European University Institute

ROBERT SCHUMAN CENTRE FOR ADVANCED STUDIES

FLORENCE SCHOOL OF REGULATION

Long-term Energy Contracts (LTC) and EU State Aid Control

This presentation does not contain any official position of the Court of Justice of the European Union

Dr Adrien de Hauteclocque

Court of Justice of the EU, Luxembourg

Loyola de Palacio Chair & Florence School of Regulation, EUI, Florence

Introduction

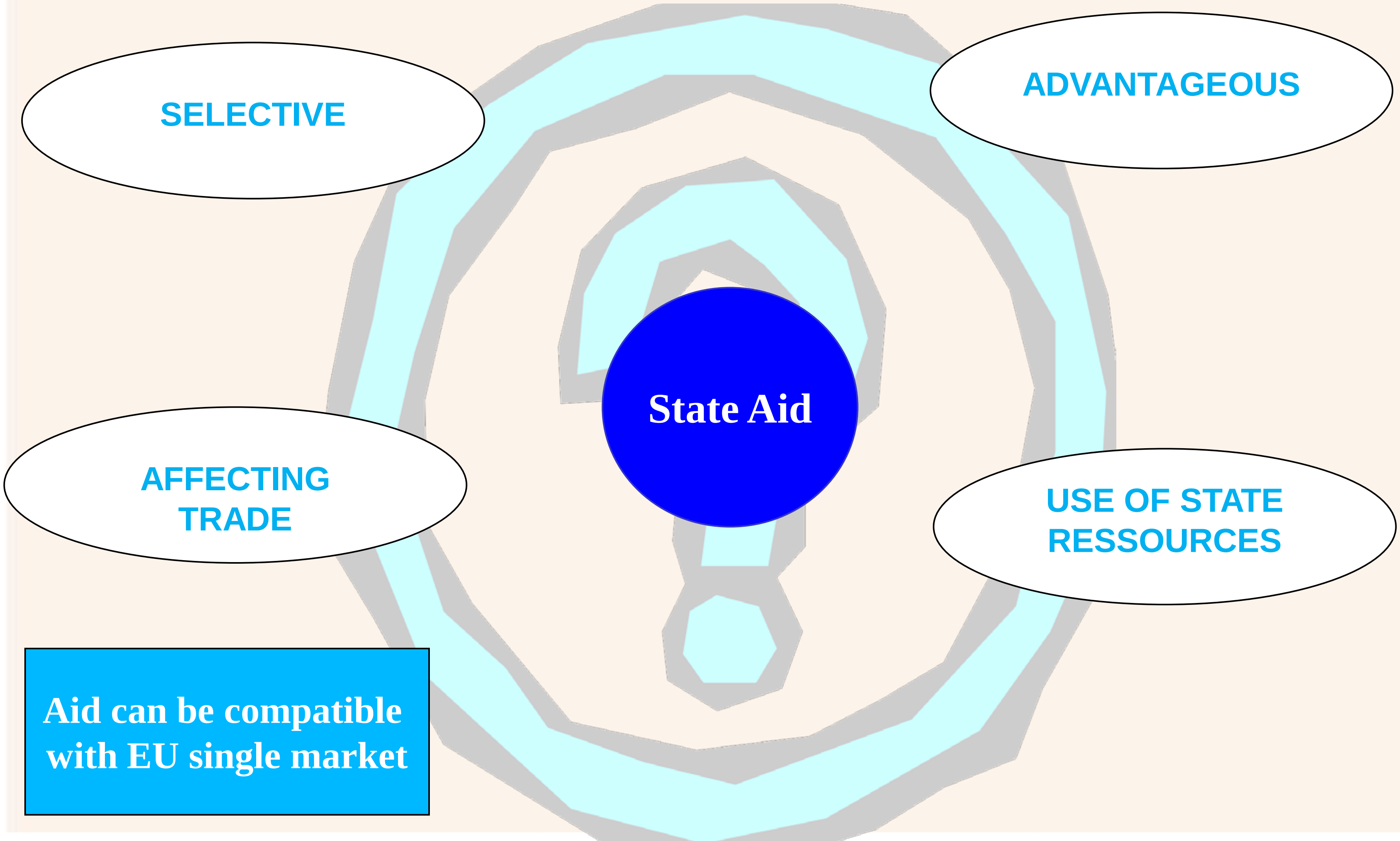
- Little ‘relevant’ guidance from the past

- New policy context, evolving legal framework:

  - ✓ Enhanced importance of state aid control in the energy regulatory context / forthcoming new environmental aid guidelines - EAG (part of State Aid Modernization - SAM)
  - ✓ Commission State Intervention Package - SIP (Nov. 2013)
  - ✓ On-going Commission and EU Court cases

⇒ Overall: **strong legal uncertainty** for investors

When is a measure a EU State Aid?



Aid can be compatible with EU single market

LTC as EU State Aid

<u>NON CONTROVERSIAL CRITERIA:</u>

- Selectivity
- Effect on competition and trade

<u>CONTROVERSIAL CRITERIA:</u>

- State resources
- Advantage

Aid granted "by a Member State or through State resources"?

