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Running out of power? Commission moderates state aid reforms for energy

The European Commission's revised Environmental and Energy Aid Guidelines have had a rocky start, fostered by an intense consultation process with member states. The new rules suggest that renewable energy sources should become 'grid-competitive' between 2020 and 2030, with current subsidies eventually being phased out. In the shorter term, member states will retain substantial discretion as to their energy policy, a discretion that is particularly valued in the context of Germany's 'Energiewende'

Increasing links between measures to counteract climate change and the effects of state aid on the internal market have led to a rethink of the state aid rules for energy. In November 2013 the European Commission explained why it would reconsider public intervention in energy in order to ensure consistency in the internal electricity market.[1] In December 2013 the Commission opened an investigation into the German Renewable Energy Act (EEG 2012).[2] On the same date, it announced a formal investigation into the UK government's planned nuclear agreement at Hinkley Point.[3] December 2013 also saw the Commission publish its draft guidelines on aid for environmental protection and energy.[4]

On 9 April 2014, the Commission adopted the final version of these guidelines,[5] which seek to promote a transition away from selective subsidy and towards market-based mechanisms, such as technology-neutral EU-wide tenders for government support. However, this transition is in a gentler (and slower) form than that envisaged in the Commission's original proposals. The more controversial topics of reform have been moderated: for example, aid for nuclear energy is omitted entirely from the guidelines, and will continue to be subject to case-by-case assessment.

General principles of the new Guidelines

Common assessment principles

As with other parts of state aid policy, a notified energy aid measure is deemed to be compatible with the internal market if the measure is designed such that the positive impact on objectives of common interest exceeds its potential negative effects on competition and trade.[6]

The general objective of aid in an environmental context is to increase the level of environmental protection compared with a counterfactual scenario in which aid is absent.[7] The objective of aid for energy will need to be defined precisely, as will its expected contribution towards this objective.[8] Such aid is considered compatible if it has an incentive effect—such as inducing behavioural changes which increase the level of environmental protection or the functioning of the energy market. The aid must not subsidise the cost of activity that an undertaking would incur absent the aid, and must not compensate for normal business risk.[9]

Costs that are eligible for environmental aid are limited to the extra investment costs calculated by comparing the aided investment with a counterfactual situation that does not have the state aid. For instance, for renewable electricity generation, the default counterfactual scenario is a conventional power plant delivering the same generation capacity. Eligible costs are the additional investment costs of a renewable power plant as compared with a conventional plant.[10]

The Guidelines introduce maximum aid intensities for specific aid measures—i.e. the gross aid amount expressed as a percentage of the eligible costs. 100% aid intensity would mean complete compensation. Permitted aid intensities differ for small, medium-sized and large enterprises: the maximum aid intensity for renewable energy and co-generation for small enterprises is 65%; for medium-sized enterprises it is 55%; and for large enterprises it is 45%.[11] If aid is granted in a competitive bidding process, these thresholds are overruled and 100% aid intensity is permitted across the board.

Evaluation

The Commission may require certain aid schemes to be subject to a time limitation of (usually) four years, and to an ex post evaluation of the effects of aid. An extension of the aid scheme beyond four years would be subject to the results of the ex post evaluation. Such scrutiny is to be applied only where the potential distortion of competition is particularly high.[12]

'Transition en douceur'

Electricity from renewable energy sources

Under the draft guidelines (December 2013), aid to established renewable energy sources could be granted for a competitive bidding process only on the basis of clear, transparent and non-discriminatory criteria. It appeared that the Commission intended to discourage feed-in tariffs (FiTs) altogether in favour of mandatory, technology-neutral bidding systems in which the cheapest source of energy won out. The final Guidelines make substantial concessions in this respect. They also remove the initial requirements that the bidding process must be open to bidders from all EU countries, and that a respective cooperation mechanism must be in place.

