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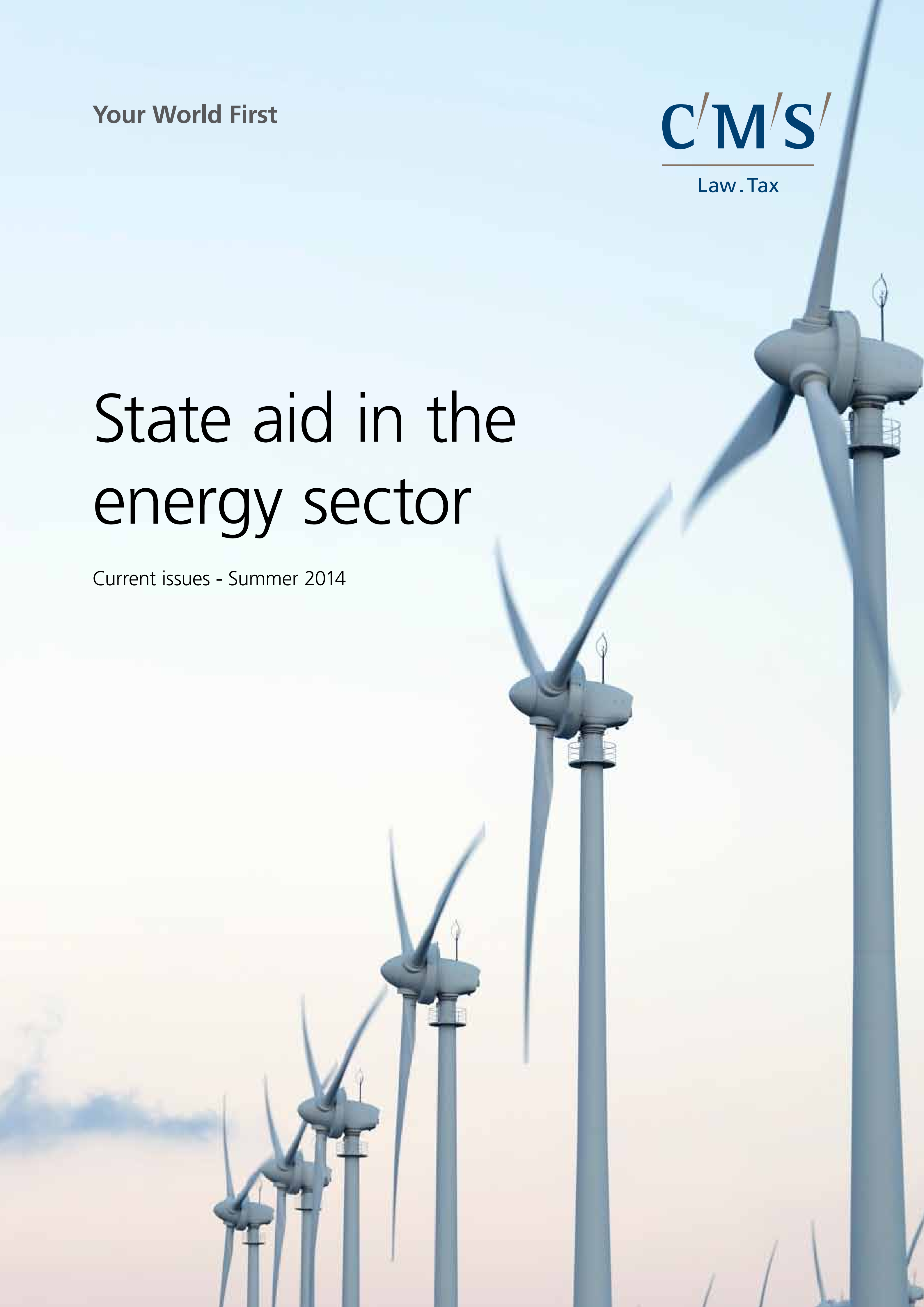
State aid in the energy sector

Current issues - Summer 2014



State aid in the energy sector

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State aid issues are under focus and under pressure across the energy markets of Europe. They arise along the entire supply chain from generation to driving an electric car. Against the background of the challenging and hotly debated issues of how to incentivise change on the demand side, implement smart technologies, achieve increasingly ambitious climate change targets and fully integrate European markets, developers need certainty to be able to take investment decisions today. State aid matters to everyone in the sector.

