II

(Acts whose publication is not obligatory)

COMMISSION

COMMISSION DECISION

of 17 September 2003

on the exemption from the Climate Change Levy which the United Kingdom is planning to implement in respect of coalmine methane

(notified under document number C(2003) 3242)

(Only the English text is authentic)

(Text with EEA relevance)

(2004/50/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community, and in particular the first subparagraph of Article 88(2) thereof,

Having regard to the Agreement on the European Economic Area, and in particular Article 62(1)(a) thereof,

Having regard to Council Regulation (EC) No 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 of the EC Treaty [1], and in particular Article 7 thereof,

Having called on interested parties to submit their comments pursuant to those provisions [2] and having regard to their comments,

Whereas:

I. PROCEDURE

(1) By letter dated 5 December 2002, the United Kingdom notified the Commission of its intention to grant an exemption from the Climate Change Levy (CCL) charged to suppliers in respect of electricity produced from coalmine methane (CM) from abandoned coalmines.

(2) By letter dated 5 February 2003, the Commission informed the United Kingdom that it had decided to initiate the procedure laid down in Article 88(2) of the EC Treaty in respect of the proposed exemption.

(3) The Commission decision to initiate the procedure was published in the *Official Journal of the European Union* [3]. The Commission called on interested parties to submit their comments.

(4) The Commission has received comments from interested parties. It has forwarded them to the United Kingdom, which was given the opportunity to react. In the light of the comments from interested parties, the Commission requested additional information by letter dated 26 May 2003. A meeting with the United Kingdom authorities was held on 11 June 2003. The United Kingdom's comments on the comments of interested parties and the information requested by the Commission were received by letter dated 10 July 2003.

II. DETAILED DESCRIPTION OF THE AID

(5) The scheme will exempt from the Climate Change Levy (CCL) supplies of electricity generated from coalmine methane (CM) from abandoned coalmines.

(6) The basic legislation for the CCL is contained in Schedule 6 to the Finance Act 2000. Section 126 of the Finance Act 2002 amends Schedule 6 to the Finance Act 2000 by inserting a new subparagraph (4A) after subparagraph (4) of paragraph 19 of that Schedule. The scheme will take effect from a day to be appointed by Treasury Order. The relevant secondary legislation (Regulations 46 to 51 of the CCL (General) Regulations 2001 — SI 2001/838) will include CM within their scope.

(7) CM is a potent greenhouse gas, currently venting into the atmosphere. At present, there are four CM extraction sites being used for electricity generation with a total generating capacity of 35MW.

[1] OJ L 83, 27.3.1999, p. 1.
[2] OJ C 69, 22.3.2003, p. 9.
[3] See footnote 2.

(8) The aim of the scheme is to incentivise the industry to develop further installations at about 40 further sites of abandoned coalmines, with around 175MW added capacity. Because of the uncertainty as to the exact level of environmental benefit from the scheme, the Government intends to hold a review of the exemption in 2004/5. However, the scheme was originally notified for a duration of 10 years.

(9) The minimum value of the exemption in its first year of operation will be around GBP 1 million. If the uptake of electricity generation plants fuelled by CM occurs as planned, revenue foregone will rise to GBP 6,3 million per annum.

(10) The aid operates by giving a tax exemption equal to a flat rate of GBP 4,30 per MWh of electricity generated from CM. The United Kingdom authorities assumed at the time of notification that, as the estimated 40 plants incentivised by the exemption will not be all uneconomical up to point of the full support level, the measure will involve some dead-weight loss.

(11) The scheme will directly benefit the generators/suppliers of electricity derived from CM, but the tax exemption is likely to be shared with the company which extracts the gas. There are three companies which currently extract CM to sell to electricity generators in the United Kingdom. These are Alkane Energy, StrataGas and Octagon Energy. The electricity generators working with them are Clarke Energy, Scottish and Southern Energy and Warwick Energy.

