that there is no reason to assume that averaged over the sectors investment will be anything other than linear over the 10-year period. Therefore, averaged over the lifetime of the agreements the annual costs of investment will be GBP 250 million.

Companies will not be allowed to receive aid under this scheme and also other aid for the investments necessary to fulfil the agreements. They can however benefit from enhanced capital allowances for energy efficient investment, a measure which does not constitute State aid under Article 87(1) of the EC Treaty ⁽¹⁴⁾.

The UK authorities undertook to provide the Commission with progress reports after each two-year review.

5. Exemption for dual-use fuels

It is proposed that energy products falling within the scope of the levy will be exempt from it where the person to whom the product is supplied intends it to be used for other purposes than as fuel. The notion of 'fuel' is not defined in the Finance Act 2000. However, according to the United Kingdom authorities it broadly covers use of energy products for motor and heating purposes. It is proposed that where an energy product is used for partly fuel and partly non-fuel purposes ('mixed uses') it will be fully exempt from the levy.

The United Kingdom authorities consider this provision as a general measure, and as part of the logic of the tax system. According to the United Kingdom, this 'dual-use' provision applies to the steel sector, to the production of aluminium, iron, lead, copper, zinc, batteries and some chemicals.

ASSESSMENT

I. EXISTENCE OF AID

1. Exemption for transport

Article 87(1) of the Treaty provides that 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 common market.

State aid, within the meaning of Article 87(1) of the Treaty also covers measures that, in various forms, mitigate the charges which are normally included in the budget of an undertaking and which have the same effect as cash grant subsidies. Consequently, a system under which the public authorities

grant to certain undertakings a tax exemption that relieves them of some of their costs and confers on them financial advantages which improve their competitive position constitutes State aid within the meaning of Article 87(1) of the Treaty if the aid is capable of affecting trade between Member States and distorting competition.

As described above, the UK Government will offer an exemption from the climate change levy for electricity, coal and gas used in public transport and railfreight. Since mineral oils and gases used by road vehicles are not within the scope of the levy, the benefit deriving from the tax exemption will accrue to railways and light railways using electricity, such as the London Underground and the Manchester Metro.

The exemption from the levy for rail freight will relieve the beneficiaries from costs they should normally bear due to the new tax and hence confers on them a financial advantage, which improves/safeguards their competitive position vis-à-vis other modes of transport and other operators. It thus distorts or threatens to distort competition. The advantage involves State resources as, through the exemption, the State suffers a loss of tax revenue. Road haulage operations, including cabotage, are completely liberalised within the European union and the measure therefore affects trade between Member States. Accordingly, the exemption constitutes aid within the meaning of Article 87(1) of the Treaty.

Also with regard to public transport, the tax exemption confers upon the beneficiaries a financial advantage that improves their competitive situation compared with their main competitors, e.g. undertakings providing public transport by road. The tax exemption thus favours certain undertakings and distorts or threatens to distort competition within the meaning of Article 87(1) of the Treaty.

Access to the international passenger transport market and the right to provide passenger transport cabotage has been liberalised through Community legislation ⁽¹⁵⁾. With regard to cabotage rights, the legislation has opened up the market to competition in respect of special regular services and of national regular services, which are provided in the course of an international regular service. The Commission recalls that urban and suburban transport services are not covered by this right to provide passenger cabotage. However, both the Community's public procurement rules and, in particular, national legislation in most Member States enhance an EU-wide market access in this respect. The Commission notes that public transport contracts in many cases takes the form of a concession contract between a transport operator and a public authority and that the detailed procedural rules

⁽¹⁴⁾ Notified N 797/2000, Commission decision on 13 February 2001.

⁽¹⁵⁾ Council Regulation (EEC) No 684/92 on common rules for the international carriage of passengers by coach and bus and Council Regulation (EC) No 12/98 laying down conditions under which non-resident carriers may operate national road passenger transport within a Member State.

contained in the public procurement directives impose only limited obligations in relation to works concessions and do not apply in the case of service concessions (16). However, although a service concession is not directly covered by the detailed rules on public procurement and work concessions are subject to only limited obligations, public entities concluding such contracts are bound to comply with the fundamental rules of the Treaty, in particular the principle of non-discrimination on the ground of nationality (17). In some cases public transport contracts may amount to public service contracts which are subject to the detailed procedural requirements of Directive 92/50/EEC on the award of public service contracts. However, where such contracts are for the provision of 'non-priority' services listed in Annex 1B of that Directive, the public authority is subject to only limited obligations in relation to the award of such contracts. The Commission however, notes that a number of Member States, of which the UK is one, have introduced EU-wide open, transparent and non-discriminatory procedures for public transport services (18). Furthermore, statistical data show that where the markets have been accordingly opened, international operators have stepped in alongside national ones. By early 2000 at least nine companies, from the public and private sectors, were acting as public transport operators in more than one Member State (19).