This update on current issues begins with a look at energy issues in the European Commission's State Aid Modernisation project, in particular at the new General Block Exemption Regulation and the 2014 Environmental Protection and Energy Guidelines. Since energy is a priority area across the Commission, we then review some important steps taken by other Brussels directorates and consider the key State aid issues in delivering the internal market.

The new Environmental Protection and Energy Guidelines reinforce the authorities' approach to the assessment of whether State aid exists and whether aid is compatible with the EU internal market. This is reflected in our table of common principles in State aid assessment.

The convergence of current priorities and themes create opportunities, but also present challenges and uncertainties for investors and contractors. We review some of these under the heading "trends and issues". This section (and this update) concludes with a brief look at some of the main points in a State aid notification procedure, which can be unclear to the beneficiary.

1. Modernisation

The European Commission is completing its State Aid Modernisation project[1]. This has involved a review and update of guidance across all sectors, taking account of practice and precedent in recent years, with the aim of updating and streamlining the approach to aid concepts and procedures.

Key to the modernisation package are three concepts:

- growth in a dynamic and competitive internal market;
- enforcement focused on cases having the biggest impact on the internal market; and
- streamlined rules and faster decision making.

The core analysis remains – is there State intervention which gives recipients a selective advantage, which distorts (or may distort) competition and affects trade between Member States.

In the energy sector the reforms display the imperfect, and in places vague, outcomes of consultation and compromise. Their true impact will become clear only as new decisions are taken in which the Commission has to give effect to the restated rules. Key areas will be in relation to renewable energy of all types, capacity markets and nuclear energy.

There are five aspects of the modernisation project which are particularly important for the energy sector[2].

Key new documents for energy investors and beneficiaries

- Revisions to the General Block Exemption **(GBER)**
- A new Communication on important projects of common European interest, including in relation to the 2020 objectives and trans-European energy networks
- New Environmental Protection and Energy Aid Guidelines **(2014 EEAG)**
- An updated Notice on the notion of State aid
- Modernisation of the procedural rules

1 State Aid Modernisation (SAM) - European Commission programme and documentation
2 Commission Regulation (EU) No 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty;
Communication from the Commission 2014/C 118/02 of 20 June 2014 - Criteria for the analysis of the compatibility with the internal market of State aid to promote the execution of important projects of common European interest;
Communication from the Commission 2014/C 200/01 of 28 June 2014 - Guidelines on State aid for Environmental Protection and Energy 2014-2020;
Communication from the Commission 2014/XXX (draft) - Notice on the notion of State aid pursuant to Article 107(1) TFEU;
Council Regulation (EU) No 734/2013 of 22 July 2013 amending Regulation (EC) No 659/1999 laying down detailed rules for the application of Article 93 of the EC Treaty.

The General Block Exemption Regulation

The GBER provides a safe haven for certain smaller projects, which do not need to be cleared individually in advance by the Commission. Its coverage includes certain environmental investment aid for energy savings measures, high efficiency cogeneration and both investment and operating aid for small scale renewables (moved from the 2008 Guidelines into the block-exemptible category). The corollary to the benefit of exemption from pre-notification is that the Member States have extended publication obligations. Each jurisdiction must maintain a comprehensive website to include information on individual beneficiaries. While individual projects do not need to be pre-notified, Member States must notify their evaluation plans before putting larger scale (>EUR 100m and >0.01% of GDP) schemes into effect. All energy schemes fall under the evaluation requirement.

The 2014 Environmental Protection and Energy Aid Guidelines

The 2014 EEAG include specific coverage of operating aid for renewables, investment aid for energy infrastructure and both investment and operating aid for generation adequacy measures. The inclusion of operating aid in both the GBER and the 2014 EEAG perhaps constitute a mark of the specific structure and requirements of the sector and the mechanics of recouping investment in energy projects, since in other sectors it is generally extremely difficult to justify operating aid and the emphasis is on infrastructure aid. How the 2014 EEAG demonstrate the key considerations of compatibility and the common approach to State aid assessment under the Modernisation project is considered below.

2. Energy – a priority area across the Commission

DG Competition is not alone in reinforcing the need for better targeted State aid in the energy sector.

It was DG Energy which in November 2013 promoted two strategy papers[3]:

— a Communication on Delivering the internal market in electricity and making the most of public intervention; and
— an accompanying Staff Working Document "Generation Adequacy in the internal electricity market - guidance on public interventions".