Grounds for initiating the procedure

(12) Contrary to the United Kingdom, the Commission did not consider the selective advantage granted by the measure to be justified by the logic and nature of the tax system itself. The Commission considered that tax to be due because of the harmful effect of the use of energy on climate change. It is therefore in the nature of the tax to exempt the use of energy, the production of which has no harmful effect. This is the case, for example, for electricity from renewable sources, as these sources do not contribute to long-cycle CO_2 [4]. Like electricity production from other fossil sources, electricity production from CM has harmful effects and is therefore of a different nature from electricity from renewable sources. In fact, electricity production from CM is no different in terms of CO_2 emissions than electricity production from natural gas. It would therefore be in the nature and logic of the tax system to tax electricity produced from CM. However, it is true that the use of CM for electricity production avoids the release of CM into the atmosphere as the unused CM is leaking. The Commission was of the opinion that the overall effect on greenhouse gas emissions did not alter the nature of the support in terms of State aid, but should be taken into account when assessing the compatibility of the measure with State aid rules.

(13) The Commission had doubts as to whether the aid, which constituted operating aid, was compatible with the Community guidelines on State aid for environmental protection (hereafter 'the guidelines') [5].

(a) The measure does not comply with point 51.2 of the guidelines as it is a new exemption from an existing tax and the United Kingdom authorities did not demonstrate a significant change in economic conditions that could justify such an exemption. Thus points 51.1(a) or (b) of the guidelines allowing for ten year tax exemptions are not applicable.

(b) CM and electricity production from CM are not renewable energy sources within the meaning of the environmental guidelines and Directive 2001/77/EC of the European Parliament and of the Council of 27 September 2001 on the promotion of electricity produced from renewable energy sources in the internal electricity market [6]. In any case, the United Kingdom did not claim that the measure was compatible with the relevant provisions in section E.3.3 of the guidelines related to renewable energy sources.

(c) Under point 51.3 of the guidelines Member States may also encourage the development of processes for producing electric power from conventional energy sources such as gas that have an energy efficiency very much higher than the energy efficiency obtained with conventional production processes. In such cases, given the importance of such techniques for environmental protection and provided that the primary energy used reduces significantly the negative effects in terms of environmental protection, a total exemption from taxes may be justified for a period of five years where aid is non-degressive. The Commission doubted that that provision was applicable in this and in any case, the notified duration of 10 years exceeds the duration of five years permitted under point 51.3 of the guidelines. The conditions of point 51.1, which could allow a ten year duration under point 51.3, did not seem to be met.

[4] See Commission Decision of 28 March 2001 relating to State aid C 18/2001 — United Kingdom, Climate Change Levy, (OJ C 185, 30.6.2001, p. 22), and in particular p. 35 and 36 on the exemption for electricity from some energy sources.

[5] OJ C 37, 3.2.2001, p. 3.

[6] OJ L 283, 27.10.2001, p. 33.

(d) The provisions relating to waste management and energy saving (points 42 to 46 of the guidelines) also seemed not to be fulfilled. The aid is not degressive, it is not strictly limited to compensating for extra production costs by comparison with the market prices of the relevant product or service, and the aid is not limited to five years. Furthermore it is questionable whether the measure can be considered as aiming at managing waste or saving energy.

(e) The United Kingdom claimed that Section F of the guidelines 'Policies, Measures and Instruments for Reducing Greenhouse Gases' should apply. That section applies to State aid potentially involved in common and coordinated policies and measures, including economic instruments, and also by means of the instruments established by the Kyoto Protocol itself, namely international emissions trading, joint implementation and the clean development mechanism. The Commission doubted that that section was applicable in this case.

(f) Council Regulation (EC) No 1407/2002 of 23 July 2002 on State aid to the coal industry [7] did not seem applicable.

(g) Finally, no other legal text based on Article 87(2) or (3) appeared to be relevant.

