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STATE AID GUIDELINES FOR ENVIRONMENTAL PROTECTION AND ENERGY (EEAG)
Review process, possible changes and opportunities
Catherine Banet
September 2020

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#### **Table of content**

ACKN	OWLEDGEMENTS	. 4
ABOU	T CERRE	. 5
ABOU	T THE AUTHOR	. 6
ACRO	NYMS	. 7
EXEC	JTIVE SUMMARY	. 9
1. I	NTRODUCTION: REVISION NEEDS AND AMBITIONS	12
1.2. 1.3. towa 1.4. 1.5. 1.6. 1.7.	General context  Need for review  The role of the EEAG in fast-tracking decarbonisation of the energy system: ards climate neutrality  EEAG revision in the context of sustainable finance  EEAG in the context of green economic recovery post-COVID-19  Formal steps in the EEAG review process  Objective of the report  Methodological approach and scope  Structure of the report	13 16 18 21 24 25 25
2. T	THE ROLE OF EEAG IN THE BROADER FRAMEWORK OF STATE AID CONTROPPENDENCY AND ENVIRONMENTAL POLICY: PRACTICE AND INTERPRETATION IE GUIDELINES	)L N
2.2. 2.3. the E 2.4.	General legal framework for State aid control and use of State aid guidelines Interaction between GBER, EEAG and secondary legislation	33 of 34
	SCOPE OF THE REVIEW: EXPECTED AREAS OF CHANGE ESSARY/EXPECTED/POSSIBLE)	42
relat adop 3.2. for tl 3.3.	Interaction between EEAG and secondary energy sector legislation: the ionship to the CEP and recast Renewable Energy Directive. Reflecting recently oted secondary legislation.  Priority areas for the von der Leyen Commission and relevant legislative initiative he EEAG revision: the European Green Deal	es 48 54
<b>4. A</b>	ALTERNATIVE WAYS OF STRUCTURING THE EEAG	58
	Three possible approaches  Elements to consider when selecting the approach	

5.	<b>GUIDING PRINCIPLES AND RECOMMENDED PRIORITY AREAS FOR TH</b>	E
EEAG	REVISION	63
	Guiding principles: methodology and assessment criteria	
6.	CONCLUSIONS AND RECOMMENDATIONS	103
REFERENCES10		
	Treaties	
(Ii)	EU legislation	108
(Iii)	Books	108
	Book chapters, journal articles	
(V)	Public documents, reports, press releases	110
(Vi)	CJEU case law	112
(Vii)	) National case law	114

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#### **Acronyms**

BIT Bilateral Investment Treaty

CBAM Carbon Border Adjustment Mechanism

CCS Carbon Capture and Storage

CEP Clean Energy Package for All Europeans

CHP Combined Heat and Power

CJEU Court of Justice of the European Union
CRM Capacity Remuneration Mechanism

DG COMP Directorate General for Competition, European Commission

DSO Distribution System Operator

ECSC European Coal and Steel Community

ECT Energy Charter Treaty

EEA European Environment Agency

EAG State Aid Guidelines for Environmental Protection

EEAG State Aid Guidelines for Environmental Protection and Energy

EIA Environmental Impact Assessment

EIB European Investment Bank
EIU Energy Intensive User

EU European Union
EV Electric Vehicle

GBER General Block Exemption Regulation

GHG Greenhouse gases

IEA International Energy Agency LCA Life Cycle Assessment

LCOE Levelised costs of (producing) energy
MFF Multiannual Financial Framework
NECPs National Energy and Climate Plans

ORE Offshore Renewable Energy
PCI Project of Common Interest

PV Photovoltaic

RED Renewable Energy Directive
RES Renewable Energy Sources
SAAP State Aid Action Plan

SAM State Aid Modernisation

SDG Sustainable Development Goals
SEIP Sustainable Europe Investment Plan
SGEI Service of General Economic Interest
SOER State of the European Environment
TEN-E Trans-European Networks - Energy
TEU Treaty on the European Union

TFEU Treaty on the Functioning of the European Union

TSO Transmission System Operator

UNFCCC United Framework Convention on Climate Change

# **EXECUTIVE SUMMARY**

#### **Executive Summary**

This Report looks at the review process for the State Aid Guidelines for Environmental Protection and Energy (EEAG) and their scope, focusing on the possible areas of change and opportunities for an improved State aid regime in the energy sector.

This report aims to identify how the revised EEAG can contribute to fast-tracking the transition towards low carbon energy systems in a cost-efficient way, consistent with internal market principles. It examines the interactions between the EEAG and State aid rules relevant for the energy sector, including the most recent interpretation of the definition of aid given by the Court of Justice of the European Union. It studies the impact of the newly adopted Clean Energy Package for All Europeans on key activities of the energy sector and the degree of coherence between the different legal provisions.

The Report intends to contribute to the review process by making concrete revision proposals in four main areas:

- 1. The EEAG should continue to be part of the compliance strategy with the EU climate and energy targets. The revised EEAG should be part of the instruments enabling compliance with the 2030 climate and energy targets and the 2050 climate neutrality objective. The revision of the GBER and the EEAG should be closely coordinated, where the general key principles of State aid support should be set in the General Block exemption Regulation (GBER) and then further detailed in the EEAG, as it has previously been the case. The close link between EEAG and GBER should therefore be maintained. Also, because of ongoing and forthcoming legislative processes under the European Green Deal, including on sector integration and sector coupling, the revised EEAG should enable the development of new technologies and measures aimed at reaching the targets set and the environmental goals defined in secondary EU legislation.
- 2. In terms of the methodological approach, there was an important improvement under the last EEAG (2014-2020) concerning the structure of the Guidelines, with a first part of the EEAG being dedicated to common assessment objectives. Through that change, a common methodological framework for the application of the EEAG was defined. As the new approach has been proven to increase legal certainty and transparency, it should be reiterated in the revised EEAG. However, there is also a need to update the methodological approach to reflect the evolution of the role of the EEAG in compliance strategy with climate and energy objectives. Different alternatives exist, oscillating between an objective-based approach and one focusing on a list of criteria for specific measures. This Report argues in favour of a combined approach between overall objectives and detailed criteria for specific measures. Under such an approach, it would be important to define clear assessment criteria to determine to which extent the measure contributes to an 'objective of common interest', as a benchmark. The definition of objectives of common interest should be updated and could, for example, integrate 'resilience'. It should also foresee consistency with the GBER on this point. Technologies and services contributing to the same objective should be subject to the same assessment criteria, in accordance with the principle of technology neutrality.
- 3. The material scope of application of the EEAG should be updated. The revised EEAG should reflect and build on the provisions laid down in the Clean Energy Package for All Europeans. They should enable the implementation of the European Green Deal without adding rules to the legally binding provisions of secondary EU law, and with due respect of the principles set in the Treaties. The revised EEAG should focus on the energy system

