STATE AID: NEW GUIDELINES FOR ENVIRONMENTAL AND ENERGY PROJECTS PUBLISHED BY EUROPEAN COMMISSION

The European Commission (the "Commission") has published its guidelines on State aid for environmental protection and energy ("the Guidelines") as part of its on-going modernisation of State aid criteria and following a consultation earlier this year (covered by our e-briefing here). The Guidelines set out the way in which the Commission will assess support schemes in Member States to ensure compatibility with Article 107(3)(c) of the Treaty on the Functioning of the European Union ("TFEU"), ie that the aid should not affect trading conditions and market development within the internal market in manner that is contrary to the common interest.

A notable change to the proposals set out in the draft guidelines is that the Commission no longer expressly distinguishes between "deployed" and "less deployed" technologies as an step when considering the aid measure (in the consultation, the Commission proposed to apply different sets of criteria in relation to aid for deployed as opposed for less deployed technology).

A key tool proposed by the Commission in the Guidelines for assessing whether aid is compatible is the use of the 'counterfactual scenario' (also referred to as the 'alternative project'): Member State/aid applicants are required to set out a credible projection of what would happen "but for" the aid. This is then used as a yardstick to judge whether the projects in question merit the aid, in accordance with specified reference criteria.

In this e-briefing we focus on the parts of the Guidelines relevant to energy projects, and in particular consider the treatment of the specified criteria and treatment of different technologies.
The decision making process is summarised in the diagram below:

1. **Overview of the structure of the Guidelines**

The Guidelines set out the following sections: (i) the scope of their application; (ii) the thresholds that trigger notification; (iii) the general assessments for compatibility with Article 107(3)(c) TFEU and the special assessments for certain technologies; (iv) the parameters of the evaluation process; (v) the application process; (vi) the reporting and monitoring obligations; and (vii) the Commission’s powers to revise the Guidelines. In this briefing we will look at points (i) to (iii) above.

**Notification thresholds**

The Guidelines set out aid notification thresholds which, when passed and if the aid is not granted on the basis of a competitive bidding process, oblige the Member State to notify the Commission that there is an application for State aid in accordance with Article 108(3) TFEU. The thresholds are quite low: (i) investment aid exceeding €15 million per undertaking; (ii) operation aid for renewables and/or combined production of renewable heat on sites where the renewable generation capacity exceeds 250MW; (iii) operation aid for the production of biofuel where the resulting production exceeds 150,000 tonnes per year; (iv) operating aid for co-generation where the electrical capacity exceeds 300MW – aid for the production of heat through co-generation will be assessed in the context of notification of electrical capacity; (v) aid for infrastructure exceeding €50 million per undertaking, per investment; (vi) aid for CCS in excess of €50 million; and (vii) aid for generation adequacy measures exceeding €15 million per project per undertaking.

Given the cost of many energy projects, these thresholds will catch a significant number of projects and the requirement for referral to the Commission could result in an increased project lead time.

**What is the aid for and how is it given?**

Once the notification threshold is passed, the Commission’s assessment of the application has two parts: what the aid is for, and the overall effect of how it is given.
The Guidelines set out objectives for which State aid may be compatible with the internal market under 107(3)(c) TFEU applicable. These include:

- aid for going beyond EU Standards or increasing environmental protection in the absence of EU standards;
- aid for early adaptation to EU standards;
- investment and operating aid for energy from renewable sources;
- aid for environmental studies;
- energy efficiency measures including cogeneration and district heating and cooling (investment and operating aid for energy efficiency and co-generation installations and aid for district heating and 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 CCS and elements of the CCS chain;
- 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; and
- aid for generation adequacy measures.