- Use of state ressources + the use of such ressources must be attributable to the state (imputability criteria)
- Single public company: still need to establish control
- Quid when:
  - Creation of fund or organisation/body to manage flows of monies susceptible to constitute state aid
  - + Parafiscal taxes / compulsory contribution

- Imputability:
    - aid granted directly or indirectly by the state
    - **or** by public or private body **designated** by the state
    - Contribution defined by statute

State Ressources

- Compulsory contribution, defined by statute, managed according to statute
- The fact that money goes through state control (including public/private body designated)
- Public policy objective
- Only if private law body:
  - Has the state effectively conferred management of aid regime?
  - Has the state neccesary conferred ressources?

Advantage (1)

- Effect-based approach
- In case of a support scheme (regime) : self obvious
  - ✓ Hungarian PPA decision: « *the State aid is achieved by […] the minimum guaranteed off-take, the price mechanism based on a capacity fee and an energy fee to cover fixed, variable and capital costs, over a long duration* ***beyond normal practice***. »
    ⇒ quid of buyer risks?
- In case of a single (public) market player (TSO, incumbent GEN…)
  ⇒ market economy investor test
  - ✓ remember *Exeltium*
  - ✓ see Sicily/Sardinia decision on interruptability services
  - ✓ beware of antitrust rules

Advantage (2)

- Service of General Economic Interest - SGEI (*à la* Altmark):
  - ✓ Aid used to target a clearly defined SGEI (SoS – Irish decision yes but Polish PPA no)
  - ✓ Compensation set in advance in an objective and transparent manner
  - ✓ No overcompensation
  - ✓ Compensation determined on the basis of an efficient operator

  ⇒ <u>Use of competitive auction systems would help (e.g. case of capacity mechanisms) but not enough (Polish/Hungary PPA decisions)</u>

Compatibility with the internal market

- Art 107(3)(c) TFEU: « *aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest* »
  - ✓ Block Exemption Regulation
  - ✓ Environmental aid guidelines (EAG)
  - ✓ Technologies not covered by EAG (e.g. nuclear)
  - ✓ Commission can negotiate some sort of ‘commitments’
- Art 106(2) TFEU on Services of General Economic Interest
  - ✓ Conditions: definition, necessity, proportionality
  - ✓ Wide margin of appreciation for Member States

Art 107(3)(c) TFEU: the Balancing Test

1. Is the aid aimed at a well-defined economic objective ?
   - ✓ Does it address a market failure or other objective ?
2. Is the aid well designed?
   a. Is it an appropriate instrument ?
      - ✓ Are there other, better-placed instrument ?
   b. Is there an incentive effect ?
      - ✓ Does the aid change the behaviour of firms ?
   c. Is the measure proportional ?
      - ✓ Could the same change be obtained with less aid ?
3. Are the negative effects on competition limited ?

⇒ **So that the overall balance is positive ?**

A well defined objective (existence of a market failure)

- EAG: environmental protection
- Quid for non-RES technologies?
  - ✓ Security of supply - SoS:

    Not clearly defined (see e.g. Elec SoS Directive)

    SIP: need for a complete assessment of GEN adequacy situation
  - ✓ Multiple objectives? e.g. SoS + low costs for consumers

    SIP: multiple objectives/market failures can be pursued
  - ✓ EAG seems somewhat unfit for nuclear analysis: fuel diversity, lower price volatily, etc… not taken into account

Appropriateness, Incentive effect & Necessity

- Appropriateness: but quid of alternative non state aid options?

  ⇒ increase of interconnections / national regulatory failures removed ? / Quid of implementation of cross-border mechanisms (RES Directive) ?

- Incentive effect & necessity of aid :

  ✓ Counterfactual: would there be an investment without aid? (level of risk, profitability, market conditions, production advantages…)

  ✓ necessity to calculate the additional investment costs associated with the (environmental) benefits (hurdle rate)

Proportionality

- Objectives: minimising support + comparision accross technologies
- Aid intensity: value of aid relative the additional costs to meet the objective (environment: 50% max., except if competitive bidding process + depends on size of the company)
- Many factors:
  - ✓ Link to market prices (e.g. design of strike price)
  - ✓ Length of support
  - ✓ Selection process (competitive bidding process)
  - ✓ Degressivity &/or regular review + exit strategy BUT no retroactive changes in regulation (SIP)

Negative effects on competition

- Protecting inefficient firms
- **Increase market power** (esp. incumbent) / impact on liquidity (/ foreclosure)
- Non discrimination among technologies
  - ✓ objective justification needed → e.g. learning effects, cost differences, optimize portfolio of technologies
- Distortion to trade accross member states (esp. localisation of investment)

⇒ **Wide margin of appreciation for the Commission + possibility to negotiate 'commitments'**

Conclusion

- Many alternative routes to non-aid and compatibility decisions
  - ✓ But hard to escape the state aid box
- Security of Supply still a ‘fuzzy’ legal concept
- Competitive tendering key in compatibility assessment but *a priori* not enough to rule out existence of aid
- Compatibility entails complex economic assessment → wide margin of appreciation for the Commission → nature of judicial control
- Necessity to look at **EU antitrust**, public procument and free movement rules (as well as Euratom Treaty for nuclear)

European University Institute

ROBERT SCHUMAN CENTRE FOR ADVANCED STUDIES

FLORENCE SCHOOL OF REGULATION

Contact:

Dr Adrien de Hauteclocque

Référendaire, Chamber of Judge M. van der Woude

Court of Justice of the European Union (General Court), Luxembourg

Advisor, Loyola de Placio Chair & Florence School of Regulation

European University Institute, Florence

tel: +352 43 03 4692

email: adrien.de-hauteclocque@curia.europa.eu