holistically (electricity, gas, heating and cooling). Such an approach is in line with both the **technology neutrality principle** and the process of **energy system integration**. The revised EEAG should enable Member States to define different **decarbonisation pathways**, across the different energy carriers, while respecting Member States' sovereignty over their energy mix.

4. Particular attention should be paid to **enforcement and judicial review of State aid rules**. Recent case law from the Court of Justice of the EU has shown the importance of the respect of procedural rules during the evaluation phase of notified aid, as well as the extensive role that the Guidelines can play in the Commission's control of State aids. Elements related to the enforcement and judicial review of the State aid rules should be considered in drafting the revised EEAG.

01

# INTRODUCTION: REVISION NEEDS AND AMBITIONS

#### 1. Introduction: revision needs and ambitions

#### 1.1. General context

The current State Aid Guidelines for Environmental Protection and Energy (EEAG) are valid for the period 2014-2020 and have been formally extended until 31 December 2021. They define compatibility criteria of certain State aid measures with the internal market under Articles 107(3)(c) of the Treaty on the Functioning of the European Union (TFEU), working as exemption to the general prohibition defined in Article 107.1 TFEU.

The past decade has seen the growing importance given to State aid rules in general, and in particular State aid guidelines, as steering instruments for the European Commission in controlling State intervention. This move is particularly visible in strategic areas such as the energy sector. Indeed, in 2014, the previous Environmental Aid Guidelines were extensively revised and extended to the energy sector. These Guidelines, applied in combination with the General Block Exemption Regulation (GBER)<sup>1</sup> and the 'de minimis' Regulation<sup>2</sup>, directly influence the manner in which Member States design national support measures in order to retain conformity with State aid rules.

Following the adoption of the State Aid Modernisation (SAM) reform package in 2012, the notification threshold for national State aid measures was raised to allow the European Commission to focus on the most contentious cases with the potentially biggest impact on the internal market. Meanwhile, environmental and energy aid still represents the first type of expenditure in Member States, following a constant increase curve since the 2008 State Aid Guidelines for Environmental Protection.3 The State Aid Scoreboard 2019 reports that 55% of total State Aid spending in 2018 was allocated to environmental protection and energy measures.<sup>4</sup> This makes these the prime objective in 20 Member States, with five of those Member States representing around 80% of the total nominal State aid spending in this area (Germany, Sweden, the United Kingdom, France and Denmark). 5 This high share closely related to the approval of renewable energy schemes and measures to help Member States reach the 20% target by 2020. Over the 2009-2018 period, the share of notified State aid spending has also increased, reaching 67.5% of the total (€231 billion), while the remainder, €81,5 billion, relates to GBER measures.<sup>6</sup> Within this amount, and although notified aid still dominates, block-exempted State aid has grown significantly to reach around 22.6% of the total State aid spending in 2018. This should be seen as a direct consequence of the SAM reform and the extension of the GBER to new environmental and energy policy objectives. Therefore, due to the large amounts of aid received by the sector, any changes to State aid rules will have important impacts on activities.

The application of State aid rules has already had far reaching consequences for governments and companies. For example, the new criteria laid down in the GBER and the EEAG have forced many Member States to reform their national support schemes for electricity generation based on renewable energy sources with the progressive mandatory use of premium and competitive bidding

 $<sup>^{1}</sup>$  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, so-called General Block Exemption Regulation (GBER).

<sup>&</sup>lt;sup>2</sup> Commission Regulation (EU) No 1407/2013 of 18 December 2013 on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to de minimis aid, so-called de minimis Regulation.

<sup>&</sup>lt;sup>3</sup> Community guidelines on State aid for environmental protection, OJ C 82, 1.4.2008, p. 1–33

<sup>&</sup>lt;sup>4</sup> European Commission, DG Competition, State Aid Scoreboard 2019, available at <a href="https://ec.europa.eu/competition/state\_aid/scoreboard/state\_aid\_scoreboard\_2019.pdf">https://ec.europa.eu/competition/state\_aid/scoreboard/state\_aid\_scoreboard\_2019.pdf</a>

<sup>&</sup>lt;sup>5</sup> Ibid, p.39.

<sup>&</sup>lt;sup>6</sup> Ibid, p.38.

<sup>&</sup>lt;sup>7</sup> The GBER has included in Section 7 (Aid for environmental protection) (Art. 36 to 49) a series of new measures: investment aid for energy efficiency measures and high efficiency cogeneration (Art. 38-40); investment and operating aid for the promotion of energy from renewable sources, including small installations (Art. 41-43); aid in the form of reductions in environmental taxes (Art. 44); and investment aid for energy efficient district heating and cooling (Art. 46). Only new aid measures are mentioned.

process for granting aid. The European Commission has been active in reviewing national measures in favour of both renewable energy and security of supply, with a series of decision on the national capacity mechanisms and a Sector Inquiry. The Court of Justice of the EU (CJEU) has also been active, in its interpretation of the State aid criteria under Article 107.1 TFEU<sup>8</sup> and the assessment method followed by the Commission in, e.g., the Tempus judgment (on appeal).<sup>9</sup> The latest judgment, annulling the Commission's approval decision of the UK capacity market, has automatically imposed a 'standstill period' on the UK's capacity market. A careful preliminary assessment of the requirements contained in the Guidelines as to the compatibility of the proposed national aid measures is also fundamental to avoiding any recovery decision by the European Commission, in the event that a Member State has granted unlawful public support.