(14) However, climate protection is a Community objective. The Commission recognised the environmental benefit for climate protection that could result from the measure, even if support for such a measure had not been envisaged by the environmental aid guidelines. However, the Commission was concerned that the design of the measure might lead to overcompensation.

(15) The quantity of electricity which could be produced from CM in the United Kingdom is not negligible. The Commission considered the potential for electricity generation from CM not only in the United Kingdom but also in other Member States. The Commission was also aware that Member States at that stage were discussing the possibility for a facultative exemption from energy taxation of electricity produced from CM in the context of the draft directive for the taxation of energy products [8]. For these reasons, the Commission wanted to give third parties the possibility to comment on the measure.

III. COMMENTS FROM INTERESTED PARTIES

(16) On 23 April 2003, the Commission received a letter dated 16 April 2003 containing comments from the Association of Coal Mine Methane Operators (ACMMO) which can be summarised as follows:

(a) ACMMO compares the situation of new investments for greenhouse gas capture in the United Kingdom with the German market, where CM is legally a 'renewable' source of electricity and benefits from the guaranteed feed-in prices under the ' Erneuerbare-Energien-Gesetz' (law for the promotion of renewable energy). While in Germany generators get GBP 46,00 per MWh, in the United Kingdom the price is GBP 17 per MWh. The United Kingdom CCL exemption would help to improve the economics of the sector and protect existing plants. In view of the economic situation in the United Kingdom it is unlikely that dead weight loss will occur. Considering the large fall in wholesale electricity prices from GPB 25 per MWh in 1998 to currently GBP17 per MWh, ACCMO even doubts that the scheme as an isolated measure will be sufficient for all the additional capacity being built, as indicated by the United Kingdom authorities.

(b) ACMMO stresses the environmental importance of the scheme. In terms of green house gas reduction, electricity produced from CM is said to be better than all the renewable technologies because it captures and uses methane, which is currently being emitting to the atmosphere from abandoned coalmines. In comparison with wind, for example, it reduces carbon dioxide equivalent emissions nine times more effectively per kWh generated. Generating electricity from captured CM also helps cut carbon dioxide emissions by substituting for fossil natural gas. The measure is targeted to the capture and use of a hazardous waste gas venting to the atmosphere and causing significant environmental damage.

(c) ACMMO expects any benefit obtained from the CCL exemption to be shared out in roughly equal proportions between the CM gas suppliers and the generators using that energy source. The most important effect of the measure is, however, not to subsidise the power generators but to give the gas suppliers an economic benefit improving the rate of return on marginal projects.

IV. COMMENTS FROM THE UNITED KINGDOM

(17) By letter of 10 July 2003, the United Kingdom authorities asked the Commission to consider approval of the notification under Section E.3.1, points 42 to 46 of the environmental aid guidelines (Rules applicable to all operating aid to promote waste management and energy saving).

[7] OJ L 205, 2.8.2002, p. 1.
[8] Fisc 311 Rev 1 ADD of 9.12.2002.

(18) The United Kingdom authorities consider that the extraction of CM gas from abandoned coalmines and its use as fuel for electricity generation comply with the intentions of that Section. They consider that the use of CM for electricity generation represents a more efficient and environmentally responsible usage. The reasons for this are diversion of methane from leakage to the atmosphere to a use with significantly less polluting end products and reduction of fossil fuel usage from natural reservoirs. There are environmental benefits at the level of the extraction of the CM gas in terms of avoided emissions and waste management as in point 42(a), because it mitigates methane leakage to atmosphere, and there are environmental benefits at the level of its use as fuel for electricity generation in terms of energy saving because its use avoids gas extraction from natural gas resources, as in point 42(b) of the guidelines.