Given the fact that transport undertakings in the passenger field show an increasing interest in entering domestic public transport markets, the Commission cannot exclude that the UK tax exemption for public transport is liable to affect trade between Member States. Accordingly, the Commission considers that the exemption for public transport from the climate change levy constitutes an aid within the meaning of Article 87(1) of the Treaty.

2. Exemption for CHP

The benefits and beneficiaries of the exemption are assessed by comparing (1) the treatment of a good quality CHP system, respectively the qualifying portions of it, with the electricity production from conventional sources, and (2) by comparing heat or steam production in good quality CHP with conventional heat or steam production.

(16) See Commission's interpretative communication on concessions under Community law (OJ C 121, 29.4.2000).

(17) European Court of Justice judgment of 7 December 2000, C 324/98 (TeleAustria).

(18) Today 11 Member States have introduced legislation or administrative arrangements that provide for competition in at least part of the bus, coach or urban rail markets. See the Commission's proposal for a regulation on action by Member States concerning public service requirements and the award of public service contracts in passenger transport by rail, road and inland waterway, COM(2000) 7 final.

(19) 2000 data from the International Union of Public Transport (UITP). 1998 data from 'Major European players in public transport — new developments in the European Union, 1997', UITP-EuroTeam, 1998.

(1) Comparison of electricity production good quality CHP — conventional power station

Conventional electricity generator:

Fuel <u>input not taxed</u>	Conventional power generator	
	Output taxed if used on-site or sold to a known end-user	Output sold to grid, consumer pays levy on electricity

Good quality CHP:

Fuel <u>input not taxed</u>	CHP system	
	Output not taxed if used on-site or sold to a known end-user	Output sold to grid, consumer pays levy on electricity

Operators of good quality CHP systems do not pay levy on the input fuel. This is in line with the general rule of the tax law, which does not tax the input fuel for electricity production in order to avoid double taxation.

I. Operators of good quality CHP systems do not pay levy on the electricity they produce from a good quality CHP for their own use.

II. Known end-users do not pay levy on electricity they purchase from a good quality CHP for their own use.

This gives operators of good quality CHP systems an advantage compared with conventional power generators who pay a levy on electricity used on site and gives known end-users an advantage compared with end-users who buy electricity from the grid for their own use. This relieves them of charges that are normally borne from their budgets and gives the recipient firms an advantage over other firms. The advantage is granted through state resources as the State suffers a loss of tax revenues. The recipients exercise an economic activity on markets on which there is or could be trade between Member States or on which firms from other Member States might wish to establish themselves. The scheme thereby distorts or threatens to distort competition and could affect trade between Member States.

The Commission assessed in particular if the exemption (a) is aid to certain undertakings, or (b) is aid to the production of certain goods.

I. Operators of good quality CHP systems

(a) *Does the exemption constitute aid to certain undertakings?*

The exemption is applied in all UK, granting automatic rights if objective quality criteria are fulfilled. The exemption for good quality CHP applies to all autogenerator CHP systems, independent of their type or size.

CHP is a technology to increase energy efficiency in the context of a wide variety of economic activities. It is strongly used in the manufacturing sectors, there in so different subsectors as refineries, chemical industry, paper and printing; food products, beverages and tobacco; metal products, machinery, equipment; mining and agglomeration of solid fuels; extraction of crude oil and natural gas; coke ovens; extraction and processing of nuclear fuels; iron and steel industry; non-ferrous metals; non-metallic mineral products extraction; textile, clothing and leather. It is also used in other industrial branches, in transport, in the service sector and for public supply (district heating).

While use in the service sector is by far not as developed as in manufacturing, CHP is also there increasingly used, e.g. for hotel (spa) facilities, and in the health sector. The exemption is even meant to have the effect to spread the use of CHP also in those sectors, where it is currently not that widely used, but which would have the potential to use it.

The application of CHP across different economic sectors

Output of CHP potential model from 1999 — capacity and sites

	Capacity		Sites	
	(MWe)	%	No	%
Chemicals	3 548	24,8 %	448	3,0 %
Food	1 834	12,8 %	742	4,9 %
Paper	1 349	9,4 %	107	0,7 %
Textiles	359	2,5 %	709	4,7 %
Other industry	466	3,3 %	634	4,2 %
Engineering	4 224	29,6 %	1 226	8,1 %
Warehouses	324	2,3 %	1 150	7,6 %
Retail	355	2,5 %	3 249	21,4 %
Public buildings	128	0,9 %	526	3,5 %
Offices	478	3,3 %	2 801	18,5 %
Hotels	119	0,8 %	659	4,3 %
District	291	2,0 %	400	2,6 %
Health	756	5,3 %	2 468	16,3 %
Education	54	0,4 %	50	0,3 %
	14 285	100 %	15 168	100 %

The following table shows the distribution of CHP systems in the UK in 1999 and the distribution of applications for good quality CHP certification:

	1999 UK CHP statistics				6 March 2001 CHPQA applications			
	Capacity		Sites		Capacity		Sites	
	MWe	%	No	%	MWe	%	No	%
Chemicals	1,180	28 %	52	4 %	1,301	38 %	38	6 %
Food	392	9 %	44	3 %	382	11 %	35	5 %
Paper	471	11 %	31	2 %	537	16 %	31	5 %
Textiles	2	0 %	3	0 %	—	0 %	0	0 %
Other industry	1,583	37 %	215	16 %	916	27 %	68	10 %
Engineering	302	7 %	16	1 %	71	2 %	3	0 %
Warehouses	—	0 %	0	0 %	—	0 %	0	0 %
Retail	6	0 %	6	0 %	14	0 %	1	0 %
Public buildings	68	2 %	350	27 %	31	1 %	181	27 %
Offices	16	0 %	40	3 %	66	2 %	23	3 %
Hotels	28	1 %	260	20 %	19	1 %	144	22 %
District heating	68	2 %	47	4 %	26	1 %	17	3 %
Health	99	2 %	204	16 %	64	2 %	111	17 %
Education	24	1 %	45	3 %	24	1 %	17	3 %
	4,239	100 %	1 313	100 %	3,451	100 %	669	100 %

The UK informed the Commission that the range of CHP applications is continuing to increase as new technology is commercialised. The electrical capacity of CHP schemes currently available ranges from 15 kWe to over 200 MWe, sized to meet the energy requirements of a very wide range of organisations. Schemes over 1 MWe are mainly found on larger industry sites, large commercial buildings, hospitals and district heating schemes, etc. These schemes are normally custom built, tailored to the energy needs of the host(s).

Schemes under 1 MWe are found in smaller industrial sites, commercial and public buildings, hotels, leisure centres, blocks

of flats and residential homes etc. These schemes are manufactured as a package with standard equipment and control systems installed within an enclosure. Standard packaged units are available in the following electrical outputs: 15, 30, 38, 54, 60, 75, 95, 110, 145, 185, 206, 220, 300, 400, 600 and 800 kWe. There are 34 CHP schemes below 1 MWe on smaller industrial sites, with an average capacity 400 kWe.

There is no minimum size for CHP systems in order to be eligible as good quality CHP and the development of the use of small-scale CHP shows that the exemption will also be of interest for SMEs.

Thus all companies throughout a wide range of sectors of the economy are beneficiaries, independent of their size, location or economic activity. The criteria for defining 'good quality' CHP are objective and not designed in a way that would limit the benefit of the exemption to specific sectors. The majority of existing CHP systems already fulfil the standard. Stations not yet fulfilling the standard can upgrade to fulfil the criteria at least for a considerable portion of their production.

(b) *Is 'good quality CHP electricity' a specific product?*

The product 'good quality CHP electricity' can be produced by a large number of companies in various sectors. In most of these sectors, CHP is not used to produce electricity as a core product of the business, but the technology is used to produce the different products of the companies more efficiently, by increasing the energy efficiency of the production process. Insofar, in the case of most of the good quality CHP operators, 'good quality CHP electricity' is not a specific product.

This may be different for a certain type of CHP system operators, namely power stations, using CHP technology for producing electricity to feed into the grid⁽²⁰⁾. For such companies, the production of electricity is their core business, and the electricity produced is in direct competition with the same product from conventional electricity producers. However, electricity from CHP systems is not exempt, if it is sold via the grid. The exemption includes only good quality CHP electricity used on site. With respect to this electricity, CHP power stations are in the same situation as any other autogenerator in any other sector of the economy which produces good quality CHP for use on site.

Therefore, it can be concluded that the exemption for good quality CHP electricity used on site is not selective.

II. Known end-users do not pay levy on electricity they purchase from a good quality CHP for their own use

Known end-users are users, whose main business is not the production of heat or power. They could produce heat and power for use on their own site, but outsource this production (because it is not their core business) to a separate entity delivering mainly to a group of known end-users (closed system). Known end-users are not 'formally' producing their own power, but practically they are in the same situation as an autogenerator, who produces power for use on site. It should also be noted that such 'closed systems' are comparable to a 'use on site situation' as regards the energy efficiency of electricity transfer compared with electricity transfer via the grid.

⁽²⁰⁾ In its decision on a temporary tax exemption for certain combined cycle power plants in the context of the continuation of the ecological tax reform in Germany (SG(2000) D109283 of 14.12.2000), the Commission argued that 'the relevant gas and steam turbine plants are being used quite predominantly to generate electricity for feeding into the grid. The technology (CHPs excluding heat extraction) is not one which can be used virtually indiscriminately in all sorts of firms in all branches of industry. Since it can accordingly be assumed that the effects of the tax exemption will be felt, if not exclusively, then at least quite predominantly in a certain sector, the measure favours certain undertakings or the production of certain goods within the meaning of Article 87(1)'. In fact there were only very few stations using this type of technology in Germany.