The November 2013 papers emphasise the Commission's view that the role of public intervention in the energy market need not be removed, but does need to change. It should aim to secure a level playing field; overcome market failures; foster technology and the deployment of innovation; and support the market by delivering appropriate investment signals. To this end the core issues include the development of new types of support for renewables; the consideration of how smart technologies might enable change in demand side responses and response services in the medium to longer term; the climate change agenda; and the need for generation adequacy.

In March 2014 these papers were followed by a Communication and Staff Working Document on energy prices and costs[4]. The promised in-depth study on full costs and subsidies of the various technologies in the electricity sector – proposed for June 2014 – has yet to appear. This will be an important document for the consideration of future supports, as to date no cross-category study at EU level exists to enable Member States and investors to point to benchmarks in terms of the proportionality of proposed aid.

At the beginning of July 2014 it was DG Sanco which announced an in-depth market study into the retail electricity market, focusing on the consumer experience and choice. DG Sanco noted in the 2014 Consumer Markets Scoreboard which gave rise to the market study that consumers are not able to take advantage of, or benefit from, market liberalisation[5].

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3 Communication from the Commission C(2013) 7243 of 5 November 2013 - Delivering the internal electricity market and making the most of public intervention;
Commission Staff Working Document SWD(2013) 438 of 5 November 2013 - Generation Adequacy in the internal electricity market - guidance on public interventions.

4 Communication from the Commission COM(2014) 21 of 17 March 2014 – Energy prices and costs in Europe;
Commission Staff Working Document SWD(2014) 20 final/2 – Energy prices and costs report

5 Commission Staff Working Document SWD(2014) 212 of 27 June 2014 - Consumer Markets Scoreboard - Making markets work for consumers 10th edition

3. Common principles in State aid assessment

Under the 2014 EEAG projects are subject to a series of common assessment principles and steps. These principles are complemented by guidance on specific matters.

Common principles – assessment steps	
Is there a clearly defined project addressing a specific issue and which pursues an objective of common European interest?	In terms of generation adequacy, for example, that would include whether the proposal was consistent with ENTSO analysis and observations.
Is there a need for State intervention?	What is that need? Why cannot the market deliver what is needed without State support?
Is the particular type of support proposed appropriate?	Could other policy instruments be used? Have other options not involving aid been exhausted (in terms of generation adequacy that would include demand side flexibilities and storage)?
Does the proposed support mechanism produce incentives to innovate?	Will the recipient engage in additional activity which absent the aid he would not carry out, or carry out only in a restricted or different manner?
Are the amounts proposed proportional to the identified need and gain?	The rule is that aid should be limited to the minimum necessary to incentivise the investment and achieve the objective.
Is the support addressed to the widest possible group?	State aid must avoid negative effects on competition, so here aid should not be targeted at specific technologies, but at broader categories.
Has care been taken to avoid negative effects on cross border trade, in particular given the aim to complete a single market in energy?	State aid is provided by Member States to recipients in a particular jurisdiction. Conflict can arise between proposals which are within Member States' own competence – for example how to maintain security of supply or what mix of technologies to incentivise to meet climate change targets – and EU wide objectives which emphasis interconnection.
Is the information transparent?	Clarity and availability of information are key.

The 2014 EEAG need not be the only guidelines used in the assessment of energy projects (which might instead or as well for example benefit from a State guarantee or fall within the parameters of a service of general economic interest (SGEI)), but the 2014 EEAG are likely to be the mainstay of new analysis and their interpretation over the coming months will be immensely important.

4. Trends and issues - challenges and uncertainties

Several themes converge to make the application of the State aid rules a priority area for the Commission, among them concerns about security of supply enhanced by current political events, the low carbon context, developments in energy technologies, and the promotion of the interconnected single market in energy.

Challenges and uncertainties

- Domestic v European priorities
- Commission investigations
- Issues for energy users
- Economic and political change
- State aid decisions after 1 July 2014
- The importance of precedent
- New mechanisms, new precedents
- Capacity markets
- Nuclear energy
- Free movement of goods

Domestic v European priorities

Those themes are not always in absolute alignment, for example when in order to maintain security of supply a Member State prefers to incentivise domestic generation rather than to increase interconnection capacity.

