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EU Revises Conditions for Compatible State Aid in the Energy Sector

New EC Guidelines confine public support to renewables, but enable state intervention for cross-border infrastructure, generation adequacy and energy-intensive industries.

Looking to 2030 and beyond,[1] the EU is softening, to some extent, its climate change policies to better factor in competitiveness considerations and ensure that renewables are deployed where it makes economic sense — reducing the need for subsidies. In this context, on 9 April 2014, the European Commission (EC) revised its existing 2008 Guidelines that describe the conditions under which EU Member States may grant aid to activities that contribute to environmental protection. The Guidelines on state aid for environmental protection and energy 2014-2020 (the 2014 Guidelines) face the challenge of reconciling parallel goals on climate change, security of supply, market integration, competition, and competitiveness. For that they provide new and detailed clarifications on state support to energy-related activities and, in particular, to various electricity generation technologies, with the exception of nuclear.

Under the 2014 Guidelines, Member State support to renewables must, at least to some extent, reflect the energy market and account for competition between technologies. In due course, most support should be phased out. The 2014 Guidelines also enable Member States to address the problems that arise from an increasing share of renewables in the energy mix. For instance, energy-intensive industries can be partially relieved from renewables funding obligations. Moreover, to respond to the new challenges thermal plants (gas and coal-fired plants) are facing due to increased renewables penetration, some Member States have adopted or are considering introducing measures to maintain generation adequacy, typically by granting generators support for investment and availability of generation capacity. The 2014 Guidelines take the view that this type of support amounts to state aid and set out the conditions that such capacity remuneration mechanisms must meet to be deemed as compatible support. The 2014 Guidelines will enter into force on 1 July 2014 and will be applicable until 2020.

Towards Market-oriented Support for Renewables

Thanks to significant public support, the share of renewables in the energy mix has increased and some renewable energy technologies have matured significantly (*e.g.*, photovoltaic solar and on-shore wind generation technologies). This market evolution has set Europe on track to meet its 2020 renewables target, but has also caused market distortions, because public support sheltered renewables from price signals. Against this background, the EC takes the view that renewables can and should be subject to the wholesale energy market reality and dynamics. Such a shift would contribute to the wider objective of an integrated internal energy market in the EU. Public support should be designed to achieve these objectives and reflect falling production costs, until subsidies eventually become unnecessary.

- **Aid for electricity generated by renewables:** The 2014 Guidelines require renewable energy generators to sell their electricity in the market and be subject to balancing responsibilities (*i.e.*, an obligation on producers to compensate for short-term deviations from their previous delivery commitments). As of 2016, public support should only be provided in the form of market-oriented mechanisms, such as premiums (*i.e.*, a top-up on the market price) or tradable certificates (§136). Feed-in tariffs can only continue for small installations (§126). The 2014 Guidelines also envision the gradual introduction of competitive bidding processes for the allocation of public support. Initially, bidding processes will be required for a small share of new electricity capacity but, as of 2017, such processes will apply to the award of all public support for renewables. However, the 2014 Guidelines allow Member States to avoid tendering (open bidding processes) under certain circumstances, *e.g.*, when only one or very few projects/sites would be eligible or when the bidding process would lead to higher support levels (§127). Finally, a Member State's aid need not be open to generators from other Member States, unless a cooperation mechanism exists between the two countries, ensuring that renewable energy produced in one Member State can count toward the renewable target of the other (§122).

- **Aid for energy from renewable sources other than electricity:** Public support can be justified when it does not exceed the difference between the total levelized costs of producing energy from a specific technology and the market price of the form of energy concerned.[2]

The 2014 Guidelines clarify that public support to renewables can only be justified until the plant has been fully depreciated (§§130, 132(d)). Exceptions are included for biomass and biogas plants (§133).

The EC will apply the new rules after 1 July 2014 to all new schemes and individual measures on which it must decide (§247). In principle, the 2014 Guidelines will not affect aid granted to the owners of existing installations (§250). For reasons of legal certainty, these installations will continue to receive aid based on existing approved state aid schemes. If, however, a Member State wishes to prolong or modify an existing scheme in the future, the 2014 Guidelines must be complied with.