The Commission considers that the same arguments apply as under point 1 (use of CHP as technology available throughout the sectors) and that the measure is not selective.

(2) Consumption of a taxable commodity for heat production (without producing electricity from it first) by a good quality CHP

Conventional production of heat:

Fuel <u>input</u> taxed	Conventional production of heat or steam (= boiler)
	<u>Heat output</u> not taxed (not a taxable commodity)

Good quality CHP:

Fuel <u>input</u> not taxed	CHP system
	<u>Heat output</u> not taxed (not a taxable commodity)

Operators of good quality CHP do not pay a levy on input fuels to produce heat. This favours them in comparison with the conventional production of heat, where the input fuel is taxed. Again, the measure does not favour certain undertakings, as CHP is a technology available in a wide range of sectors.

The Commission therefore concludes that the exemption on CHP does not constitute State aid according to Article 87(1) of the EC Treaty.

3. Exemption for electricity generated from some energy sources

Firms purchasing electricity generated from some energy sources as defined in the description are fully exempt from the levy on the electricity. This relieves them of charges that are normally borne from their budgets and gives the recipient firms an advantage over other firms. The advantage is granted through state resources as the State suffers a loss of tax revenues. The recipients exercise an economic activity on markets on which there is or could be trade between Member States or on which firms from other Member States might wish to establish themselves. The scheme thereby distorts or threatens to distort competition and could affect trade between Member States. However, any company in any sector of the economy is able to purchase electricity from these sources. Thus, the tax exemption does not favour certain undertakings or the production of certain goods and is therefore not selective.

But it has to be also considered that the exemption will favour at the same time the generators of electricity from these sources feeding the electricity into the grid. It thus favours this type of electricity producer compared with producer of conventional and CHP electricity. In this respect, the exemption is selective.

However, the preliminary objective of the tax is an environmental one, namely the reduction of CO₂. The levy is introduced to penalise the use of energies producing long-cycle CO₂, as these emissions are responsible for climate change.

A tax aiming at reducing CO₂ could have been structured in a way so that it reflects the *carbon content* of different fuels. However, there are good reasons to base the calculation of the levy rates on the energy content of different fuels: Firstly, targeting emissions via the energy content of fuels is an appropriate way to reduce them as this approach increases the energy efficiency of fuel use⁽²¹⁾. Secondly, given the current structure of the electricity and distribution industries, it is only possible to determine the carbon content of electricity as a broad average. On that basis, the additional fuel switching that would be induced by such an approach is likely to be limited. Thirdly, structuring the levy with regard to the *energy content* of different fuels has the advantage of simplicity.

None of the sources of energy listed in the notification contributes negatively to long-cycle CO₂ emissions. They hence are not fuels for which a penalisation in form of the levy is intended.

However, the exemption is not extended to all energy sources which do not contribute negatively to long-cycle CO₂ emissions and in particular does not apply to nuclear power and to hydro power of more than 10 MW. This choice is justified for the following reasons: While nuclear power does not contribute to CO₂ emissions, it has a number of other effects which are not desirable from an environmental point of view. With regard to large hydro power, it should be considered that the CCL scheme is targeting environmentally friendly energy sources with significant development potential. As the potential of large hydro plants has already been largely developed, it does not fall into the target group of the scheme. The Commission also notes that its proposal on a directive on the promotion of electricity from renewable sources also includes only hydroelectric installations below 10 MW⁽²²⁾.

The Commission therefore considers that as none of the exempted energy sources contributes to long-cycle CO₂ emissions, which is fully in line with the objective of the levy, the exemption for electricity from the energy sources notified by the UK Government is justified by the nature or general scheme of the tax system. The Commission considers that the exemption therefore does not constitute State aid within the meaning of Article 87(1) of the EC Treaty and Article 61(1) of the EEA Agreement.

However, even if the exemption would constitute State aid, it could be declared compatible with Article 87(3) of the EC Treaty.

4. Tax reduction for companies entering into climate change agreements

Firms entering into climate change agreements are exempted for 80 % of the levy. This relieves them of charges that are normally borne from their budgets and gives the recipient firms an advantage over other firms. The advantage is granted through State resources as the State suffers a loss of tax revenues. The recipients exercise an economic activity on markets on which there is or could be trade between Member States or on which firms from other Member States might wish to establish themselves. The scheme thereby distorts or

threatens to distort competition and could affect trade between Member States. Only companies fulfilling specific criteria can enter into climate change agreements. Thus, the tax exemption favours certain undertakings or the production of certain goods and is therefore selective.

It is not a measure which would be in the nature of the tax law.

The levy reduction for companies entering into climate change agreements therefore constitutes State aid under Article 87(1) of the EC Treaty.