Instead, the final Guidelines foresee a 'transition en douceur' (a gradual transition). In principle, the FiT regimes are to be progressively replaced by competitive bidding processes—although there are numerous stipulations that effectively confirm existing FiT regimes. During a transitional period of 2015–16, aid for at least 5% of new renewables capacity must be granted in a competitive bidding process.[13] From 2016, new aid measures are to be granted as a premium to the market price, and beneficiaries are to sell directly to the market, in order to bring forward the market integration of electricity from renewable sources.[14]

From 2017 onwards, member states granting aid should normally set up competitive tenders, except in specific cases—for instance, for small installations, or in order to avoid strategic bidding or underbidding.[15] The Commission will look favourably on competitive tenders that are technology-neutral, and in these circumstances it will 'presume that aid is proportionate'.[16] However, a bidding process can be limited to specific technologies if this is justified by various conditions such as diversification of generation or grid stability.[17]

The new guidelines will have no effect on aid paid to the owners of existing renewable generation assets. These will continue to receive aid based on existing approved state aid schemes.[18]

Exemptions for energy-intensive sectors

In order to support the competitiveness of European industry, the Guidelines allow specific EU energy-intensive sectors that are particularly exposed to international trade to be relieved of some of the burden of financing renewables. The Commission argued that exemptions may be necessary to avoid a loss of competitiveness for electro-intensive European industries that compete in global markets.[19] While the initial proposals allowed a limited number of targeted exemptions, their scope has been significantly widened for the final Guidelines.

Energy-intensive industries, such as steel or aluminium refining, will be able to benefit from aid in the form of reductions in obligations to provide funding support for electricity from renewable sources.

The 68 industry segments listed in Annex 3 to the Guidelines can be granted aid on the basis of their energy-intensity and/or trade exposure. Outside these specific sectors, exemptions can still be compliant if the undertaking belongs to a sector with a trade intensity of at least 4% at EU level and an electro-intensity of at least 20%.[20] Aid is considered proportionate if at least 15% of the renewable surcharge is still borne by the undertaking.[21] Member states can limit the exposure of electro-intensive industries still further 'when needed'. At the extreme, for undertakings with an electro-intensity of at least 20%, the costs of financing renewable energy can be limited at 0.5% of the gross value added of the undertaking concerned.[22]

Impact on energy policy in Germany

On 8 April 2014, the German government announced changes to its energy reform (Energiewende) policy and passed a draft law, EEG 2014.[23] This policy was threatened by the Commission's draft state aid proposals, but that threat receded as the Commission modified and softened its plans.[24]

From the perspective of German energy reform, the Commission's final Guidelines differ in two key ways from the draft state aid guidelines. The first is that they relax the requirement for government support to be technology-neutral. Following discussions with the Commission, the German government explicitly dismissed, in the explanatory note to EEG 2014, 'the introduction of a quota model or a technology-neutral support'.[25] The note further states that the level of support will be determined by technology-specific tenders no later than 2017, and that a pilot project will be conducted for open-space solar panels.[26]

The second key change was to relax the restrictions on industry exemptions from financing aid to renewable energy. While the German economics and energy minister stated that around 1,400 undertakings will be eligible, as opposed to more than 2,000 previously,[27] it is unclear that the total quantum of exemptions, which currently stands at €5.1bn, will be reduced.[28]

The German government abandoned its 'green electricity privilege' of the EEG 2012, which the Commission had found might result in discriminatory taxation.[29] The 'privilege', or reduced surcharge, was available to suppliers only if 50% of the electricity portfolio was sourced from domestic renewable electricity produced in plants that were not already more than 20 years in operation. The Commission's concern was that this policy discriminated between domestic and imported electricity from renewable sources produced in similar plants.

In 2013, the Commission indicated that companies that have profited from exemptions under the EEG 2012 may have to pay back exemptions already granted. This sparked discussion among German companies which feared that, on the balance sheet, they needed to form provisions for contingent liabilities for 2013, and in the management report, to discuss the risks related to the investigation procedure. However, the transitional rules on exemptions are more benign than expected. According to the final Guidelines, such aid granted before 2019 is compatible if it either satisfies the new criteria or foresees an adjustment plan to converge with the new rules, 'to be established progressively and at the latest by 1 January 2019'.[30]

In the German industry community these transitional rules are now widely taken to mean that the clawbacks under EEG 2012 will be nil or insignificant. Not surprisingly, many industry associations and unions welcomed the EEG 2014 explicitly.[31]

In all, the new Guidelines are less revolutionary than might have been expected when the draft emerged towards the end of 2013. The idea of a 'transitional period' is familiar from the aviation state aid guidelines adopted by the Commission in February, which envisage a ten-year adjustment period.[32] As with aviation, the Commission's approach to state aid reform in energy allows for a gradual process of adjustment. There is no immediate upheaval for the renewable energy sector or for energy-intensive industries. That said, the Commission envisages that, in the 2020s, renewables will reach a mature phase of competing in the market without state support. This elimination of state support, assuming that it happens, will be a significant change to market conditions.

