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COMMENTARY

European Union Issues New Guidelines on State aid for Environmental Protection and Energy

On April 9, 2014, the European Commission adopted new Guidelines on State aid in the field of environmental protection and energy for 2014-2020 (the "**New Guidelines**"). State aid is generally prohibited under European Union ("EU") competition rules, but may be allowed under certain conditions where it is in the overall interest of the EU. The New Guidelines set out the conditions under which State aid in the field of environmental protection and energy can be declared compatible with the EU internal market on the basis of Article 107(3) of the Treaty on the Functioning of the European Union (the "**TFEU**"). They will apply as of July 1, 2014 and replace the previous Guidelines on State aids for environmental protection entered into force in 2008.

Compared to the previous Guidelines, the New Guidelines expand well beyond the environmental field into the energy area and also further simplify and clarify the assessment of State aid measures, based on the Commission's decision-making practice and policy developments in recent years.

The adoption of the New Guidelines followed three rounds of public consultation (the latest of which ended February 14, 2014), which sparked numerous comments from Member States, public authorities and stakeholders, and even led to the unusual circumstance of a vote by the European Commissioners, in which one Commissioner voted against and three abstained. The New Guidelines constitute one of the most important elements of the Commission's ambitious State aid reform package, as set out in its Communication on EU State aid modernization published May 8, 2012. The main objectives of this package are to (i) foster growth in a strengthened, dynamic and competitive EU internal market, (ii) focus enforcement on cases with the biggest impact on the internal market, and (iii) streamline State aid rules and accelerate the issuance of decisions by the Commission.

The New Guidelines will significantly impact the EU's energy profile, including the future of energy production from renewable sources, electricity prices, and hence, the overall direction of European competitiveness in the energy sector and beyond within the next few years. For instance, they establish basic rules for assessing Member State legislation favoring the production of renewable energy and exempting certain energy-intensive industries from the ensuing cost, which is one of the most hotly contested issues in EU State aid law over the past few years. In particular, the New Guidelines are designed to help resolve multi-billion Euro State aid cases pending on this question, especially in Germany and France.

Main objectives. The Commission seeks to fine-tune the balance between the need for public funds in support of renewable energy and the goal of ensuring competitive markets. On the one hand, the Commission considers that "*well-designed public support measures can make a key contribution to achieving the EU's energy and climate objectives for 2020 and strengthening cross-border energy flows, thus ensuring that European companies and consumers have access to more affordable energy.*" On the other hand, the Commission points out that public support measures, which largely induced the tremendous growth in renewable energy over recent years, has caused serious market distortions and increased energy costs for consumers. Thus, the Commission finds that "*it is time for renewables to join the market*" through "*more efficient public support measures that reflect market conditions, in a gradual and pragmatic way.*"

In this context, the new EU framework for environmental and energy State aid aims at supporting Member States' efforts in reaching their 2020 climate targets, while addressing the market distortions that may result from subsidies granted to renewable energy sources. It also promotes a gradual move to market-based support for renewable energy. The overall rationale of the New Guidelines is to favor the achievement of a competitive low-carbon economy, as well as the integration of the EU internal energy market through fewer, but better targeted and more cost-effective State aid measures.

Scope of the New Guidelines. The New Guidelines apply to State aid granted for environmental protection or energy objectives in all sectors governed by the TFEU, including those sectors subject to specific EU State aid rules (e.g., transport, coal, agriculture, forestry, fisheries and agriculture), unless provided otherwise. However, the New Guidelines do not apply to (i) the design and manufacture of environmentally friendly products, (ii) the financing of environmental protection measures relating to transport infrastructure, (iii) stranded costs (which remain subject to the regime set out in the Commission's 2001 Communication), (iv) State aid for research, development and innovation (which are subject to the 2006 Framework for State aid for research and development and innovation, as currently under review by the Commission), and (v) State aid for biodiversity measures (which usually fall within the scope of the rules set out for Services of General Economic Interest). In addition, environmental and energy aid may not be awarded to firms in difficulties, as defined by the Guidelines on State aid for rescue and restructuring undertakings in difficulty.