Commission investigations

Member States' investment programmes may be investigated by the Commission, for example in relation to feed in tariffs in France. In March 2014 (following confirmation from the European Court of Justice in December 2013 that State aid was involved) the Commission concluded that a French scheme under which on-shore wind generators are compensated for additional production costs was in line with the applicable guidelines (in that case the 2008 Guidelines on Environmental Aid, the predecessor of the 2014 EEAG) and that the producers were not overcompensated[6].

6 Commission approves aid for on-shore wind power in France; opens in-depth inquiry into tax reductions for large energy consumers - IP/14/327, 27/03/2014 *(Case no. SA. 36511)*

Issues for energy users

It is not only investors who may benefit from State support and draw the Commission's attention. At the same time as clearing the on-shore wind FiTs in France, the Commission opened an in-depth phase 2 investigation into whether certain reductions in renewable energy surcharges to large energy consumers are compatible with the State aid rules[7]. A somewhat similar position exists in Germany, where in December 2013 the support to electricity from renewable sources and the reduction in renewables tariff surcharge for energy-intensive companies triggered the application of the State aid rules by the Commission. The support to electricity from renewable resources was then declared compatible aid, while the Commission began a full investigation into a reduction in renewables tariff surcharge for energy-intensive companies, which was ended against a payment of EUR 30 million in July 2014[8]. On 1 August 2014 a new Renewable Energy Act was enacted in Germany and declared by the Commission to be fully compatible with the State aid rules.

Economic and political change – which rules apply?

The influence of economics and politics cannot be avoided. When recession hits and governments change, Member States respond with changes to their legislation. Investors need to know whether they can rely on the position as it was when they initiated their projects. Assuming that the project has not changed, the general rule is that the applicable law remains that in place when the first State aid decision was taken (or which led to a finding that no State aid was involved). Developers in the Czech Republic who had put their facilities into operation between 2008 and 2011 were relieved in June 2014 to see this principle upheld when the Commission confirmed that a 2012 law on solar project support should apply only to installations commissioned since 1 January 2013[9].

State aid decisions after 1 July 2014

Potential beneficiaries need to keep a careful watch on new EU rules as they are developed, however. The 2014 EEAG apply to all Commission decisions taken from 1 July 2014, irrespective of the date of notification. In the case of the tariff reductions for large energy consumers in France, the decision will be under the 2014 EEAG (which include provisions dealing with this issue).

The importance of precedent

The Commission both calls for the adaptation of support to new circumstances, and wants to be certain about the effects of those new kinds of support. It is itself always under scrutiny from the Legal Service, keen to insure against challenge and anxious to reflect the interplay between the strategies and policies of concerned Directorates. In this respect precedents are important.

New mechanisms, new precedents

But sometimes there are no precedents. The UK is the first to adopt a Contracts for Difference mechanism to support a variety of renewable technologies "for our reforms to build the world's first low carbon electricity market"[10]. Investment Contracts representing early versions of these CfD supports were awarded in April 2014, explicitly subject to State aid approval and noting that the methodology for the allocation of further CfDs had been designed with the 2014 EEAG in mind. Both the overall scheme and the sizeable individual projects needed the Commission's blessing. This was given in late July 2014, with Commissioner Almunia remarking that the UK had contributed "a fine example of how to promote the decarbonisation of the economy with market-based support mechanisms, at the lowest possible cost for consumers"[11].

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7 As above

8 Commission approves German renewable energy law EEG 2014 IP/14/867, 23/07/2014 *(Case no SA. 38632)*

9 Commission approves Czech Scheme supporting renewable energy IP/14/664, 11/06/2014 *(Case no SA. 35177)*

10 DECC press release of 23/04/14 "Government unveils eight major new renewables projects"

11 Commission authorises UK aid package for renewable electricity production IP/14/866 23/07/14

Across many of the newer Member States the detail of the decisions (publication will be after the excision of confidential information) on the application of the 2014 EEAG and other State aid arguments to the principle of a CfD mechanism - the nature of its incentive effect, the competitive allocation methods, as well as on the proportionality of the specific UK measures (timeframe, terms and conditions, strike price) - will be an important influence on the design of new support frameworks.

Capacity markets

The Commission recognises the real risks of insufficient generation capacity. Rules for the introduction of capacity markets now feature in the 2014 EEAG. They demonstrate the inclusion of single market and low carbon themes in the development of State aid policy on security of supply. Member States must present adequate analysis of the causes of inadequate generation and demonstrate that they have addressed the right incentives for investment.