5. Exemption for dual-use fuels

The United Kingdom's position is that the dual-use exemption is a general measure that does not constitute State aid. They claim that the CCL is a tax imposed on the use of energy products used *as fuel* and that the exemption is in line with Council Directive 92/81/EEC of 19 October 1992 on the harmonisation of the structures of excise duties on mineral oils⁽²³⁾ ('the Mineral Oils Directive') as well as the Proposal for a Council Directive restructuring the Community framework for the taxation of energy products⁽²⁴⁾ ('the proposal'), in so far as only the use of energy products for motor and heating purposes falls within its scope.

According to the United Kingdom authorities, the purpose of the extension of this exemption to mixed uses is to provide certainty and clarity for the taxpayer, who is the fuel supplier, as to whether or not, on the basis of scientific advice, any use of a commodity by the customer is exempt from the levy. The United Kingdom authorities do not consider it to be technically feasible to objectively apportion with sufficient accuracy the fuel and non-fuel uses of energy products within certain processes.

The Commission considers that the exemption gives the benefiting companies an advantage, which is financed through State resources. In assessing whether this exemption is a general measure, as the United Kingdom authorities claim, or whether it constitutes State aid, the Commission considers it necessary to assess whether the effects would favour certain undertakings or the production of certain goods. The Commission notes that, according to the information provided by the United Kingdom authorities, the exemption will favour the production of certain goods, namely some metals (including aluminium, iron, lead, copper and coke) as well as batteries and some chemicals. The Commission therefore has doubts that the exemption can be considered as a general measure.

The Commission notes that it falls to be assessed whether the exemption can be justified on the basis of the nature and logic of the tax system. The Commission notes the claim made by the United Kingdom authorities that the imposition of the levy solely on energy used for fuel is consistent with the provisions of the Mineral Oils Directive and the Proposal for a Council Directive restructuring the Community framework for the taxation of energy products.

⁽²¹⁾ The approach of taxing harmful emissions approximately via the energy content of fuel is, for example, also used for car emissions.

⁽²²⁾ COM(2000) 279 final.

⁽²³⁾ OJ L 316, 31.10.1992, p. 12.

⁽²⁴⁾ OJ C 139, 6.5.1997, p. 14.

The Commission notes that the climate change levy is a tax on the non-domestic use of energy, which broadly covers use as heating fuel, lighting or for motive power. The levy will not apply to fuels used for other than these purposes. Such a definition of the scope of an energy tax, whereby not all uses of fuels are taxed, may be in the logic of a system such as that established in the Mineral Oils Directive and in the Proposal for a Council Directive restructuring the Community framework for the taxation of energy products.

However, the proposed exemption for dual-use fuels goes beyond such a definition of the scope of the levy.

Firstly, the exemption may not treat comparable situations equally, in so far as some dual-use processes are exempt from the levy, while other processes, which may also fall to be considered as dual-use, are not exempted.

Secondly, the UK exempts fuels entirely from the levy, even if they are only partially used for non-energy purposes as defined above.

1. The Commission notes that the Proposal for a Council Directive restructuring the Community framework for the taxation of energy products is not in force and cannot be automatically relied upon as a reference point to establish the logic and general nature of the tax system. However, it may provide some indication of whether the dual-use provision can be considered as a general measure, although Article 13(1) refers to fuels used *principally* for the purposes of chemical reduction. The Commission has doubts, however, that the exemption is fully consistent with the proposal, as it does not extend to energy used in all *metallurgical* processes, as would be required under Article 13(1)(a) of the proposal. The Commission notes that according to the United Kingdom authorities, a metallurgical process is a process which results in the production of metal, for example, from ore. The Commission has doubts that this interpretation is consistent with the notion of metallurgical process in the proposal. In order to be consistent with the proposal, it appears that energy used in all metallurgical processes, namely in any metal production process, would be exempt from the levy.
2. The Commission further notes the United Kingdom's claim that it is not possible to apportion the fuel/non-fuel use amounts of energy products in certain processes with accuracy; and that for reasons of clarity and certainty, a full exemption from the levy is necessary for mixed uses. The Commission has doubts, however, that the United Kingdom authorities cannot establish a mechanism whereby an estimation of fuel/non-fuel uses for certain processes can be made and levy imposed accordingly.

The Commission further notes that, if the energy part in the dual-use were to be fully exempted, the result may be not in line with the objective of the levy to reduce CO₂.

For the reasons given above, the Commission has doubts that the exemption for energy products used for purposes other than as fuel can be considered as a general measure and not as State aid.

II. LEGALITY OF THE AID

By notifying its intention to introduce the tax scheme, the UK has complied with its obligation under Article 88(3) of the EC

Treaty to inform the Commission, in sufficient time to enable the latter to submit its comments, of any plans to grant or alter aid.

III. COMPATIBILITY OF THE AID

The aid's compatibility with the common market under Article 87(3)(c) of the EC Treaty has been assessed on the basis of the Community guidelines on State aid for environmental protection (OJ C 37, 3.2.2001, p. 3).