Concessions to Energy-intensive Industries

Subsidies for renewables regularly lead to increases in electricity prices, *e.g.*, through special charges levied on top of the wholesale electricity price. These subsidies often affect both households and industries. However, high electricity costs can have particularly adverse effects on certain industry sectors, which are (i) intensive electricity users and (ii) exposed to global trade, facing a competitive disadvantage towards rivals from outside the EU where electricity prices are lower (*e.g.*, from the US, due to the shale gas boom). The EC was subject to intense pressure from industry associations and some Member States to acknowledge this risk. Indeed, the 2014 Guidelines introduce EU-wide rules on exemptions from renewables financing obligations (§§183-184). With these rules, the EC aims to reduce carbon leakage problems — whereby companies relocate outside the EU because of electricity costs — and also to stop harmful subsidy races between Member States.

The 2014 Guidelines include a very large list of sectors that can benefit from an exemption (*e.g.*, 68 sectors, including chemicals, metals, paper and ceramics). In addition, albeit under strict conditions, a Member State can exempt companies from a sector that is not listed (§187, fn. 89). In any event, companies eligible for an exemption must still pay a certain share of the renewable surcharge themselves (at least 15 percent of the surcharge, which may be reduced by the Member State to 0.5 percent of the gross value added of the beneficiary) (§§186, 189-191). To ensure a level playing field between competing industries, if a Member State decides to grant an exemption from renewable energy surcharges to one of the eligible sectors (either listed or not), this exemption must apply in an objective and non-discriminatory way to all competitors in the sector, whose situations are factually comparable (§188).

EU Member States must fully comply with the eligibility and proportionality criteria outlined in the 2014 Guidelines for this type of support by 1 January 2019. In the meantime:

- From 1 July 2014 to 31 December 2018, exemptions from funding support to renewables can be justified if the support complies with an adjustment plan, which should entail a progressive decrease of the aid to the levels outlined in the Guidelines (§§194-196).

- Member States also need to prepare adjustment plans for funding exemptions granted between 1 January 2011 and 1 July 2014 (§197). Member States must notify to the EC any adjustment plans within 12 months after the entry into force of the 2014 Guidelines (§§200-201).

Ensuring Adequate Capacity

With the increasing share of renewables in the energy mix, electricity generation in many Member States has shifted from a system of stable supply towards a system in which numerous, small-scale suppliers provide variable amounts of energy. The shift presents new challenges for supply security (§217). The EC acknowledges this risk. However, surprisingly, the 2014 Guidelines suggest that, without prior assessment, Capacity Remuneration Mechanisms (CRMs) will, as a rule, constitute state aid. Put simply, the EC assumes that CRMs invariably involve state aid, so Member States must always notify the EC to receive clearance for CRMs as “compatible aid.” This is an undue generalization. The 2014 Guidelines ignore the fact that market-based CRMs exist and should be regarded as an element of a new market design and not as a form of public support. As such, these CRMs do not contain any state aid element and would not require EC notification and clearance. The 2014 Guidelines remain silent on this key question, simply setting out the conditions that Member States must satisfy to introduce such CRMs; for example encouraging producers to build new generation capacity or preventing producers from shutting down existing plants.

To ensure the EC will allow public support for CRMs, the 2014 Guidelines require Member States to demonstrate that the market is not able to deliver adequate capacity in the absence of state intervention (§220). Before resorting to public support, Member States must first consider alternative ways of achieving generation adequacy, such as facilitating demand-side management and increasing interconnection capacity (§221). In any event, the 2014 Guidelines clarify that public support should only compensate generators for the readiness to deliver electricity and should not include any remuneration for the sale of energy (§226). The beneficiary is also entitled to a reasonable rate of return (§229). Public support for CRMs should give preference to low-carbon generators in case of equivalent technical and economic parameters (§234(e)).