The New Guidelines identify various environmental and energy measures that may be compatible with Article 107(3)(c) TFEU under certain conditions:

- Aid for exceeding EU standards or increasing the level of environmental protection in the absence of EU standards
- Aid for early adaptation to future EU standards
- Investment and operating aid for energy from renewable sources (i.e., renewable non-fossil energy sources)
- Aid for environmental studies
- Energy efficiency measures, including cogeneration and district heating and district cooling
- Aid for resource efficiency and waste management
- Aid for the remediation of contaminated sites
- Aid for relocation of undertakings
- Aid in the form of tradable permits
- Aid for CO2 capture, transport and storage ("CCS")
- Operating aid in the form of reductions in or exemptions from environmental taxes
- Operating aid in the form of reductions in funding support for electricity from renewable sources
- Aid for energy infrastructure
- Aid for generation adequacy measures

The New Guidelines will enter into force on July 1, 2014 and will be applicable until December 31, 2020. Following their entry into force, the Commission will apply the New Guidelines to all notified aid measures for which it is called upon to make a decision, even if the projects were notified prior to July 1, 2014. Unlawful environmental or energy aid will be assessed in accordance with the rules in force at the date on which the aid was granted. The Commission also clarifies that it will not retroactively apply the New Guidelines to any individually notifiable aid granted on the basis of an already approved aid scheme. Member States are nonetheless required to amend their existing national environmental and energy aid schemes in order to bring them into line with the New Guidelines no later than January 1, 2016. In exception to this, schemes for operating aid for renewable sources and cogeneration need only be brought into line with the New Guidelines if they are prolonged or adapted.

State aid to nuclear projects not covered. As anticipated for several months, the New Guidelines do not include public support measures to the nuclear industry. Thus, such measures must be notified to the Commission and assessed under the general provisions of the TFEU on State aid. Earlier in the process, a leaked draft of the New Guidelines included several pages on how the Commission would address State aid measures in the nuclear industry, but the New Guidelines abandoned these proposals following an intensive lobbying effort led by Germany, and including several other EU governments. Generally, this has been viewed as a victory for the anti-nuclear lobby and a setback for the nuclear industry, particularly in the U.K. where a new generation of reactors is proposed. Whether this is actually a setback is debatable, since the nuclear industry may actually benefit from falling outside of the scope of the New Guidelines and thereby retaining more flexibility for future individual nuclear cases. The ongoing formal State aid probe into the Hinkley Point C nuclear power station in the U.K., opened by the Commission on December 18, 2013, pertains to the U.K.'s plan to spend approx. £16 billion to build a new nuclear facility with EDF Energy. The plan involves, among other elements, a guaranteed price for nuclear power known as the "strike price." This investigation is very much regarded as a test case that should probably set a major precedent for future nuclear investments in the EU.

Common compatibility assessment principles. The New Guidelines provide the compatibility criteria for environmental and energy individual aid and aid schemes, which are subject to the notification obligation pursuant to Article 108(3) TFEU. In line with the Commission's decision-making practice, the New Guidelines are based on a "balancing test," which requires that the positive impact of the aid towards an objective of common interest exceeds its negative effects on trade and competition, taking into account the "polluter pays" principle established by Article 191 TFEU. In particular, the Commission will consider a State aid compatible with the EU internal market only if it satisfies each of the following criteria:

- *Contribution of a well-defined objective of common interest: t*he aid must ensure an increased level of environmental protection compared to the level that would be achieved absent the aid, or must ensure a competitive, sustainable and secure EU internal energy market;
- *Need for state intervention:* the aid must correct market failures which remain unaddressed by other policies and measures;
- *Appropriateness of the aid measure:* the aid must be the less distortive policy instrument and the less distortive type of aid instruments in order to reach the specific objective of common interest;
- *Incentive effect:* the aid must induce the beneficiary to change its behavior to increase the level of environmental protection or the functioning of the EU energy market, which it would not do without the aid (e.g., no aid can be granted where the aid beneficiary would already be obliged to undertake the aided action pursuant to EU legislation);
- *Proportionality of the aid:* the aid amount must be limited to the minimum necessary to achieve the environmental protection or energy objective aimed for, which is generally the case where the aid corresponds to the (net) extra cost necessary to meet the objective, compared to the counterfactual in the absence of aid (or do not exceed a given percentage of the eligible costs of a project, i.e., the maximum aid intensity);
- *Avoidance of undue negative effects on competition and trade:* the negative effects of the aid must be sufficiently limited, so that the overall balance of the measure is positive (in order to keep the distortions of competition and trade to a minimum, the Commission will put great emphasis on the selection process of the aid beneficiary(ies) which, where possible, should be conducted in a non-discriminatory, transparent and open manner).
- *Transparency:* Member States must publish information on their State aid schemes and ad hoc aid measures.

Investment and operating State aid for renewable energy production. In recent years, renewable energy sources have been heavily supported by fixed tariffs, leading to market distortions. In particular, support mechanisms have simultaneously led to significant cost increases for electricity customers and sheltered renewables producers from risks, allowing the production of electricity irrespective of actual demand. This has impacted wholesale electricity prices and weakened price signals for investment in electricity generation.

The New Guidelines aim at better integrating renewables into the EU electricity market on a gradual basis, limiting State aid to what is strictly necessary. They foresee the progressive introduction of auctioning or competitive bidding processes for allocating public support, as well as the gradual replacement of feed-in tariffs by feed-in premiums (a top-up on the market price), thereby exposing renewable energy sources to market signals. In 2015-2016, Member States will start implementing competitive bidding procedures for a small share of their new capacity from renewables. As from 2017, Member States shall set up tenders to grant support to all new installations. Small installations and technologies in an early stage of development can, however, be exempted from participating in competitive bidding processes. The New Guidelines define small installations as those producing less than 6 MW of wind power (or 6 generation units), or 1 MW of power from other renewable sources, such as solar or biomass. In addition, small installations below 3 MW (or 3 generation units) for wind or 500 kW for other sources will be allowed to continue to benefit from any form of aid, including feed-in tariffs.

The New Guidelines will have no effect on aid given to the owners of existing installations, who will continue to receive aid based on existing approved aid schemes. The Commission will authorize aid schemes for a maximum period of ten years. If maintained, the scheme should be re-notified after such period. As regards food-based biofuel, existing and newly notified schemes should be limited to 2020.

State aid in the form of electricity charge reductions for energy-intensive companies. In recent years, the financing of renewable support measures has led to an increase in electricity costs in many Member States. Cost increases have emerged either directly through a specific charge levied from electricity consumers on the top of the electricity price, or indirectly through additional costs faced by electricity suppliers due to obligations to buy renewable energy, which are subsequently passed on the electricity consumers. Such additional costs affect the competitiveness of energy-intensive industries, in particular those exposed to strong international competition, and raises the risk of so-called "carbon leakage," whereby industries relocate outside of the EU to escape excessive environmental costs of operating within the EU.

In this context, the New Guidelines allow Member States to partially relieve cost burdens for a limited number of energy-intensive sectors (such as the manufacturing of chemicals, paper, ceramics or metals) or individual companies. This is done through State aid in the form of reductions on charges levied to support renewable sources, while establishing safeguards to limit distortions of competition and avoid harmful subsidy races between Member States. For example, the Commission will only approve aid that is:

- *limited to beneficiaries who are exposed to a competitive risk, i.e.* companies belonging to a predefined list of eligible sectors (as set out in Annex 3 of the New Guidelines) or, alternatively, companies with a high "electro-intensity" (electricity costs accounting for at least 20% of gross-value added) and that are active in a sector exposed to international trade (4% of trade intensity, calculated as the total trade of the sector with third countries, relative to the market size in the EU);
- *non-discriminatory:* the aid should be granted in the same way to all competitors in the same sector if they are in a similar factual situation; and
- *proportionate:* the aid beneficiaries must pay at least 15% of full renewable surcharge, provided that Member States will have the possibility to further limit the amount of the renewable surcharges to be paid under certain circumstances.