1. Exemption for transport

According to Article 87(3)(c) of the Treaty, aid may be considered compatible with the common market if the aid will facilitate the development of certain economic activities or certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest.

As described above, the UK has adopted a substantial transport plan, the aim of which is to improve the UK transport system by way of reducing road congestion and pollution and providing better and more reliable public transport. One key target of this plan is to increase the use of rail and to create a sustainable mobility. However, to meet the plan's target, substantial investments in rail infrastructure and rolling stock will be necessary. The UK Government has estimated that in addition to these investments, the cost of the climate change levy could add approximately GBP 15 million per year to rail operators' costs.

The Commission has for some time pursued a policy of achieving a sustainable mobility through a balanced intermodal transport system and a central aim of the Common Transport Policy is the promotion of a modal shift from road to other more environmentally friendly modes of transport.

For instance, the Commission communication on the future development of the common transport policy⁽²⁵⁾ proposes a Community framework for sustainable mobility which Member States, together with the Community, have to implement by measures ensuring that the development of transport system lead to a 'sustainable pattern of development by respecting environment and, in particular, by contributing to the solution of major environmental problems, such as the limitation of CO₂'. The communication also makes it clear that state aid does have a role to play, not only in modifying the cost relationship of modes, but also in rendering certain modes more competitive⁽²⁶⁾.

Moreover, a sustainable public transport system is liable to contribute to economic development and employment as it helps to clean up the environment by using less energy, making less noise and producing fewer pollutants. It also reduces social exclusion by allowing people without the use of a car to gain access to jobs, schools, shops, medical facilities, etc.⁽²⁷⁾.

⁽²⁵⁾ Commission Communication COM(92) 494 final, 2 December 1992, 'The future development of the common transport policy'.

⁽²⁶⁾ See Commission Decision of 21 April 1999, Case N 588/98 (Environmental subsidy for the transport of goods by rail) (OJ C 166, 12.6.1999, p. 6).

⁽²⁷⁾ See Commission Communication COM(1998) 431 final of 10 July 1998, 'Developing the citizen's network'.

The Commission considers, that, although the levy is introduced for long-term environmental reasons, it could in the short or medium term jeopardise or hamper the overall UK transport strategy to promote rail as a mode of transport and to attain a sustainable and environmentally friendly transport system, a goal that is shared by the Community as a whole.

It is however also true that, in view of the climate change levy, the beneficiaries of the tax exemption will be relieved of expenditure that they normally would have to bear and which hence gives them a competitive advantage. However, the Commission also notes that the beneficiaries' main competitors, operators providing road transport service, will not be subject to the new levy. Therefore, the de facto effect of the aid will only be that the competitive situation between the beneficiaries and their main competitors will be maintained at the same level as it was before the levy was introduced.

The Commission notes that without the tax exemption, the beneficiaries are likely to suffer a loss of competitiveness since their main competitors — undertakings providing road transport services — will not be subject to the climate change levy. It is thus considered that the aid under scrutiny is likely to facilitate the development of a sustainable public transport and rail freight. As described above, the development of these sectors is in line with the policy pursued by the Community as a whole and is thus in the common interest. Furthermore, as the de facto result of the aid will only be that the competitive situation between the beneficiaries and their main competitors will be maintained at the same level as it was before the levy was introduced, the Commission finds — on balance — that the aid will not affect trading conditions to an extent contrary to the common interest.

In addition, according to Article 73 of the Treaty, aid shall be compatible with the Treaty if it meets the needs of coordination of transport. Article 3(1)(b) of Council Regulation (EEC) No 1107/70, which implements Article 73 of the Treaty, allows that, until the entry into force of common rules on the allocation of infrastructure costs, aid may be granted to undertakings that have to bear expenditure relating to the infrastructure used by them, while other undertakings are not subject to a like burden.

Different modes of transport impose different levels of external costs, which, in the absence of harmonised rules on infrastructure charging, are not adequately reflected in the price that users pay for the use of a particular infrastructure. This situation is further liable to distort competition between different transport modes with a negative environmental impact. It is, in particular noted that users of rail infrastructure do not fully benefit from the relatively low external costs they impose on society as compared with other modes with relatively higher external costs⁽²⁸⁾. The Commission considers, under such circumstances, that users of rail infrastructure are operating under conditions that need to be coordinated within the meaning of Article 73 of the Treaty, read in conjunction with Article 3(1)(b) of Regulation (EEC) No 1107/70⁽²⁹⁾.

⁽²⁸⁾ Commission White Paper COM(1998) 466 final, 'Fair payment for infrastructure use: A phased approach to a common transport infrastructure charging framework in the EU'.

⁽²⁹⁾ See Commission Decision ... N 47/1999.