When assessing the mechanics of a support scheme targeted at one of the above, the broad objective that the Commission considers whether the support will lead to an increased contribution to the EU energy and environmental goals without overly adversely affecting trading conditions in a manner contrary to the common interest. To assess this, a project must meet all of the 7 specific criteria:

- incentive effect;
- contribution to a well-defined objective of the common interest;
- need for State intervention;
- appropriateness of the aid;
- proportionality of the aid;
- the extent to which it affects competitiveness between Member States; and
- the transparency of the aid.

Below, we take each of the seven criteria in turn.

**The incentive effect**

Aid for energy and the environment can only be found compatible with the internal market where it has an incentive effect ie where the relevant aid causes the beneficiary to behave in a manner that achieves the common EU goals of increasing environmental protection and improving the security, affordability and sustainability of the energy market in a manner which would not occur but for the aid.

As the objective of the aid is seen as incentivising desired behaviour rather than rewarding existing good behaviour, aid will not be granted retrospectively where a project is implemented and then later applies for aid. However, aid may be seen to incentivise behaviour – and therefore granted – where an EU standard has been adopted but has yet to enter force, provided that the adoption to the EU standard by the beneficiary occurs one year prior to the enforcement of the standard. The final Guidelines are quiet about the validity of granting aid to projects that are commenced and desirable in relation to the green objectives and subsequently become unviable due to a change in economic circumstances.

To assess whether the incentive effect exists in a given case, at the point of application for aid the potential beneficiary is required to set out the scenario of what would occur without the aid. The credibility of this assessment should subsequently be checked by the national granting authority.
The Member State is required to demonstrate the incentive effect to the Commission and provide clear information as to the increase in the level of environmental protection and the level of market distortion that the aid is likely to have.

**Contribution to a well-defined objective of the common interest**

When making the application, the Member State has to clearly define the objective it is seeking to achieve through the aid and what the contribution of the proposed aid is. This can be done through a variety of supporting evidence including environmental studies, but there is a presumption that the aid will meet this objective when the project is co-funded by the European Structural and Investment Funds.

Where notification of the Commission is triggered, the Guidelines encourage applications to demonstrate the increased level of environmental protection that the aid will engender, in particular in relation to: (i) abatement technologies – reduction in GHG and pollutants; (ii) existing EU standards – the overall effect of the aid in delivering reduction in pan-EU pollution; and (iii) future union standards – the increased rate that the aid will have on the meeting of future EU standards.

**Need for state intervention**

Need is identified where it is clear that the market will not deliver the material outcome that is required by the EU targets or the more stringent targets that Member States may have set. It is up to Member States to identify and prove this failure. However, mere market failures will be insufficient in themselves to justify state intervention. The issues causing the market failure have to be looked at in the round and only where the other policies and measures are failing to achieve their objectives and where State aid will not undermine these measures will state intervention be permissible.

The Commission identifies four types of market failure: (i) negative externalities – for example where pollution is not adequately priced; (ii) positive externalities – where part of the benefit from the investment will be enjoyed by parties other than the investor; (iii) asymmetric information – where there is a discrepancy in the information available between the market elements and this increases the perceived / actual risk for investors and therefore puts investors off; and (iv) coordination failures – where the effectiveness of a project is undermined by diverging interests of investors.

**Appropriateness of aid**

The proposed aid will only be deemed appropriate if it assists with meeting the common objective and the same ends are not achievable through the application of other less distortive policy or aid instruments: direct State aid is a last resort and all other policy options should be exhausted.

**The proportionality of aid**

In assessing this, the Commission will look at whether the aid amounts to the minimum that is required to achieve environmental protection or another targeted energy objective. This assessment is done on the basis of whether the aid corresponds to the net extra cost necessary to achieve the objective with reference to the counterfactual scenario. The net extra cost is the difference between the economic benefits and costs to the counterfactual scenario set out. The Commission notes that it can be difficult to determine the economic benefit and, where there are measures that are not subject to an individual assessment, they will be deemed proportional where they do not exceed the "maximum aid intensity", which is defined as a percentage of the eligible costs as defined in the Guidelines.