(19) The use of CM for electricity production is the only practical one. There is only one other viable usage for CM. Two plants use it as burner tip fuel for certain manufacturing processes, such as ceramic and glass production. However, this use depends upon appropriate local demand for the gas, and is not applicable to most sites. Alternative measures of abatement/use of CM, such as flaring the emitted gas would be completely uneconomic and impractical and therefore do not represent a viable option — the variability that exists in the natural rate of gas flow, caused by atmospheric pressure, can result in flares being extinguished. The gas does not have a sufficiently high calorific value for it to be piped into the United Kingdom's gas grid to be mixed with natural gas.

(20) Under Section E.3.1 of the guidelines, point 46 states that the duration of non-degressive aid should be limited to five years, and its intensity must not exceed 50 % of the extra costs.

(21) The aid would not exceed 50 % of the extra costs. The aid provided by exemption from CCL is 0,43p/kWh. The United Kingdom authorities were advised by ACMMO that the total production costs of electricity can be divided 50/50 between the costs for CM gas and the costs for electricity generation for a typical current plant where the two operations act as separate business entities. Therefore the aid would amount to 0,215p/kWh in respect of the gas extraction and 0,215p/kWh in respect of the electricity production.

(22) The United Kingdom authorities provided detailed cost figures to the Commission. Those figures are different from those the United Kingdom used previously and reflect the current economic scenario. Compared with their situation at the time of notification, potential beneficiaries are now faced with higher financing costs and the amount of viable gas on potential sites is less than expected (so increasing unit costs).

(23) Regarding the CM gas, the latest information suggests that the production costs are 0,89 (existing plant) or 1,07 (in new plants) p/kWh (in terms of chemical energy), equivalent to 26 or 31 p/therm. This compares to the price for the alternative gas for this utilisation which would be natural gas at a price of around 20 p/therm. As the tax rebate is based on the electricity produced from the gas, i.e. half of 0,43 p/kwh = 0,215, it must be adjusted to allow a comparison with the price of natural gas. CM generators operate at 36 % efficiency (40 % expected for new plant), so only 36 % of the rebate (0,08p/kwh chemical energy) can be allocated to each unit of chemical energy. In terms of chemical energy the current market price of natural gas is 0,68 p/kWh. The rebate represents therefore between one and two fifths of the difference between the market price of natural gas (0,68 p/kWh) and the cost of CM gas (0,89 to 1,07 p/kWh). The aid provided is therefore less than 50 % of the extra costs.

(24) Regarding the electricity production from CM, latest information suggests that the production costs are 2,13 (existing) or 2,37 (new) p/kWh excluding the costs of the CM gas, or 4,61 or 5,04p/kWh including the costs of the CM gas. This compares to the typical generation costs (indicative figures) for electricity from new build natural gas of 0,87p/kWh excluding gas costs, or 2,11p/kWh including gas costs. The aid provided is therefore less than 50 % of the extra costs.

(25) As regards timescales, the British Government would accept a revision of the proposed timescale from ten years to five years, and would reserve the right to reapply for State aid approval at the end of the period.

(26) At present there are no CM companies which are subsidiaries of coal companies and the British Government is not aware of any coal companies with plans to develop CM plant. The disused mines themselves are in public ownership.

V. ASSESSMENT OF THE AID

The existence of State aid

(27) The CCL on electricity is charged to suppliers of electricity. The measure exempts electricity from CM from the levy. It is assumed that the whole tax exemption is passed on to the electricity generators using CM as input and to the CM gas suppliers in roughly equal proportions by the suppliers through higher purchase prices ([9]). These generators and the CM gas suppliers, which represent a specific category of undertakings, are therefore granted an advantage. The advantage is granted through State resources as the State suffers a loss of tax revenues. The recipients exercise an economic activity on markets (electricity and natural gas) on which there is trade between Member States. The scheme thereby distorts or threatens to distort competition and could affect trade between Member States.

(28) The selective advantage which the measure grants, is not justified by the logic and nature of the tax system itself. In this respect, the Commission maintains the reasoning in its decision to initiate the procedure as summarised in point 12 of this decision. The Commission notes that by letter of 10 July 2003, the United Kingdom notified the scheme as State aid under the environmental aid guidelines.