The Commission accordingly holds also the exemption provided for in Article 3(1)(b) of Regulation (EEC) No 1107/70 to be relevant for the tax exemption in question, in so far as the UK climate change levy for electricity, gas and coal used for rail freight and public transport may entail additional costs connected to the use of railway and light railway infrastructure as compared with, in particular, road transport.

In view of the foregoing considerations, the Commission concludes that the notified tax exemption for public transport and rail freight shall be deemed compatible with the common market.

2. Exemption for electricity generated from some energy sources

Even if, contrary to the assumption made above, the exemption for electricity generated from the sources notified by the UK Government is not justified by the nature or general scheme of the levy system, and therefore constitutes State aid, the Commission considers that such aid must be deemed compatible with the common market in accordance with Article 87(3)(c) of the EC Treaty.

By virtue of point 51(1)(a), second indent, of the environmental aid guidelines, when, for environmental reasons, a Member State introduces a new tax in a sector of activity or on production in respect of which no Community tax harmonisation has been carried out, exemption decisions covering a 10-year period may be justified where a Member State makes a tax reduction subject to conditions that have the same effect as agreements relating, among other things, to reduction in emissions.

The climate change levy is a new tax introduced in a sector which is not yet covered by Community tax harmonisation. As stated above, the UK authorities have undertaken to renotify or amend the relevant legislation after an initial period of 10 years. The tax exemption is only granted for electricity produced from the notified sources which do not contribute negatively to long-cycle CO₂ emissions. Therefore, in the present case, the exemption is subject to the condition that emissions are indeed avoided. The result of this exemption is thus actually better than what can possibly be achieved under a CCL agreement. The fact that the levy is charged on electricity produced from other sources which do not contribute to long-cycle CO₂ emissions is not relevant in this context, since the Member State may decide, for justified reasons linked i.a. to its environmental or energy policy, to reserve such a benefit to a particular category of energy sources.

For these reasons, the conditions set out in the environmental aid guidelines are fully met and, if the exemption in favour of electricity generated from the notified sources constitutes State aid, it must be considered compatible with the common market.

3. Tax reduction for companies entering into climate change agreements

The climate change levy is a new environmental tax on products in respect of which no Community tax harmonisation has been carried out.

Although companies will have to make investments in order to achieve the targets of the agreements, the tax reduction is not directly linked to and expressed as a percentage of eligible investment costs. The tax reduction thus constitutes operating aid.

The UK introduces these tax reduction in order not to endanger the competitiveness of energy-intensive industrial sectors, for which the full rate of the levy would be a high increase of their costs and for which the levy is a competitive disadvantage in particular as there is not tax harmonisation on energy consumption at the Community level.

Points 47 and 48 of the environmental aid guidelines consider that when adopting taxes that are to be levied on certain activities for reasons of environmental protection, Member States may deem it necessary to make provision for temporary exemptions for certain firms notably because of the absence of harmonisation at European level or because of the temporary risks of a loss of international competitiveness.

If the tax is to be levied as the result of an autonomous decision on the part of a Member State, the firms affected may have some difficulty in adapting rapidly to the new tax burden. In such circumstances there may be justification for a temporary exemption enabling certain firms to adapt to the new situation.

In general, tax measures in question should make a significant contribution to protecting the environment. Care should be taken to ensure that the exemptions do not, by their very nature, undermine the general objective pursued (point 50 of the environmental aid guidelines).

The climate change levy taxes the energy consumption. By increasing the costs for energy, it will contribute to a more efficient use of energy, and thereby to the reduction of CO₂ emissions and will thus make an important contribution to environmental protection. The tax reduction are conditional on climate change agreements. These agreements establish emission reduction targets or energy efficiency targets, which will contribute to the same objective as the tax itself. They thus do not undermine the general objective of the tax pursued.

In this situation, tax exemptions may be justified for a 10-year period with no degressivity if the Member State concerned and the recipient firms or associations of firms undertake to achieve environmental protection objectives during the period for which the exemptions apply.

Such agreements may relate, among other things, to a reduction in energy consumption or a reduction in emissions (point 51(1)(a) of the environmental aid guidelines). The tax reductions are conditional on the associations of firms or companies entering into climate change agreements, which pursue the objectives required by the guidelines.

Point 51(1)(a) of the environmental aid guidelines allows such agreements to be concluded not only at the level of individual firms, but also at the level of associations of firms. The climate change agreements are firstly concluded at the level of associations, with underlying agreements setting targets for individual companies. As long as the sector target is

achieved, underperforming companies within the same sector may also benefit from the levy reduction. However, any free-rider-benefit is most likely to be limited by sector discipline exercised internally in the associations. In any case, underperforming companies run the risk that the sector target will not be met, in which case only the underperforming companies of the sector will have to pay the levy.