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[1] European Commission (2013), 'Delivering the internal electricity market and making the most of public intervention', Communication from the Commission, C(2013) 7243 final, 5 November.

[2] European Commission (2013), 'State aid: Commission opens in-depth inquiry into support for energy-intensive companies benefitting from a reduced renewables surcharge', press release, 18 December.

[3] European Commission (2013), 'State aid: Commission opens in-depth investigation into UK measures supporting nuclear energy', press release, 18 December.

[4] European Commission (2013), 'State aid: Commission consults on draft rules for state support in energy and environmental field', press release, 18 December.

[5] European Commission (2014), 'Guidelines on State aid for environmental protection and energy 2014-2020', Communication from the Commission, C(2014) 2322, 9 April. Hereafter referred to as 'EEAG'.

[6] EEAG, para. 26.

[7] EEAG, para. 30.

[8] EEAG, para. 31.

[9] EEAG, para. 48.

[10] EEAG, Annex 2, p. 2.

[11] EEAG, Annex 1, p. 1.

[12] EEAG, para. 243.

[13] EEAG, para. 127.

[14] EEAG, para. 125.

[15] EEAG, para. 126.

[16] EEAG, para. 127.

[17] EEAG, para. 127.

[18] European Commission (2014), 'Energy and Environmental State aid Guidelines – Frequently asked questions', 9 April.

[19] EEAG para. 183.

[20] EEAG para. 187.

[21] EEAG para. 189.

[22] EEAG para. 190.

[23] Entwurf eines Gesetzes zur grundlegenden Reform des Erneuerbare-Energien-Gesetzes und zur Änderung weiterer Bestimmungen des Energiewirtschaftsrechts, 8 April 2014.

[24] *Financial Times* (2014), 'Brussels bends to pressure from Germany on clean energy subsidies', 6 April.

[25] Gesetzentwurf der Bundesregierung: Entwurf eines Gesetzes zur grundlegenden Reform des Erneuerbare-Energien-Gesetzes und zur Änderung weiterer Bestimmungen des Energiewirtschaftsrechts, 8 April 2014, p. 3.

[26] Gesetzentwurf der Bundesregierung: Entwurf eines Gesetzes zur grundlegenden Reform des Erneuerbare-Energien-Gesetzes und zur Änderung weiterer Bestimmungen des Energiewirtschaftsrechts, 8 April 2014, p. 128.

[27] Bundesminister für Wirtschaft und Energie, Sigmar Gabriel, Pressekonferenz zum Kabinettbeschluss über den Entwurf eines Gesetzes zur grundlegenden Reform des Erneuerbare-Energien-Gesetzes (EEG), Bundesministeriuem für Wirtschaft, 8 April 2014.

[28] According to press news, which refers to internal studies by a renowned economics institute, the level of exemption may increase even further because of the new Guidelines. See *Spiegel Online* (2014), 'Ökostrom-Einigung mit Brüssel: EU genehmigt zusätzliche Industrierabatte von bis zu 2,5 Milliarden Euro', 9 April.

[29] European Commission (2013), 'State aid: Commission opens in-depth inquiry into support for energy-intensive companies benefitting from a reduced renewables surcharge', press release, 18 December.

[30] EEAG, paras 194–201.

[31] For example, Industriegewerkschaft Bergbau, Chemie, Energie (2014), 'Klare Fortschritte in der Energiepolitik', Pressearchiv, 8 April; Bundesverband der Deutschen Industrie e. V. (BDI) (2014), 'BDI-Präsident Grillo begrüßt Einigung zwischen Berlin und Brüssel', Pressemitteilungen, 8 April.

[32] European Commission (2014), 'State aid: Commission adopts new guidelines for state aid to airports and airlines', press release IP/14/172, 20