If the case for the introduction of a supported capacity market can be made, the mechanism should support only availability (not the sale of power), be open to generation from other Member States and include both existing (for example retrofitting plants) and new generation capacity. Member States should also establish alternative measures such as better interconnection, electricity storage and more flexible or reduced electricity consumption.

A capacity market mechanism is included in the UK's Electricity Market Reforms. The Commission approved the design at the same time as its positive decision on the CfD programme[12]. Key components of the Commission's compatibility decision were the UK government's demonstration that the capacity market was introduced only following a thorough investigation of its necessity and the potential for alternative measures to contribute to the security of supply objective; that the measure itself will be open to a range of technologies, including demand side response and interconnection; and the use of auctions to ensure that aid granted is limited to the minimum necessary.

As with its views on the UK's CfD methodology, the Commission's detailed analysis of the UK's design and rationale for its specific capacity mechanism will likely be regarded as an indicator of how the Commission will interpret the broad provisions of the 2014 EEAG for other Member States.

Nuclear energy

Nuclear energy remains conclusively outside the 2014 EEAG. It is well known that in December 2013 the Commission started an in-depth phase 2 investigation into the proposals for the Hinkley new nuclear power plant in the UK[13]. Although the UK authorities consider that it too should benefit from a CfD mechanism (as well as a credit guarantee), the Hinkley project is hugely different in terms of scale, technology and specific combination of proposed supports from "average" renewable developments. Combined with the lengthy timeframe of a phase 2 investigation (the Commission's full 18 month administrative timetable would end in June 2015), this means that the eventual decision is likely to be of little use to investors looking for early indications of Commission thinking on new treatments for non-nuclear low carbon projects.

Free movement of goods

Free movement issues also arise. When a Finnish wind farm developer brought a case against the Swedish authorities' refusal to enable it to participate in the Swedish green certificate system, the Swedish court asked the European Court of Justice to decide the point of law. In July 2014 the ECJ held that although the scheme constitutes a restriction on the free movement of goods, that restriction is justified by the public interest objective of promoting the use of renewable energy sources so that Sweden was legitimately able to reserve a national support scheme for the national production of green energy[14].

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12 Commission authorises UK Capacity Market generation scheme IP/14/866 23/07/14

13 Commission decision letter of 18/12/13 "State aid SA. 34947 (2013/C) (ex 2013/N) – United Kingdom Investment Contract (early Contract for Difference) for the Hinkley Point C New Nuclear Power Station"

14 Case C-573/12 *Alands Vindkraft AB v Energimyndigheten* judgment of 1 July 2014

6. Process points

Finally, the notification process can be unclear to the potential beneficiary. A Member State in pre-notification discussions with the Commission will often want to maintain confidentiality in order to be able to engage in a full exploration of the available arguments and interpretation of the applicable guidelines, especially where those guidelines are as yet untested. The Commission is interested to hear the beneficiary's perspective, but in particular in the case of a scheme having many potential beneficiaries, that perspective will likely be filtered through the Member State contacts.

Unless the matter is one of the restricted list that falls within the simplified procedure (none of the examples considered in this note does so), the first document the Commission publishes will be a press release on its decision, followed by the non-confidential full text of the decision, whether that is to clear the aid or to open a phase 2 investigation. Potential beneficiaries should try to stay as close as possible to the relevant sponsoring department.

The good news is that a positive decision once given is usually clear as to the scope of the approved aid, the amount available, the period covered and any reporting requirements or other conditions.

Further, the Commission is generally opposed to ex-post reassessments of particular supports. In its FAQs on the 2014 EEAG, the Commission has stated clearly that the new guidelines will have no effect on aid already being paid to the owners of existing installations. Such investors will continue to receive aid based on existing approved state aid schemes, to maintain their legitimate expectations on the returns on their existing investments.

Your CMS contacts

CMS takes a lively interest in State aid developments. We would be very happy to discuss the impact on your business of any of the matters covered above, or other state aid issues. Please do not hesitate to get in touch with your usual CMS contact or with Susan Hankey, Robert Lane or Munir Hassan in London (+44 207 367 3000), Fritz von Hammerstein in Germany (+49 40 376 300), Christophe Barthélemy in Paris (+33 1 47 385 580), or Andrzej Blach in Warsaw (+48 22 520 5555), who will be delighted to help or to direct you to an energy State aid specialist in your jurisdiction.

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