**Avoidance of undue negative effects on competition and trade**

Though the Commission acknowledges that the point of State aid is to distort the market to develop the green economy, their primary concern is the extent that the aid given to companies will distort both the local market and the development of technologies and projects within that market and the wider European single market. These concerns are classified by the final Guidelines into market distortions and location effects.

To assess whether the levels of distortion caused by the aid are too great, the Commission will look at the overall environmental effect of the measure in relation to the negative effect (profitability) of direct competitors not in receipt of aid. There is concern that aid levels may displace activities between the Member States with companies setting up in the areas with the highest levels of support. Therefore, aid that merely results in a change of location of the activities rather than an improvement in the environmental effect will not be deemed compatible with the internal market.

Where notification is triggered, the Commission will assess whether the aid leads to: (i) supporting inefficient production and therefore impedes productivity and growth; (ii) distorting dynamic incentives; (iii) creating or enhancing market power or exclusionary practices; and (iv) artificially altering trade flows or the location of production. All of these criteria are there to ensure that one Member State should not poach jobs and development benefits from another and that market control over development and project selection isn’t completely eroded.
Transparency

Member States are under an obligation to publish the details of the granting authority, the aid scheme and the beneficiaries and associated details with each grant. The information must be published after the decision for the grant has been taken and must be kept for 10 years (a period corresponding with the maximum length of time aid can be authorised for prior to review).

2. Aid for energy from renewable sources

The Guidelines include a special section on the treatment of renewables. The stated objective is to encourage renewable technology in a manner that results in the technologies becoming grid competitive while adhering to the 2020 and 2030 green energy targets.

Operating aid as a premium for energy from renewables

For aid for renewable energy to be deemed compatible, the Guidelines set out criteria that must be fulfilled:

To encourage market integration by renewables generators, they will be required to sell their electricity directly into the grid and become subject to market obligations and the following conditions will apply to all new aid schemes by 1 January 2016: (i) aid granted by premium will oblige generators to sell directly into the market; (ii) aid beneficiaries will be subject to standard balancing responsibilities unless a liquid intra-day markets exist; and (iii) provisions are made to ensure that there is no incentive to generate electricity under negative prices.

The above conditions do not apply to installations with a generating capacity of under 500 kW and demonstration projects except for electricity from wind energy where an installed capacity of 3MW or 3 generation units applies.

During the transitional phase from 2015 to 2016 at least 5% of the aid is granted by way of competitive bidding on the basis of clear, transparent and non-discriminatory criteria unless Member States could demonstrate that: (i) there is only a very limited number of projects or sites that would be eligible; (ii) the competitive bidding process would result in higher support levels; and (iii) a competitive bidding process would result in low project realisation rates.

There is an automatic presumption of proportionality where the bidding process is open to all renewable generators on a non-discriminatory basis. However, it is permitted to limit the bidding process to specific technologies where opening the process up would be detrimental regarding any of the following: (i) the longer term potential of a new and innovative technology; (ii) the need to achieve a diverse energy mix; (iii) network constraints and grid stability; (iv) system integration costs; or (v) the need to avoid distortions in the raw materials market that may be caused by biomass. Aid may be granted without competitive bidding for installations with a generating capacity of under 1MW and demonstration projects except for electricity from wind energy where an installed capacity of 6MW or 6 generation units applies.

The aid will only be granted until the point at which the costs of the plant have been fully depreciated in accordance with normal accounting rules. The exception to this is biomass which, due to the low start-up costs and low running costs, will be treated differently.

Operating aid in the form of green certificates for renewable energy

Though from the level of detail there is a bias towards aid in the form of market premiums rather than green certificates, the Commission will support aid in this form provided there is evidence that such support: (i) is essential to support the viability of the renewable energy sources concerned; (ii) does not result in overcompensation looking at the aggregate cost of the scheme over time and across technologies or for individual less deployed technologies; and (iii) does not dissuade renewable generators from becoming more competitive.