In parallel, another recent practice has developed, consisting in the assessment of the compatibility of State aid measures directly or indirectly related to environmental protection or energy - such as nuclear energy and coal phase-out - under Article 107.3(c) TFEU, and not under the Guidelines, because falling outside the material scope of the latter ones. If the assessment of these measures indeed falls outside the EEAG, there remains a need for coherence in the assessment method, not least when justifying the measure as contributing to the same policy objectives.

The Guidelines have already had important effects in a series of energy activities and measures, such as capacity mechanisms, support for renewable energy and support to energy-intensive industries. However, Guidelines are merely a tool for the European Commission to control the shaping and implementation of national measures. With the continuing decarbonisation of the economy and the industrial sector in Europe, the further financing framework - including through State aids - of technologies such as carbon capture and storage (CCS), biofuels and biomass energy, energy storage, energy infrastructure, hydrogen applications and, above all, electrification (e.g. e-mobility infrastructures, public lighting, smart cities and homes) needs to be clarified as a matter of primary importance. There is a crucial need to coordinate between the different initiatives announced under the European Green Deal and the overarching goal of climate neutrality by 2050.

In the aftermaths of the COVID-19 pandemic, the role of the EEAG, as well as other horizontal Guidelines, need to be given further attention. Indeed, certain State aid measures could not only help achieve environmental and energy policy objectives, they could also support the European economy in the context of the coronavirus outbreak and its negative economic consequences. Therefore, the revised EEAG should be aligned with a European strategy for green recovery.

#### 1.2. Need for review

Previous revision processes of State aid guidelines show that there is a need for important updates to the content of the Guidelines at the end of each validity period. This is particularly the case for sectors such as energy, which are subject to rapid and deep changes in terms of economic models, technologies and actors. There is also a need to align on newly adopted policy objectives that the implementation of the Guidelines supports.

Importantly, pursuant to Article 108(1) TFEU), the Commission is obliged not only to keep all systems of aid existing in the Member States under constant review in cooperation with the latter, but also to propose to them any appropriate measures required by the progressive development or by the functioning of the internal market. This entails, as confirmed by the case law, that the Commission shall keep the Guidelines under continuous review for the purposes of anticipating any major

<sup>&</sup>lt;sup>8</sup> Case C-405/16 Germany v. Commission

 $<sup>^{9}</sup>$  Case T-793/14 Tempus Energy Ltd and Tempus Energy Technology Ltd v European Commission. Now on appeal, as Case C-57/19 P.

developments not covered by those measures.<sup>10</sup> This implies that the Commission can amend or repeal its Guidelines.<sup>11</sup> This makes the Guidelines 'one element' of the obligation of regular, periodic cooperation on the part of the Commission and the Member States.<sup>12</sup> To fulfil this obligation, the practice has been to adopt guidelines for a set time period, ensuring they will be regularly reviewed.

On 7 January 2019, the Commission launched an evaluation of several State aid rules - including the EEAG - in the form of a 'Fitness Check'. In addition, in 2019, the European Commission conducted a target consultation for evaluating the EEAG (2014-2020).<sup>13</sup> The consultation aims to get feedback on the implementation of both the GBER (Section 7) and the EEAG, and to receive insights about potential gaps, overlaps or excessive regulatory burden. The Directorate General for Competition (DG COMP) of the European Commission also commissioned a retrospective evaluation study on the EEAG and the relevant provisions of the GBER, which was published in 2020.<sup>14</sup>

#### **Experiences with previous guidelines**

Based on the published answers to the European Commission's Targeted Consultation on the Evaluation of the EEAG, it appears that stakeholders have notably valued the fact that the 2014 EEAG have:

- guaranteed a higher level of transparency in drafting and assessing support schemes;
- contributed to greater scrutiny of competition and market distortions, cost-effectiveness and security of supply;
- contributed to promoting a certain level playing field among the topics covered by the Guidelines;
- established a clearer link between EU environmental and energy objectives and the use of State aid control.

#### Rationale for revising the EEAG

The revision of the EEAG, and related GBER provisions, is justified by the following five key reasons:

- 1. The aim of the EEAG (2014-2020) was to support EU countries in reaching their 2020 climate and energy targets while addressing the market distortions that may result from subsidies granted to renewable energy sources. The climate and energy targets have recently been revised as part of the Clean Energy Package for All Europeans and the climate neutrality target by 2050, as endorsed by the European Council in December 2019, soon to be enshrined in the forthcoming European Climate Law. Given that the EEAG, like the GBER, are crucial instruments in supporting Member States in their efforts to meet climate and energy targets, there is a need for target and objectives alignment.
- Many new provisions of the Clean Energy Package for All Europeans, particularly in the Renewable Energy Directive, the Electricity Directive and the Electricity Regulation, need to be reflected in the revised EEAG.

<sup>&</sup>lt;sup>10</sup> Case C-431/14 P, Hellenic Republic v European Commission, para 71.

<sup>&</sup>lt;sup>11</sup> Cases T-254, 270 and 270/00 *Hotel Cipriani v Commission* [2008] ECR II-3269, para 293, upheld on appeal in Cases C-71/09 P [2011] ECR I-4727.

 $<sup>^{12}</sup>$  See, in particular, judgments in Case  $\underline{\text{C-311/94}}$ ,  $\underline{\text{IJssel-Vliet}}$  [1996] ECR I-5023, paras.  $\underline{\text{36-37}}$ ), and  $\underline{\text{C-242/00}}$ ,  $\underline{\text{Germany v Commission}}$ , ECR [2002] I-05603, para.  $\underline{\text{28}}$  and the case-law cited.

<sup>&</sup>lt;sup>13</sup> Targeted Consultation for the Evaluation of the Guidelines on State aid for Environmental protection and Energy 2014-2020 (EEAG), Public consultation period from 14.05.2019 to 19.07.2019, available at <a href="https://ec.europa.eu/competition/consultations/2019\_eeag/index\_en.html">https://ec.europa.eu/competition/consultations/2019\_eeag/index\_en.html</a>

<sup>&</sup>lt;sup>14</sup> 'Retrospective evaluation support study on State aid rules for environmental protection and energy', prepared for the European Commission by E.CA Economics, Centre for Competition Policy and Sheppard Mulin, Final Report, 2020.