Member States should amend, where necessary, all related schemes to bring them into line with the 2014 Guidelines by 1 January 2016. This applies to CRM schemes, which were adopted without notification to or clearance from the EC, raising significant legal certainty questions for beneficiaries of such CRMs

(Co-)Financing Cross-Border Energy Infrastructure

Modern cross-border energy infrastructure is important to ensure supply security and to integrate renewables into the internal energy market. The EC estimated that investment needs for such infrastructure will amount to EUR200 billion by 2020 (§202). However, market operators lack incentives to carry out these investments, given that costs and benefits can occur asymmetrically among the different market participants and Member States. The EC acknowledges this issue and enables Member States to finance investments in trans-European energy infrastructure projects[3] and in energy infrastructure in underdeveloped regions (§207). According to the 2014 Guidelines, the aid may cover up to 100 percent of the funding gap, *i.e.*, the portion of the discounted cost of the initial investment not covered by the discounted net revenues of the project (§213). For other projects, the EC will assess on a case-by-case basis whether state aid is necessary (§208).

Implications for Industry and Outlook

The 2014 Guidelines mark a new era for the application of EU state aid rules in the energy sector. Realizing the profound impact that public subsidies for renewables have had on energy markets and consumer prices, the EC and Member States are now set to look more closely into competition and market distortions, cost effectiveness and supply security considerations. The Guidelines aim to achieve climate change objectives and simultaneously lower retail prices for the benefit of consumers (industries and households). To achieve this, energy cost increases must be contained, price signals for investments in electricity must resurge and the internal energy market must function without impediments.[4]

However, given the controversial nature of these issues (even within the EC itself) and the extensive negotiations preceding the adoption of the 2014 Guidelines, unsurprisingly, much of the guidance is fairly vague and open ended. Member States will retain significant discretion when designing their public support measures (*e.g.*, technology neutrality will be introduced slowly since openness of bidding procedures can be subject to discussion between each Member State and the EC; the necessity of a bidding process can also be disputed by the Member State; trade- and electricity-intensity of non-listed sectors can be calculated *ad hoc*; the reasonable rate of return included in the remuneration has to be estimated, etc.). Industry's input on these issues will be critical. For instance, companies and trade associations are best placed to provide information on the long-term potential of different generation technologies, possible overbidding/underbidding practices, the exposure of an industry to global trade and its energy needs, average rates of return in the energy sector, etc. Such information would be very helpful to Member States when they prepare notification forms to the EC. Moreover, under the revised state aid rules, the EC can directly address requests for information to beneficiaries and any third party and even impose fines on companies or associations which submit incorrect or misleading data.[5]

Looking ahead, the 2014 Guidelines will be further explained and refined in the EC's future decisional practice. The number of complex cases is bound to increase, which will cause additional delays to the already slow state aid decision-making process. The 2014 Guidelines will form the basis for the EC's decisions on all or most of several high-profile pending state aid investigations. As a result, additional guidance can be expected, *e.g.*, on exemptions for energy-intensive industries through the decisions in the German EEG-surcharge and the French tax reductions cases. Outside the scope of the 2014 Guidelines, the EC will decide on how Member States can support new nuclear generation projects in its decision in the UK Hinkley Point case.

Finally, the assumption in the 2014 Guidelines that all CRMs *a priori* qualify as state aid poses a serious threat to the stability of CRMs that are already in force in some Member States. Beneficiaries of such CRMs will now face the challenge of defending the legality of these schemes and ensuring legal certainty for the future.

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Endnotes

[1] See COM (2014) 15, "A policy framework for climate and energy in the period from 2020 to 2030", 22 January 2014 and COM (2011) 21, "A resource-efficient Europe – Flagship initiative under the Europe 2020 Strategy", 26 January 2011. See also SWD (2013) 438-442, "Delivering the internal electricity market and making the most of public intervention", 05 November 2013.

[2] As per the new Guidelines, the levelized costs of producing energy can include a reasonable return on capital (§132).

[3] See Regulation 347/2013 of 17 April 2013 on guidelines for trans-European energy infrastructure and repealing Decision No 1364/2006/EC and amending Regulations (EC) No 713/2009, (EC) No 714/2009 and (EC) No 715/2009 [2013] OJ L115/39.

[4] In this sense, the 2014 Guidelines are fully in line with all the objectives that the EC plans to achieve with the State aid Modernisation initiative. See COM (2012) 209 EU State aid Modernisation, 8 May 2012.

[5] See Article 6a of Regulation 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 108 of the treaty on the functioning of the European Union [1999] OJ L83/1 (as amended).