The New Guidelines will apply retroactively for the assessment of reductions in the financing of renewables for energy-intensive users.

Since the 2008 Guidelines did not foresee the possibility of such reductions, the Commission recently opened two State aid cases regarding respectively (i) reductions granted to energy-intensive companies on a surcharge for the financing of renewable energy in Germany, known as the German EEG-support system (in-depth investigation opened December 18, 2013), and (ii) three types of reductions granted to large energy consumers on renewable energy surcharges in France (the so-called "*contribution au service public de l'électricité*"—CSPE) designed to finance the support for on-shore wind (in-depth investigation opened March 27, 2014, following a judgment of the EU Court of Justice on December 19, 2013 – Case C-262/12, *Association Vent de colère*, confirming that the French support for the production of electricity from on-shore wind installations involves an intervention through state resources and hence, State aid within the meaning of the TFEU). Soon after their entry into force, the New Guidelines will therefore apply to these two State aid cases, which should considerably help to "solidify" the principles laid down in the new EU framework for environmental and energy State aid.

State aid to energy infrastructure. Since a modern infrastructure is crucial for an integrated energy market and for achieving the EU's climate and energy goals, for the first time, the New Guidelines include rules for assessing State aid to energy infrastructure. Where market operators cannot deliver the energy infrastructure needed, the Commission acknowledges that State aid may be necessary to overcome market failures and to ensure meeting the considerable investment needs in energy infrastructures of European significance (about €200 billion until 2020, as estimated by the Commission). However, State aid to energy infrastructure (in principle, investment aid) should focus on infrastructure projects improving cross-border energy flows or contributing to regional cohesion (i.e., promoting infrastructure in Europe's less developed regions). The aided energy infrastructure should also be open to access by third parties and subject to tariff regulation, in order to benefit all users.

State aid to secure generation adequacy. The New Guidelines also include State aid rules to secure adequate electricity generation. In the event of a risk of insufficient electricity generation capacity, the New Guidelines allow Member States to introduce so-called "capacity mechanisms" to encourage producers to build new generation capacity, to prevent them from shutting down existing plants, or to reward consumers for reducing consumption during peak hours. Under the New Guidelines, Member States shall clearly demonstrate the reasons why the market cannot be expected to deliver an adequate generation capacity in the absence of intervention. Since aid to generation adequacy may contradict the objective of phasing out environmentally harmful subsidies including those for fossil fuels, Member States should also primarily consider alternative ways of achieving generation adequacy, such as facilitating demand-side management, developing electricity storage and increasing interconnection capacity. Moreover, the State aid should solely reward the availability of capacity (remuneration per MW) and not the sale of electricity (remuneration per MWh) and should not unduly favor national generation or any particular technologies, in order to limit the risks of distortions of competition.

Interplay with the General Block Exemption Regulation on State aid measures ("GBER"). The Commission's State aid modernization package also encompasses a revision of the 2008 GBER, which exempts unproblematic categories of aid from prior notification to the Commission. In the draft amended GBER submitted to public consultation, the Commission proposes, among other things, to revise and extend the list of environmental and energy aid that may benefit from an exemption (e.g., certain forms of aid to promote renewable energies or district heating, to clean up contaminated sites, or to improve energy efficiency in buildings). According to the Commission, automatically exempted measures may cover up to 40% of the public expenditure in the environmental and energy field and will therefore significantly simplify the granting of support measures with a limited potential for distorting competition. The new GBER will be adopted in May 2014 and enter into force on July 1, 2014 in parallel with the New Guidelines.

The New Guidelines will directly affect many companies operating in the EU, including producers of electricity from renewable sources and energy-intensive companies. In coordination or in parallel with EU Member States, companies now have several months before the entry into force of the New Guidelines. This will be a time to not only assess how to best adapt to the new rules and constraints, but also to identify possible new opportunities arising from the revised EU framework.

The Commission's New Guidelines are available here.

Lawyer Contacts

For further information, please contact your principal Firm representative or one of the lawyers listed below. General email messages may be sent using our "Contact Us" form, which can be found at www.jonesday.com.

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