- 3. As a consequence of their national commitments under the 2015 Paris Agreement<sup>15</sup> and the Energy Union Governance System,<sup>16</sup> most EU Member states have adopted or are in the process of adopting **'climate laws'** that enshrine in law their legally binding commitments in terms of target compliance and reporting obligations. Those climate laws vary in content, but constitute important drivers for the adoption of more ambitious climate and energy legislations and policy measures. In parallel, **climate litigation** cases, such as the landmark Urgenda case in the Netherlands<sup>17</sup> and the Climate Case Ireland,<sup>18</sup> are challenging public authorities' liability and duty of care, urging governments to take more ambitious initiatives in the area. This combination of factors will encourage national governments to adopt a series of plans and support schemes which will need notification under the EU State aid regime, and which will trigger the revision of the EEAG.
- 4. **The energy sector has undergone fundamental changes** during the past few years, and the new realities both in terms of markets, technologies and actors need to be reflected in the revised EEAG.
  - During the validity period of the EEAG (2014-2020), some changes in market fundamentals have taken place. Notably, production costs for renewable energies have fallen, with little or no need for support. Renewables need to be fully integrated to the internal energy market, and face the same price signals as other wholesale energy market participants. The progressive phase-out of the support to these now-competitive renewable energies was the objective pursued by the European Commission. At the same time, the European Commission has always recognised that there will still be a need for support for innovative technologies and measures.
    The need for support has therefore changed in nature and, sometimes in form.
  - The revised framework should address new developments that are absent in the current EEAG, areas which are insufficiently covered or measures that need to be updated. For example, important developments have been taking place in relation to the **electrification** of sectors such as transport, with the deployment of electromobility, EV charging stations, cold ironing for shipping and batteries; digitalisation and the development of smart cities. Concerns over **system adequacy** grown, resulting in different responses in different countries, with some capacity mechanisms involving State aid elements. With the adoption of the Clean Energy Package, the role of **demand response**, **flexibility services and storage** is better recognised in EU legislation. However, there is still a need to support flexibility resources and storage in order to enable further investments in renewable energy sources and to contribute to system adequacy, in particular in those countries that are phasing out fossil fuels on a large scale but lack interconnection capacity.
  - This report points out a series of areas where there is a need for change and improvement. It also identifies where there is still a need for public support. There is still a financing gap for the measures necessary to fast-track decarbonisation, while remaining market failures need to be addressed in the Guidelines. Furthermore, actors may also face distortions related to regulated market (natural monopolies), where market failure concept cannot be applied (e.g. electrical infrastructure), which also need to be addressed in the Guidelines. The increased

<sup>&</sup>lt;sup>15</sup> Paris Agreement to the UNFCCC, 2015.

<sup>&</sup>lt;sup>16</sup> Regulation (EU) 2018/1999 of the European Parliament and of the Council of 11 December 2018 on the Governance of the Energy Union and Climate Action.

<sup>&</sup>lt;sup>17</sup> Supreme Court of the Netherlands, The State of the Netherlands v. Stichting Urgenda, 20.12.2019, ECLI:NL:HR:2019:2007.

<sup>&</sup>lt;sup>18</sup> Supreme Court of Ireland, Friends of the Irish Environment v. Ireland, 31.07.2020, [2020] IESC 49.

targets under EU climate and energy framework reinforce this need. The revised EEAG should also, as a general principle, avoid any market distortions.

5. Recent case law by the Court of Justice of the EU has challenged the **implementation of the Guidelines**, with decisions showing a higher intensity in the judicial review. This raises two questions: one on the general approach followed by the Guidelines, and one on their implementation by both the Member States and the European Commission.

# 1.3. The role of the EEAG in fast-tracking decarbonisation of the energy system: towards climate neutrality

#### Fast-tracking decarbonisation

Lowering the costs of strategic measures while maintaining competition is frequently a key objective when discussing eligibility criteria in State aid guidelines revision. This consideration remains central in the revision of the EEAG, but an additional dimension relates to the speed of the changes needed, and how to incentivise, through State aid measures, a rapid decarbonisation of, notably, the whole energy system.

The need for increased speed in decarbonisation was stressed by the European Environment Agency (EEA) in its 2020 State of the European Environment (SOER), which concluded that - even if the EU is well on track and even in advance in meeting its EU GHG emissions reduction target of 20% by 2020 - the projections based on current measures fall short of the 40% target for 2030 and require drastic reductions to meet 2050 goals. The reduction curve may become even steeper if the 2030 GHG emissions reduction target is increased as part of the process for the adoption of the proposed EU Climate Law. <sup>20</sup>

Likewise, the European Commission has elaborated a long-term vision for climate and energy policies in the 2018 Communication 'A clean planet for all,'21 which makes clear that attaining the mid- and ambitious long-term goals set by the EU will necessitate 'a wholesale systematic transformation of Europe's economies and societies', including in the ways in which we produce and consume energy (today accounting for over 75% of the EU GHG emissions).

State aids have an important role to play in enabling the deployment of existing eligible measures, but also in stimulate further innovation in low carbon technologies. The crucial role of States aids in this regard is recognised by the European Commission in its Progress report on 'Accelerating Clean Energy Innovation', which ranks State Aids as action  $\#1.^{22}$  In order to speed up the decarbonisation of the energy system, it will be necessary to both use existing technologies at large scale and to develop new ones. This dual need – for deployment of existing low carbonisation technologies and development of demonstration technologies - should be reflected in the new Guidelines.

### Make use of the technologies available today at full – Accommodating a stepwise approach

<sup>&</sup>lt;sup>19</sup> 'The European environment – state and outlook 2020', European Environment Agency (EEA), December 2019, available at < <a href="https://www.eea.europa.eu/publications/soer-2020">https://www.eea.europa.eu/publications/soer-2020</a>>. See also: 'Total greenhouse gas emission trends and projections in Europe', EEA, available at <a href="https://www.eea.europa.eu/data-and-maps/indicators/greenhouse-gas-emission-trends-6/assessment-3">https://www.eea.europa.eu/data-and-maps/indicators/greenhouse-gas-emission-trends-6/assessment-3</a>.