(29) In conclusion, the Commission considers that the tax exemption involves State aid to electricity generators using CM and to CM gas suppliers. Such an aid which is not linked to investment is operating aid.

(30) As regards the argument from ACMMO that electricity from CM receives beneficial treatment under the German Erneuerbare-Energien-Gesetz which threatens competition, the Commission notes that following the ruling of the Court of Justice of the European Communities in Case C-379/98 PreussenElektra AG ([10]), the Commission decided that the EEG does not constitute State aid within the meaning of Article 87(1) of the EC Treaty ([11]).

Compatibility of the aid

(31) The Commission assessed the compliance of the State aid with Article 87(3)(c) of the Treaty under the environmental aid guidelines, and in particular Section E.3.1 thereof.

(32) Methane from abandoned coalmines is a waste gas and when venting to the atmosphere a potent greenhouse gas. Methane from abandoned coalmines cannot be avoided or (with some minor exceptions) be viably used anymore, except for electricity production. If unused, the gas will leak to the atmosphere. The Commission therefore considers that the extraction of methane from abandoned coalmines for electricity production is a way of managing waste in a responsible manner and is therefore consistent with the spirit of point 42(a) of the guidelines.

(33) Using CM for electricity production will lead to energy savings. It will contribute to saving other fossil fuel sources from being used for the same purpose. If unused, methane and CO_2 from other electricity production would vent into the atmosphere. By substituting other energy sources, it helps to decrease the total amount of greenhouse gases damaging the atmosphere. As the purpose of energy saving measures is the sustainable use of energy sources and the reduction of greenhouse gases, the measure can be considered to contribute to energy saving in line with point 42(b) of the guidelines ([12]).

(34) Operating aid for waste management and energy saving can be considered compatible with point 46 of the guidelines, if the aid is limited to five years and does not exceed 50 % of the extra costs. By letter of 10 July 2003, the United Kingdom authorities have limited the duration of the scheme to five years and have demonstrated that the aid will not exceed 50 % of the extra costs either at the level of the CMM gas suppliers aor at the level of the electricity generators.

(35) In addition, the Commission notes that Article 15(1)(b) of the Common Position of the Council on the proposal for a Council Directive restructuring the Community framework for the taxation of energy products and electricity ([13])envisages a facultative exemption from electricity taxation for electricity generated from methane emitted by abandoned coal mines.

VI. CONCLUSION

(36) For the reasons set out above, the Commission considers that the measure constitutes State aid within the meaning of Article 87(1) of the EC Treaty. The aid is in line with Article 87(3)(c) of the EC Treaty and the environmental aid guidelines.

([9]) It cannot be excluded that suppliers do not pass on the entire benefit of the exemption and keep a small part of it through their price negotiations with electricity generators using CMM. This is nevertheless supposed to be minimal. In all previous cases concerning exemptions or reductions from eco-taxes on electricity charged to suppliers, the Commission has considered that the real beneficiaries of the aid are the producers of electricity.

([10]) [2001] ECR I-2099.

([11]) NN 27/2000 — Germany, EEG law, OJ C 164, 10.7.2002, p. 5.

([12]) For the same reasoning see Commission Decision on State aid N74/B/2002 — Finland; OJ C 59, 14.3.2003, p. 23, and in particular point 3.2.2 of the decision.

([13]) See footnote 8.

HAS ADOPTED THIS DECISION:

Article 1

The exemption from the Climate Change Levy, instituted by Section 126 of the Finance Act 2002, which the United Kingdom is planning to implement in respect of electricity produced from coalmine methane from abandoned coalmines is compatible with the common market within the meaning of Article 87(3)(c) of the Treaty.

Implementation of the aid is accordingly authorised for a period of five years.

Article 2

This Decision is addressed to the United Kingdom of Great Britain and Northern Ireland.

Done at Brussels, 17 September 2003.

For the Commission

Mario MONTI

Member of the Commission