

9 October 2014

European Commission Approves Hinkley Point C State Aid

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The European Commission has decided that the revised UK support package for EDF's Hinkley Point C nuclear project is compatible with EU State aid rules.

In doing so, the Commission found that although the UK's deal with EDF included State aid, such aid was permissible. This was particularly so given the need to support private financing for a project of such "unprecedented nature and scale."

Even so, the Commission tightened the economics of the project considerably. As a condition for its clearance, the Commission required EDF to pay higher fees for a State guarantee that will be provided to support the debt incurred constructing the plant, as well as mandating that any profits over the level originally anticipated are shared more generously with consumers than had been proposed in the UK's original deal with EDF.

This decision will provide important guidance for nuclear State aid throughout the EU. However, it also highlights challenges for subsequent projects; in particular, how will they demonstrate the need for aid as more generation capacity is added? Also, as the perceived need for aid declines, the permitted intensity of aid is likely to follow. These factors and public debate surrounding this investigation demonstrate the need for EU nuclear project sponsors and investors to engage early and proactively in the State aid process.

Background and the Hinkley Point C Investigation and Decision

In December 2013, following notification by the UK Government of its proposed support to the Hinkley Point C project, the European Commission decided to initiate an investigation under the EU's State aid rules. EU State aid rules essentially prohibit EU Member States from using Member State public money to benefit individual businesses or sectors, absent advance approval by the Commission.

During its 11-month investigation the Commission expressed "serious doubts" that the proposed State aid measures met the criteria for approval. In particular, the Commission appeared unconvinced that the Hinkley Point C project needed public

support at all. And even if it did, the Commission considered the strike price overly generous. Further, the Commission doubted that the Hinkley Point C project company (an EDF subsidiary called NNB Generation Company) was selected in a sufficiently fair way and considered that the UK should have provided a more rigorous assessment of NNB Generation Company's costs and future profitability in setting the level of guaranteed revenue.

In response to the Commission's position, the UK government agreed to modify its planned support in the following ways:

- The UK Treasury will raise its guarantee fee significantly, reducing the subsidy by more than £1 billion (€ 1.3 billion); and
- Any profits exceeding the currently estimated rate of return will be shared with the granting UK public entity (and ultimately the UK consumers). If profits exceed a further higher threshold (thought to be 13.5%), then the granting UK public entity will obtain 60% of such gains. Moreover, this profit sharing mechanism will be in place for the 60 year lifetime of the project rather than just for the initially envisaged 35 years.

Granting approval on 8 October 2014, the Commission stated that with these modifications the UK authorities have **reduced the UK citizens' financial contribution to the project** while demonstrating that the State aid would address a **genuine market failure** caused by the need for replacement generation capacity and the unprecedented nature and scale of the Hinkley Point C project, which would otherwise be unable to obtain financing. The Commission also noted that the State aid provided was **proportionate to the objective pursued** and **avoids any undue distortions of competition** in the EU internal market. Importantly, the Commission also reaffirmed the right of the **EU Member States to determine their own energy mix**.

Impact of the Decision

With respect to the Hinkley Point C project, despite these modifications, the fundamental elements of the UK financing support package (the credit guarantee, the proposed strike price(s) and the 35-year period of the CfD) have remained intact, allowing EDF to demonstrate reliable revenues for a sufficiently long period to support debt financing.

The Hinkley Point C decision is now the most important State aid decision in the nuclear sector. As the leading case and in the absence of Commission guidelines on State aid for nuclear energy, the Commission and Member States will inevitably look to the Hinkley Point C decision for guidance in future nuclear State aid investigations. However, this does not mean the Decision provides an easy blueprint for subsequent projects. Other EU nuclear project sponsors and investors face a number of difficult issues that should be at the heart of planning for subsequent projects.

Our initial views on these "lessons learned" are as follows:

Lessons Learned

- **Consider carefully and early how you will explain and evidence the need for State aid** (i.e., the market failure that aid is designed to remedy). The Commission was ultimately convinced about this for Hinkley Point C, but unlike Hinkley, subsequent projects will not be unprecedented and the "supply gap" will shrink as Hinkley and other renewable projects become committed.
- **Identify and mitigate your project's State aid "weaknesses."** With an early assessment, delays, costs and uncertainties of the investigation may be mitigated or avoided altogether.
- **Support the Member State concerned.** Be involved early on and help the Member State with the development of its strategy and arguments, as well as the preparation of submissions to the Commission.

- **Appoint legal and economic advisers.** Such advisers can help you make an early and realistic assessment of your strategy and arguments and the capacity of the Member State to effectively pursue a State aid notification and investigation.
 - **Develop a public affairs plan and political strategy.** It is critical to advocate the need for public financial support for nuclear new build – especially to incoming European Commissioners for Energy and Competition. The Hinkley Point C investigation and the strong public positions that governments, political leaders and NGOs have taken – in support and against the aid provided – demonstrates the importance of politics in State aid investigations and decisions.
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