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FORTUM GROUP'S CONTRIBUTION TO THE EU (EUROPEAN UNION) COMMISSION DRAFT RULES ON THE CLIMATE, ENERGY AND ENVIRONMENTAL STATE AID GUIDELINES ('CEEAG')

The Fortum Group welcomes the objective of reviewing the EU State Aid rules in line with the EU climate neutrality goal. In our comments, jointly prepared by Fortum and Uniper, we have highlighted several core principles (i.e. a meaningful price signal including CO2 price, using public money rather than leveraging costs in the form of levies, using the carbon content as the main basis for an environmental bonus) as essential drivers for the fulfilment of the Green Deal.

The path to meeting the EU's climate goals will require substantial financial investment. We therefore fully endorse the efforts of the European Commission to support public and private investments, especially through the review of the Climate, Energy and Environmental State Aid Guidelines (CEEAG).

Fortum is a European energy company with activities in more than 40 countries. We provide our customers with electricity, gas, heating and cooling as well as smart solutions to improve resource efficiency. Together with our subsidiary Uniper, we are the third largest producer of CO2-free electricity in Europe. With close to 20,000 professionals and a combined balance sheet of approximately EUR 60 billion, we have the scale, competence and resources to grow and to drive the energy transition forward. Fortum's share is listed on Nasdaq Helsinki and Uniper's share on the Frankfurt Stock Exchange (for more information: www.fortum.com)

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Uniper's EU Transparency Register ID: 285977820662-03

Our contribution to the draft rules on the EU Climate, Energy and Environment Guidelines (CEEAG) is included below.

General principles

We welcome the update of the State Aid guidelines. It is important to align State Aid rules with the objectives of the established EU climate neutrality goal and the EU's 'Fit for 55' legislative package. While we support the approach to focus more clearly on the climate impact of State Aid, **widening the scope of the CEEAG** to new technologies and instruments, such as hydrogen and contracts for difference (CfD), is also a positive step.

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In general, we also want to point out that the CEEAG go hand in hand with the **General Block Exemption Regulation (GBER)**, which lays down the conditions under which certain aid measures are declared compatible with the internal market without any need for prior notification to the European Commission. Here, we regret that the revised GBER will not be published before the end of the CEEAG consultation.

We believe that a **functioning market and strong CO2 steering** remain key drivers for implementation of the climate targets, and we need to create the favourable framework conditions to encourage and facilitate investments in new clean technologies and innovations, such as hydrogen, synthetic fuels and CCS/CCU. Public support should be considered to help these new technologies mature and to facilitate their market take-up.

Overall, transparent, clear and smooth guidelines are key to support the implementation of State Aid without creating additional bureaucratic burden.

Investment aid should be preferred over operating aid. However, in new business models where operating expenses represent the majority of the costs, such as hydrogen electrolysis[i], there is a need for operating aid to help this technology mature and become competitive in the longer term. Thus, acknowledging the importance of operating expense (OPEX) support for certain technologies relevant to climate change may be a game changer to achieve the EU's climate targets. As such, clearer statements should be included in the CEEAG to indicate to Member States that providing OPEX support for certain technologies may be in line with State Aid rules.

The **increase of the default aid intensity** to 30% of eligible costs is the correct approach to incentivise new investments. The alternative concept of State Aid based on the **financial gap** may be a tool, but, given the high bureaucratic impact of this tool, it should remain an exceptional instrument. The relationship of the aid intensity vs financial gap approach is not consistent within the draft. In some sections, the financial gap approach is more easily applied than in other sections. Whilst the gap approach may provide for an additional financial tool, **it may be worth considering an increase in the default aid intensity just for certain activities needed to implement the 'Fit for 55' package**, instead of relying on a complex concept of determining the funding gap in exceptional cases. Here, more clarity would be useful.

In general, **Aid cumulation** rules should be applied. However, the provisions on the Aid cumulation limits should not apply in cases where projects receive financing from the EU recovery funding in addition to support from national support schemes.

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Supporting the development of the clean hydrogen economy

(*4.2 Aid for the reduction and removal of greenhouse gas emissions including through support for renewable energy, 4.3 Aid for clean mobility, 4.9 Aid for Energy infrastructure*)

With the 'Green Deal', the EU is committed to implementing an ambitious climate agenda with a view to reaching carbon neutrality by 2050. It is accepted that hydrogen will play a significant role especially in those economic activities where decarbonisation through direct electrification is not possible or is challenging.

Power-to-X is a key technology especially for the decarbonisation of industries, and potentially for transport, heating, and cooling. However, the business solutions currently available are not yet economical, and the market does not provide enough signals for investments (i.a. a higher CO2 price to facilitate the decarbonisation of activities). Therefore, the technology cost gap needs to be addressed to advance the development and adoption of these technologies in the years to come.