The Commission assessed these agreements for the sectors concerned by this notification as required in point 51(1)(a) of the guidelines and concludes on the basis of the targets as they are set out in draft form, that they contribute considerably to increased energy efficiency and directly or indirectly to CO₂ reductions. This positive assessment is based on the most recent available information described above and on the appraisal of the UK authorities that these targets would not be lowered in the final phase of the negotiations. The Commission therefore reminds the UK authorities that in case the environmental benefit of the final targets would be lower than of the envisaged targets, the tax reduction for these agreements would not be covered by the present Commission decision.

For some sectors, the UK authorities were not yet in a position to provide even provisional information on targets. The Commission is therefore not in a position to assess the value of these agreements and cannot express an opinion on them. These agreements are therefore not covered by this decision.

The loss of levy reduction for the future while the company has at the same time to catch up on the targets is an efficient mechanism to keep companies in the agreement and to lead to the fulfillment of the targets. Together with the recuperation mechanism proportional to non-achieved targets at the end of the agreement period is a penalty mechanism which fulfils the requirements of the environmental aid guidelines.

The scheme allows carbon emission trading among entities committed to a climate change agreement. This will allow overperforming entities to sell carbon emission certificates to underperforming companies in order for them to meet their targets.

This may be seen as an allocation of a limited number of transferable emission permits to overperforming companies. The State thus provides them with an intangible asset, which can be sold on a market to be created. It can be assumed that the permits will actually have a value to an extent, as the underperforming companies would either have to invest themselves or would otherwise lose the levy reduction.

Having regard to these circumstances, to the fact the permits are allocated for free, and in line with points 69 to 71 of the Community guidelines on State aid for environmental protection, the Commission cannot exclude that the arrangements constitute aid granted by a Member State or through State resources in any form whatsoever.

Theoretically, a company able to sell its permits at a certain price may use the resulting cash-flow to improve its competitive position in the UK or in other Member States.

It cannot be excluded that there is a potential distortion of competition between companies covered under climate change agreements and other companies in other Member States. There may also be a potential effect on trade between Member States. In view of all this, the Commission cannot exclude that the possibility for carbon emission trading may constitute State aid in the meaning of Article 87(1).

According to point 71 of the abovementioned guidelines, the Commission has a large margin of discretion in order to assess emission trading systems. In the present case, the Commission considers any aid from this arrangement to be compatible with Article 87(3)(c) of the EC Treaty for the following reasons:

- trading is limited to entities committed to climate change agreements,
- trading is only allowed for verified surplus carbon,
- trading allows to achieve the targets in a cost-effective way and put sectors in a position to offer ambitious targets,
- the value of the permits will be limited by the alternatives open to the companies in the climate change agreements, thus, the potential distortion of competition must be considered to be limited,
- companies will have to invest beyond the investments needed to fulfil their own targets in order to obtain permits. Thus, there will be an effective and concrete counterpart from the benefiting companies.

A wider emission trading scheme, in which later on emission trading should also be possible with CCL companies, is going to be notified to the Commission soon.

In assessing the general terms of the agreements, the Commission did not find any element which, by itself, could cause participating undertakings or sector associations to restrict competition through emission trading in a way contrary to Articles 81 or 82. The UK undertook that it will keep under review the behaviour of participants in trading activity and note that competition rules apply to that behaviour.

4. Exemption for dual-use fuels

Assuming that the exemption for dual-use fuels constitutes State aid, the Commission has doubts on its compatibility with the environmental aid guidelines:

1. The provision exempts energy consumption for some processes causing considerable CO₂ emissions and thus may run counter to the objective of the tax to reduce CO₂ emissions.
2. The exemption is not temporary, and not granted with a view of enabling companies to adapt to the new tax (point 48 of the environmental aid guidelines).
3. The exemption is not made conditional on the conclusion of agreements in order to achieve environmental protection objectives, nor is the tax subject to conditions that have the same effect as agreements (point 51(1)(a) of the environmental aid guidelines).
4. The UK has not demonstrated that firms eligible for the exemption must nevertheless pay a significant proportion of the national tax (point 51(1)(b) of the environmental aid guidelines).

CONCLUSION

- The Commission therefore concludes that the levy reduction for companies covered by climate change agreements is compatible with the requirements of the environmental aid guidelines and Article 87(3)(c) of the EC Treaty,
- the Commission concludes that the tax exemption for public transport and rail freight is compatible with Article 87(3)(c) of the EC Treaty,
- in the light of the foregoing considerations, the Commission, acting under the procedure laid down in Article 88(2) of the EC Treaty, requests the United Kingdom to submit its comments and to provide all such information as may help to assess the **exemption on dual-use fuels**, within one month of the date of receipt of this letter. It requests your authorities to forward a copy of this letter to the potential recipient of the aid immediately.

The Commission wishes to remind the United Kingdom that Article 88(3) of the EC Treaty has suspensory effect, and would draw your attention to Article 14 of Council Regulation (EC) No 659/1999, which provides that all unlawful aid may be recovered from the recipient.”