3. The treatment of different technologies: biomass, carbon capture and bioliquids

It is acknowledged by the Commission that there are certain technologies the use and/or development of which is in line with the common objective and yet is not adequately supported by the general framework of the Guidelines. Therefore they have set out certain technology specific guidelines.

Aid for existing biomass plant after depreciation

As the business model for biomass is acknowledged by the Commission as different from other technologies, the Guidelines allow for the fact that plant development/conversion costs are lower but long term fuel costs may be higher. To prevent
conversion back to fossil fuel, the Guidelines state that operating aid after depreciation may be permissible subject to detailed conditions.

The Commission will consider continued provision of operating aid after depreciation where a reversion or conversion to fossil generation would otherwise be more economically advantageous provided the following are met:

(i) the aid is only for the renewable energy;
(ii) the aid is compensatory for the difference in profitability if fossil fuels were used;
(iii) credible counterfactual evidence is provided that without the support there would be a reversion to fossil fuels; and
(iv) a monitoring mechanism is put in place to ensure that the use of fossil fuels is still more economically advantageous than biofuels.

Aid for CCS

There is a presumption by the Commission that aid for CCS addresses a residual market failure that can only be rebutted by evidence to the contrary. Allowing for the other CCS regulation the Commission presumes that both investment and operating aid is appropriate provided all the other conditions (set out in paragraph 1 above) are met. However, the aid is to be provided for the CCS technology and not for the plant emitting the carbon, irrespective of whether it is coal, biomass or another industrial installation.

Bioliquids

The Commission believes that the overcapacity in the food based biofuel market means that there should be no investment aid in new and existing capacity but aid may be permissible to convert from food based biofuel to plant based biofuel. Other than this, investment aid may only be granted for advanced biofuels. Operating aid for food based biofuel may only be granted until 2020.

4. Aid for energy infrastructure

The Commission recognises that there is the need for energy infrastructure, other than oil infrastructure, supported by aid. However, the manner in which the criteria are interpreted is different. Such aid will fulfil the common interest criteria as energy infrastructure is seen as beneficial to their functioning of the internal market. However, to demonstrate the need for aid for infrastructure the applicant has to show that tariff financing is insufficient and the Commission must pass each project on a case-by-case basis and in doing so examine the extent to which the infrastructure is open to third party access and whether the tariff structure will produce the required outcome. The same tests for the incentive effect set out in paragraph 1 above will apply as with those connected to proportionality. The only difference is that the total of the aid should not exceed 100% of the eligible costs (as defined by the Guidelines). Where the infrastructure in question is subject to internal market rules, the Commission will deem it not to have an adverse effect in terms of competition.

5. Support for generation adequacy

Given the intermittent nature of many renewables key for the transition to a green economy, the Commission will permit aid for generators offering capacity. This aid will meet the common objective if it is targeted at non-fossil capacity. The Member State must also demonstrate the need for the capacity. The Commission will assess this by looking at:

(i) the impact of variable generation from neighbouring countries in meeting the energy needs;
(ii) the impact of demand side participation including demand side management;
(iii) the impact of potential or actual interconnectors including those that are planned; and
(iv) any other element that might exacerbate the generation adequacy problems including regulatory and market failures.

Aid is deemed appropriate if it meets only those of the operator's costs incurred by remaining available. The incentive effect is regarded as set out in paragraph 1 above. The proportionality of the aid is assessed by the beneficiaries earning a reasonable rate of return as decided through a competitive bidding process combined with a mechanism that prevents windfall profits. In order not to adversely affect competition and trade, the measure should:
(i) not reduce incentives for interconnection investment;
(ii) not undermine market coupling;
(iii) not undermine investment decisions or other decisions by operators regarding balancing or ancillary services;
(iv) not strengthen market dominance; and
(v) give preference to low carbon generators in case of equivalent technical and economic parameters.

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