We believe that the EU hydrogen economy needs to develop on the basis of European and national policies that are focusing on the carbon content and an EU-wide system of guarantee of origin. We note positively that renewable hydrogen has been incorporated in various sections, such as 4.1 on renewables, 4.3 on clean mobility, and 4.9 on energy infrastructure. However, we see it also key that the CEEAG also recognise the contribution of electrolytic hydrogen produced from the most decarbonised power grid mixes. The importance of low-carbon hydrogen could be indirectly mentioned in paragraphs 63, 64, 74 or 108 as a product 'conducive to the achievement of the European Climate Law objectives for 2030 and 2050'. Low-carbon hydrogen will play a decisive role in ramping up the use of renewable hydrogen while contributing to greenhouse gas emission reductions.

It is important to design subsidy mechanisms dynamically in order to ensure a fair balance between investment security for the investor and the lowest possible public cost. To facilitate a level playing field between Member States, the CEEAG should define a common framework and principles for subsidising hydrogen investments and production, whilst taking technology neutrality and unbundling rules into consideration. Strong carbon pricing and related mechanisms (e.g., carbon contracts for difference) are the key elements, but it is also important to ensure that national tax and levies systems support the development of the carbon-free hydrogen economy instead of adding to the cost burden. This is the basis from which hydrogen production can and will, over time, become competitive.

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Decarbonisation of the heating sector

(*4.10 Aid for district heating or cooling*)

The heating sector requires urgent and systemic decarbonisation and there are plenty of development opportunities. Currently, only minor parts of the heating and cooling sectors are covered by the EU ETS (electrical heating and district heating and cooling), whilst some others (building-specific H&C solutions) remain outside. We welcome the policy priority in the upcoming 'Fit for 55' package to include the heating sector under the ETS – this should ensure the most cost-efficient transition towards decarbonised heating solutions whilst allowing for a harmonisation of national schemes at the EU level. Systemic solutions to enable the transition to energy-efficient, low-carbon heating are needed. To support this process, the revised State Aid rules should allow for such investments. By coupling the heating and also the transport and energy-intensive sectors with the electricity market, one can propel climate mitigation. The revised State Aid rules should allow for the promotion of efficient individual heating solutions and DHC (District Heating and Cooling) systems, i.e. investment aid, or through other nationally determined measures, e.g. taxation.

Advancing carbon removal technologies

(*4.1 Aid for the reduction and removal of greenhouse gas emissions including through support for renewable energy*)

The acknowledgement of carbon removal and CCUS technologies in the new guideline is welcomed.

More generally, carbon removal is a positive externality that provides no value for the operator (in the absence of legal requirements/tradable certificates) but a benefit to society at large. Therefore, it is justified that the State Aid intensity for CO2 removal could be 100%. State Aid should be focused on CCS/CCU/DAC technology development and industrial-scale demonstration projects to make CCS/CCU/DAC financially sustainable without State Aid in the longer run. CCU should be further defined in the CEEAG: the addition of CCU is useful and welcome, but a definition would be needed. Clear roles and procedures, e.g. for MRV, are needed in due time to use this promising tool to fight climate change. A delegated act, as announced in the EU ETS legislative proposal, may be late to support the current discussions on promising business cases in companies to develop CCU.

Under the current framework, only the transportation of CO2 via pipelines is considered eligible for State Aid. Other relevant transportation forms that can be monitored, such as ships, trucks, and trains, could be included in the scope of State Aid rules.

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Biodiversity

(*4.6 Aid for the remediation of contaminated sites, for the rehabilitation of natural habitats and ecosystems, and for biodiversity and nature-based solutions*)

In the biodiversity section of the guidelines, support for environmental projects related to hydropower should be recognised as eligible for State Aid, either under the State Aid guidelines or the General Block Exemption Regulation.

Renewable energy support systems

(*4.1 Aid for the reduction and removal of greenhouse gas emissions including through support for renewable energy*)

The approach to broaden the guidelines to cover all decarbonisation rather than just renewables is welcome. Those RES technologies, such as onshore wind and solar, that have already reached cost parity in some parts of Europe should not be subject to new subsidy schemes. To ensure more stable returns and longer-term visibility for new renewable investments, PPAs (Power Purchase Agreements) or similar long-term contracts should be facilitated.

To ensure a level playing field, subsidy schemes should be technology neutral and open for all CO2-free technologies, not only selected ones. For example, while acknowledging the important contribution of offshore wind to planned hydrogen production, it is important to avoid creating market distortions with technology-specific subsidies and new market arrangements.