Proposal for a Regulation of the European Parliament and the Council establishing the framework for achieving climate neutrality and amending Regulation (EU) 2018/1999 (European Climate Law), European Commission, COM(2020)80 final, 04.03.2020.
 European Commission Communication, 'A Clean Planet for All – A European strategic long-term vision for a prosperous, modern, competitive and climate neutral economy,' COM(2018) 773 final, 28.11.2018.

<sup>&</sup>lt;sup>22</sup> Commission Staff Working Document, Progress in Accelerating Clean Energy innovation 2018, SWD(2019) 157 final, 9.4.2019.

The argument raised here is that the EEAG should both enable the use of the technologies that are available today (mature technologies) and to support the deployment of new technologies. For example, PV and wind (some) are mature technologies, and do not need a large amount of support (ex little premium), but the deployment rate could be higher. One question is the extent to which this can be incentivised under the revised EEAG while accounting for competition law requirements (potential market distortion due to the size of the market share) and issues of local acceptance.

Arguing for the further and rapid deployment of low carbon technologies at a larger scale than today, may raise issues of **local acceptance**. In many countries, local opposition to new production or infrastructure projects, including for renewables, has been a major barrier. It is not the purpose of the EEAG to address local acceptance issues, and this concern should in principle be addressed during the permitting procedure and public consultations on environmental/strategic impact assessments.

On wind, the European Commission has announced the adoption of a strategy on offshore renewable energy – focusing on offshore wind – by the end of 2020,<sup>23</sup> but will also need to support onshore wind developments. Those initiatives focused on specific technologies will have consequences in terms of support, both in terms of generation facility and infrastructures.

#### A holistic approach for the whole energy system

First, the EEAG should continue to pursue the objective of an **integrated internal energy market** (**IEM**) in the EU. The revised EEAG should contribute to provide the right market signals, in accordance with the objectives and principles set in primary and secondary legislation.

Second, the EEAG should build on existing binding rules for **energy market design**, as laid down in secondary legislation. They should guarantee a consistent implementation of the rules for the IEM, in line with the Union's objectives, as defined in the Treaties.<sup>24</sup> Deviations from the common rules for energy market design, either to address a specific market failure or provide some flexibility, should be accepted on a restrictive basis, and assessed as an exception to the principles for energy market design and notably the energy-only market. This is the case, for example, of capacity remuneration mechanisms.

Another important point of departure is that the revised EEAG should take a **holistic approach**, to the **energy system**. Such an approach is in line with both the **technology neutrality principle**<sup>25</sup> and the process of **sector integration.**<sup>26</sup>

#### **Enabling different decarbonisation pathways**

As reflected in the National Energy and Climate Plans (NECPs),<sup>27</sup> decarbonisation of the European energy system relies on different national strategies. In respect of the **principle of Member State sovereignty over the choice of their energy mix**, as defined in Article 194.2 of the TFEU, and without prejudice to Article 192.2(c) TFEU,<sup>28</sup> the revised EEAG should enable Member States to define different **decarbonisation pathways**, across the different energy vectors. The next generation of

 $<sup>^{23}</sup>$  'Adjusted Commission Work Programme 2020', Communication from the European Commission, COM(2020)440 final, 27.05.2020.

<sup>&</sup>lt;sup>24</sup> On the principle of consistency between Union's policies and activities, see below the introduction to Section 3 of this Report.

<sup>&</sup>lt;sup>25</sup> See Section 5.1.2below.

<sup>&</sup>lt;sup>26</sup> Se Section 5.2.10 below.

 $<sup>^{27}</sup>$  National Energy and Climate Plans, as introduced by Regulation (EU) 2018/1999 on the Governance of the Energy Union and Climate Action of 11 December 2018.

<sup>&</sup>lt;sup>28</sup> Pursuant to Article 194.2 TFEU, each Member State maintains its 'right to determine the conditions for exploiting its energy resources, its choice between different energy sources and the general structure of its energy supply'. This is without prejudice to Article 192.2(c) TFEU, which provides that the Council can adopt 'measures significantly affecting a Member State's choice between different energy sources and the general structure of its energy supply' if the Council act unanimously in accordance with a special legislative procedure, and therefore by way of derogation from the ordinary decision-making procedure.

EEAG help reach the 2030 and 2050 targets and will necessarily serve the purpose of identifying pathways. The EEAG have a crucial role to play in designing those pathways, both for the purpose of decarbonisation and the green economic recovery post-COVID 19. In so doing, they should remain flexible in order to avoid locking out any options.

Indeed, decarbonisation involves an increased reliance on **electricity** and a deeper electrification of different sectors. For the **gas sector**, decarbonisation will also be instrumental to reach climate neutrality goals in hard-to-abate sectors and in certain industrial processes. Similarly, for **heating and cooling**, new measures will enable the decarbonisation of other sectors that are difficult to abate, such as housing.

#### Issues to be addressed by the revised EEAG:

- How to tailor the revised EEAG in a way that will enable to speed up the pace of decarbonisation, electrification and digitalisation of the energy sector?
- Which eligibility criteria can enable this rapid decarbonisation?
- Should the EEAG distinguish between eligible measures that can contribute to (a more) rapid decarbonisation? And if so, under which criteria?
- How the EEAG can identify pathways towards decarbonisation and green recovery?
- With due respect to the principle of Member States' sovereignty over the choice of energy mix, the EEAG should enable Member States to define **pathways** towards decarbonisation of the energy system.

#### 1.4. EEAG revision in the context of sustainable finance

This paragraph seeks to question whether the EEAG should take into account the new regulatory framework for sustainable finance that is currently developed.

This new framework, put in place around – notably - the Taxonomy Regulation, applies primarily to private investments, and there is **no direct legal link to the State aid regime** applicable to energy and the environment and the EEAG. Such a disconnection should remain at the present time, for reasons of both competences and because the new framework is still under development and does not offer legal certainty. There is an important distinction to be made between the nature of the instruments, and the competence provided under each between the Commission and the Member States. However, there could be some indirect effects, notably in relation to the definitions and type of assessment criteria under the different financing instruments. Consequently, it is not recommended to establish any link between the revised EEAG and this 'still under development' EU sustainable framework which has a different scope and is subject to different procedures.

#### **EU** sustainable finance framework

Following the adoption of the **Clean Energy Package for All Europeans (CEP)**, the announcement of the **European Green Deal** and the adoption of the **Commission's action plan on sustainable finance**, <sup>29</sup> a series of new or revised financing instruments have been proposed. These come in addition to existing funding instruments favouring environmental and energy projects of national or cross-boundary nature. All those financing instruments and funding mechanisms rely on eligibility criteria. The question of the relationship between those different frameworks should be raised.

<sup>&</sup>lt;sup>29</sup> Communication from the Commission, 'Action Plan: Financing Sustainable Growth', COM(2018)097 final, 8.3.2018.

'Sustainable finance' generally refers to the process of taking due account of environmental<sup>30</sup> and social<sup>31</sup> considerations when making investment decisions, leading to increased investment in longer-term and sustainable activities and to the achievement of the Sustainable Development **Goals (SDGs).**<sup>32</sup> It also has a **governance** dimension<sup>33</sup> that ensures that the environmental and social considerations are included into decision-making processes. Assessed in combination, those three considerations or dimensions result in the definition of environmental, social and governance (ESG) factors, which are used to assess investment risks, risk mitigation measures and potential value creation. Financing of environmental measures will address areas covered by the EEAG scope of application but using different instruments. In the area of private undertakings, this mainly consists of fixed income tools (green and general-purpose SDG-linked bonds), subsidised loans (e.g. EIB or national promotional banks facilities), grants and tax provisions.

Within the context of sustainable finance, the following EU policy and legal initiatives are to be followed:

- **Benchmark regulation -** The proposed amendment to the benchmark regulation will create a new category of benchmarks comprising low-carbon and positive carbon impact benchmarks, which will provide investors with better information on the carbon footprint of their investments.34
- Taxonomy Regulation In May 2018, the Commission presented a package of measures as a follow-up to its action plan on financing sustainable growth. These include three proposals including one on taxonomy.<sup>35</sup> In December 2019, the European Council and the European Parliament reached political agreement on the text of a proposed Regulation on the Establishment of a Framework to Facilitate Sustainable Investment - the so-called 'Taxonomy Regulation'. The Regulation was adopted in June 2020.36 This will establish an EU-wide classification system (or taxonomy) intended to provide firms and investors with a common framework for identifying to what extent economic activities can be considered to be 'environmentally sustainable'. Together with the Disclosure Regulation1, the Taxonomy Regulation will require firms to disclose the degree of environmental sustainability of mainstream funds and pension products that are promoted as environmentally friendly, or to include disclaimers where they are not, as well as requiring firms that are subject to the Non-Financial Reporting Directive<sup>2</sup> to provide certain information in relation to the Taxonomy Regulation in their related filings. In addition, individual Member States will need to abide by the criteria of the Taxonomy Regulation in relation to public measures, standards or labels concerning financial products or corporate bonds offered by issuers and other financial market participants to be labelled as environmentally sustainable. The requirements relating

<sup>&</sup>lt;sup>30</sup> Environmental considerations will encompass environmental protection measures in the broad sense, including climate change

mitigation and adaptation measures, as well as related environmental risks such as natural disasters.

31 Social considerations will notably cover issues of inequality, inclusiveness, labour relations, investment in human capital and communities.

European Commission, Sustainable finance website, <a href="https://ec.europa.eu/info/business-economy-euro/banking-and-">https://ec.europa.eu/info/business-economy-euro/banking-and-</a> finance/sustainable-finance\_en

<sup>&</sup>lt;sup>3</sup> Governance has in that context a broad understanding and refers to management structures, employee relations, remuneration, and applies to both the public and private sectors.

<sup>&</sup>lt;sup>34</sup> Proposal for a regulation amending Regulation (EU) 2016/1011 on low carbon benchmarks and positive carbon impact benchmarks

<sup>&</sup>lt;sup>35</sup> The package includes 3 proposals aimed at:

establishing a unified EU classification system of sustainable economic activities ('taxonomy');

improving disclosure requirements on how institutional investors integrate environmental, social and governance (ESG) factors in their risk processes;

creating a new category of benchmarks which will help investors compare the carbon footprint of their investments.

<sup>&</sup>lt;sup>36</sup> Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088.

to the climate-related objectives of the Taxonomy Regulation are due to apply from December 2021, with other requirements at the end of the following year.

• The EU Budget or Multiannual Financial Framework 2021-2027 – The Multiannual Financial Framework (MFF) sets the maximum level of resources ('ceiling') for each major category ('heading') of EU spending for a period of seven years. In addition to a financial plan, it also sets the EU's long-term priorities. The resources proposed for the 2021-2027 MFF are distributed across seven headings (Single market innovation and digital, Cohesion and values, Natural Resources and Environment, Migration and Border Management, Security and Defence, Neighbourhood and the World and European Public Administration) representing the EU's long-term priorities. They include spending programmes and funds that are the basis for implementing the EU budget;

The European Green Deal Investment Plan or Sustainable Europe Investment Plan (SEIP) - On 14 January 2020, the Commission presented the European Green Deal Investment Plan - known as SEIP - which is the investment pillar of the EU Green Deal. SEIP is structured around three 'dimensions':

- Financing: The SEIP will mobilise funding of at least €1 trillion of sustainable investments over the next decade. The funding will provide from EU budget, but only. The SEIP funding will originate from: (i) part of the EU Budget (2021-2027) for climate and Environment (€503 billion); (ii) the InvestEU mechanism, based on public-private investment (€279 billion)37; (iii) National Co-financing and structural funds (€114 billion); (iv) the Just Transition Mechanism (€100-143 billion), based on a mix of EU, EIG and Member States' funding; and (v) the ETS revenues (€25 billion).
- Enabling: The SEIP will create an enabling framework to facilitate and stimulate public and
  private investments needed for the transition to a climate-neutral, green, competitive and
  inclusive economy. The EU will provide 'tools' for investors, insisting on sustainability criteria
  as part of the financial system, but also as part of green budgeting and green procurement
  strategies. Of specific interest from the revision of the EEAG, the SEIP foresees that the EU
  will 'design ways to facilitate procedures to approve State Aid for just transition regions.'
- *Practical support*: The European Commission will support public authorities and project developers in planning, designing and executing sustainable projects.