The support for renewable energy sources in national schemes should follow established European or global standards for increasing liquidity and promoting market development. Minimum standards, such as a European register, could be positive for promoting cross-border activities in capturing the benefit of the EU single market. As such, considerations such as footnote 53 should be given greater emphasis.

The design should be as market-based as possible to expose producers to market prices and minimise market distortions. We support the approach whereby subsidies should not be paid during hours with negative market prices. Subsidy schemes should also be technology neutral and open for cross-border participation. Tenders have proven to be a successful way of bringing down the cost of innovative technologies. Subsidies should be channelled via State budgets rather than added on to the final electricity price in the form of surcharges or levies.

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Compensating energy system services (ancillary services) in an increasingly volatile power market, and the role of natural gas in supporting a safe and secure energy transition

(*4.8 Aid for the security of electricity supply*)

In addition to purely environmental consideration, the revised State Aid policy should enable support for services that, for example, CO2-free flexible power production brings when moving towards an increasingly more volatile power system. For example, a specific ancillary services support mechanism is currently under development in Sweden, and similar concepts will be needed also in other countries to ensure that CO2-free capacities contributing to system stability will have sufficient economic incentives to stay online.

State Aid guidelines and the electricity market regulation need to recognise the changing fundaments in the power markets and ensure that new market designs ensuring all climate-neutral production forms remain competitive in the market and are remunerated for the value they provide to the system.

We also welcome that the CEEAG covers natural gas, insofar as these investments are compatible with the Union's 2030 and 2050 climate targets. Natural gas infrastructure and related power generation play a very important role in the transition process and in underpinning the further deployment of renewable energy sources. The approach to support State Aid for natural gas investments, as long as safeguards are respected (i.e. consistency with the Union's climate targets), is therefore justified – in particular in terms of ensuring security of supply in an ever more intermittent power system. However, the preconditions under which the transitional use of natural gas may be still supported through State Aid programmes seem rather bureaucratic. CCS/CCU readiness, together with being in line with 2050 greenhouse gas neutrality, should be regarded as sufficient when evaluating national programmes.

When specifically addressing security of supply as in section 4.8, we believe this topic should address and cover all energy sources, including gas.

State Aid and taxation

(*4.7 Aid in the form of reductions in taxes or parafiscal levies*)

It is necessary to ensure compatibility between the EU ETS, State Aid and taxation. All CO2-emitting production should be subject to ETS-driven carbon pricing or a (national) CO2 tax, but not both. This principle should be clarified both in the revisions of the EU State Aid Guidelines and the Energy Tax Directive. In some countries, district heating production is covered by the EU ETS, but it is also subject to additional national CO2 taxation, whereas the heating of individual buildings is not always subject to any CO2 steering – neither in the form of an ETS nor through CO2 taxation. This effectively distorts competition between different heating methods. Such overlapping policy

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steering on certain production technologies can be seen as a hidden (national) subsidy to those production technologies that are not subject to overlapping policy steering.

Emissions trading at the EU level should be the leading instrument to steer fuel switching and the shift to carbon-neutral activities in these sectors.

EU Taxonomy should not become a reference methodology to the CEEAG

We take note of paragraph 69 in the draft CEEAG which refers to the use of the EU Taxonomy Regulation 2020/852 and, in particular, the 'Do No Significant Harm' criteria for balancing the weighing effects on trade and competition.

Whilst we understand the underlying logic, we are convinced that the approval of any support scheme shall not be subject or indirectly aligned to the compliance with EU Taxonomy criteria. Although the Regulation was adopted in 2020, there are a number of Delegated Acts still under development that may cause substantial regulatory uncertainty for projects that might be subject to State Aid under the implementation of the CEEAG.

Furthermore, we do see the EU Taxonomy criteria as conflicting with the principle of technology neutrality and unnecessarily reducing the reliance on climate-neutral technologies that could be tapped into and placed in competition in order to achieve decarbonisation most cost-effectively.

As such, evaluating State Aid programmes following the premature and not yet proven tool of EU Taxonomy is not suitable, and references to the EU Taxonomy should therefore be deleted.
Against this background, we believe that a CO2 standard or assessment of emitted CO2 or removed CO2 emissions would be a more objective parameter to assess the climate impacts of the investment needed.

Energy infrastructure

(Section 4.9 on aid for energy infrastructure)

We welcome the fact that the proposed guidelines clearly reiterate that State Aid issues only arise where the infrastructure is operated outside the natural and legal monopolies of the grid operators (no cross-subsidisation). Aid is extended to new infrastructures, foreseen for all forms of renewable and low-carbon gases or carbon dioxide infrastructures. +++

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[i] OPEX support, especially for hydrogen, is of utmost importance given that electricity costs are the biggest cost component in hydrogen production