In relation to the COVID-19 outbreak and the following economic downturn, this framework has been updated and completed with the new recovery instrument, 'Next Generation EU'.<sup>38</sup>

• Other relevant EU funding mechanisms include the **Innovation Fund** and the **Connecting Europe Facility** which relies on the **PCI list and TEN-E regulation review.** 

Some projects dependent on the grant of financial support, including in the form of State aid. Among the relevant sustainable finance tools to be reflected are the following three: SDG and green bonds (private capital); subsidised loans (e.g. EIB public money); and grants (SEIP and MFF public money).

<sup>&</sup>lt;sup>37</sup> The European Investment Bank is to play a key role in the award of the funding.

<sup>38</sup> Europe's moment: Repair and prepare for the next generation, European Commission, press release, 27 May 2020, IP/20/940.

#### Foreign subsidies and a global approach to sustainable finance and fair trade

In parallel, the question can also be raised as to **how to deal with foreign subsidies** (from outside the EU) for products or services that will access the internal energy market. In June 2020, the European Commission adopted a White Paper on Foreign Subsidies in the Single Market, which identifies areas of concern and future legislative proposals to be put forward in 2021. This question is particularly relevant for the reform of State aid rules in general and for GBER/EEAG, as they all help maintain the competitiveness of European undertakings and ensure fair competition under ambitious climate and energy objectives. When it comes to foreign subsidies, the EEAG may need to consider two elements: the extent to which the Energy Community countries follow the EEAG; and the proposal for an EU carbon border tax.

- Energy Community countries are in a special situation. As close neighbours with access to the EU energy market, the manner they support energy products and services, can also affect the internal energy market. The Energy Community Treaty contains provisions on public aid in the energy sector.<sup>39</sup> Articles 18(2) and Article 94 of the Treaty as well as Article 2 of the Dispute Settlement Rules of Procedure establish a strict homogeneity principle as regards the application of EU and Energy Community rules. EEAG are application to the Energy Community. As a consequence, the Energy Community Secretariat will follow the considerations and requirements set out in the EEAG when assessing the compatibility of environmental and energy aid with the functioning of the Energy Community Treaty under Article 18(1)(c) and 18(2) of the Treaty. The Energy Community Secretariat also considers that the EEAG are to be followed by national enforcement authorities in order to ensure their uniform and homogeneous application in the entire Energy Community.<sup>40</sup>
- The European Commission's proposal for reform of the World Trade Organization (WTO) and, more directly, the carbon border tax - also referred to as carbon border adjustment mechanism (CBAM) - will be shortly discussed here and put in perspective with EEAG revision.

#### Issues to be addressed in the revised EEAG:

- How to ensure consistency between the objectives and eligibility criteria set by those different instruments?
- How should the EEAG and those instruments be aligned?
- The EEAG revision shall focus and foster higher GBER exemptions to boost the European Green Deal for sustainable companies and business such as power grids, EVs infrastructures/Energy efficiency/Power plants repurposing projects
- The eligibility criteria of the SEIP and funding tools are already aligned.
- External dimension / foreign subsidies / Energy Community Treaty countries.

#### 1.5. EEAG in the context of green economic recovery post-COVID-19

The revised EEAG should, and de facto will, be part of the European strategy for a green recovery, in close relation to the implementation of the European Green Deal. Indeed, it will be an important

<sup>&</sup>lt;sup>39</sup> Article 18(1)(c) of the Treaty provides that any public aid which distorts or threatens to distort competition by favouring certain undertakings or certain energy resources is to be considered incompatible with the proper functioning of the Treaty insofar as it may affect trade of Network Energy between the Contracting Parties. Article 19 of the Treaty extends the application of this provision to public undertakings and undertakings to which special or exclusive rights have been granted.

40 Policy Guidelines by the Energy Community Secretariat on the Applicability of the Guidelines on State Aid for Environmental

Protection and Energy 2014-2020, PG 04/2015 / 24 November 2015.

tool and frame not only for the European Commission but also for the Member States in that respect. <sup>41</sup> By granting State aids within the energy and environmental sectors, Member States can support companies, innovation and jobs creation in Europe and therefore contribute to both the decarbonisation of the energy system, and to the economic recovery, placing emphasis on sustainable growth areas.

During the first weeks of the virus outbreak in Europe, in Spring 2020, the European Commission provided Member States with guidance on using the flexibility provided by the EU State aid Framework, notably under Article 107(2)(b) TFEU (enabling Member States to compensate companies for the damage directly caused by exceptional occurrences) and Article 107(3)(b) (enabling Member States to remedy a serious disturbance to their economy). Importantly, the Commission adopted a dedicated Temporary Framework to support the economy of the Member States in the context of the coronavirus outbreak (Temporary Framework).<sup>42</sup> This takes the form of a Commission Communication laying down the assessing criteria of the notified national aid measures. It has been subject to several amendments. In its approach to state aid approval, the Commission has been permissive, meaning that the interpretation of the compatibility criteria has been flexible.<sup>43</sup> The aid has also been approved within a very short timeframe. At the same time, it has also been communicated that: first, the approval of State aid measures related to the recovery could be made conditional on 'green' criteria; and second, that State aid rules will again be applied 'as normal' when the pandemic threat and the need for heavy state intervention, is over.<sup>44</sup>

The experience gained from applying the Temporary Framework raises a series of general questions for the future of the EU State aid regime; more specifically, it may have some indirect effects on the EEAG scope and methodology. A detailed analysis of those issues and whether the Commission has the competence to request Member States to add 'green requirements' when approving notified aids, would go beyond the scope of this Report, but some questions can be highlighted. It should also be recalled, preliminarily, that the notified aid measures in the context of Temporary Framework are assessed under Article 107(2)(b) TFEU and Article 107(3)(b) TFEU, while the aid measures assessed under the EEAG are notified on the basis of Article 107(3)(c) TFEU. In the decisions taken under the Temporary Framework, the extent to which Member States could themselves set environmental conditions to the award of the aid has not been questioned by the Commission. Indeed, it has even confirmed that the Member States are free to add further conditions to, for example, recapitalisation measures, in line with additional policy objectives such as the European Green Deal and the digital transformation agenda ('the twin transitions'). Such has been the case in France, where the government has made the award of aid to Air France and Renault conditional upon the fulfilment of ecological requirements.<sup>45</sup> The Temporary Framework, in its amended and consolidated version, encourages Member States to design national measures in line with those two objectives and request large companies receiving recapitalisation support to report on 'how the aid received supports their activities in line with EU objectives and national obligations linked to the green and digital transformation, including the EU objective of climate neutrality by 2050'.46 However, the Commission recalls in the Temporary Framework that when the aid measure has for primary objective to 'support

<sup>&</sup>lt;sup>41</sup> In its Temporary Framework, the European Commission mentions notably that the forthcoming revised EEAG 'will contribute to a recovery strategy for the European economy that meets the important green and digital twin transitions in line with EU and national objectives.' See Communication from the Commission, 'Amendment to the Temporary Framework for State aid measures to support the economy in the current COVID-19 outbreak,' C(2020) 3156 final, 08.05.2020, para. 15).

<sup>&</sup>lt;sup>42</sup> Temporary Framework to support the economy in the context of the coronavirus outbreak, as amended <a href="https://ec.europa.eu/competition/state\_aid/what\_is\_new/covid\_19.html">https://ec.europa.eu/competition/state\_aid/what\_is\_new/covid\_19.html</a>

<sup>&</sup>lt;sup>43</sup> The Commission itself refers to the need to apply the 'full flexibility' offered by the EU framework. 'COVID-19: Commission sets out European coordinated response to counter the economic impact of the Coronavirus', European Commission, Press Release IP/20/459, 13.03.2020.

 <sup>&</sup>lt;sup>44</sup> Europe's Competition Chief Says Subsidy Restrictions Will Return Once Coronavirus Fades, The Wall Street Journal, 29.04.2020.
 <sup>45</sup> Aides de l'État à Air France et Renault : les conditions écologiques à ce plan "sont insuffisantes" pour Greenpeace, FranceInfo, 30.04.2020.

 $<sup>^{46}</sup>$  Consolidated Version of the Temporary Framework, para. 45.

green and digital innovation and investment, and increase the level of environmental protection', it must be granted in line with the relevant State aid rules, which primarily are the EEAG.<sup>47</sup>

Of particular interest for the revision of the EEAG has been the question to know whether the approval of State aid measures notified by Member States in the context of COVID-19 should be made conditional to environmental or ecological criteria (such as climate performance and biodiversity), and if so, how should those conditions be defined. A joint definition of the environmental/ecological conditions at the European level is needed to avoid any further distortions of competition on the internal market, as a result of differing national approaches. However, the European Commission has so far refused to adopt joint environmental conditions under the Temporary Framework, based on the reason that it does not have the competence to do so. Since the Temporary Framework has already been adopted, introducing environmental conditions only for future aid measures may create distortions of competition. Would the Commission decide to introduce environmental conditions, those should coincide with the criteria to be laid down in the revised EEAG and applied in a consistent matter. Differing criteria would create further distortions of competition and slow down the decarbonisation process.

In May 2020, the European Commission unveiled a green economic recovery plan and the European Semester Spring Package. Some elements of those new plans could be reproduced in the EEAG and reflected in both the definition of common objectives and in assessment measures. One of the three pillars of the recovery plan will take the form of a 'Recovery and Resilience Tool'.48 The objective of resilience is reiterated in the second pillar of the same plan, dedicated to a new Strategic Investment Facility, which will help invest in value chains key to the 'resilience and strategic autonomy' of Europe. Because the COVID-19 pandemic was not the first sanitary crisis and will not be the last, the need to strengthen the 'resilience' approach seems to be of primary importance. Resilience was already referred to by the European Commission in its strategies on climate adaptation and agriculture/forest ecosystems. The Commission is referring to resilience in the European Green Deal in the same context, and adds the role of the financial system in increasing resilience to climate and environmental risks, in particular when it comes to the physical risks and damage arising from natural catastrophes.<sup>49</sup> The criterion of resilience, which is already present in some of the Commission's State aid guidelines,<sup>50</sup> should also be inserted as a common objective and an assessment criterion in the revised EEAG. The relevant environmental and energy aid measures under the EEAG would complement those covered by other guidelines and would notably reinforce the contribution of the energy sector to 'resilience building'. As an example, the further deployment of renewable energies, resources adequacy and smart grids investments can directly contribute to resilience, and can be tailored to strengthen it. The next question is to know how far the EEAG can go in supporting the recovery of the European economy as part of environmental and energy aid measures. Here, a distinction must be made between support to undertakings in difficulties as a consequence of the economic downturn following the COVID-19 pandemic, and support to undertakings in the form of aid for energy and the environment which would contribute to a green recovery post-COVID-19. Only the latter is directly relevant for the present discussion.<sup>51</sup> Article 107(3)(c) TFEU concerns State aid

<sup>47</sup> Communication from the Commission, 'Amendment to the Temporary Framework for State aid measures to support the economy in the current COVID-19 outbreak,' C(2020) 3156 final, 08.05.2020, para. 15.

<sup>&</sup>lt;sup>48</sup> European Commission, 'Von der Leyen outlines ambitious recovery plan for Europe, Announcement AC/20/889, 13 May 2020.

<sup>&</sup>lt;sup>49</sup> The European Green Deal, Communication from the Commission, COM(2019) 640 final, 11.12.2019.

<sup>&</sup>lt;sup>50</sup> See for example the European Union Guidelines for State aid in the agricultural and forestry sectors and in rural areas (2014-2020), OJ C 204, 1.7.2014, p. 1-97. Reference is made to resilience in, among others: para. (300), 'climate friendliness and resilience of [farmers'] undertaking and/or investment'; para (500), 'investments improving the resilience and environmental value'; para (509) on minimum environmental requirements in the context of the afforestation and creation of woodland: (b) the selection of species, varieties, [...] must take account of the need for resilience to climate change and to natural disasters; Section 2.1.4. 'Aid for investments improving the resilience and environmental value of forest ecosystems'

<sup>&</sup>lt;sup>51</sup> Environmental and energy aid do not in principle fall under the scope of the EEAG (2014-2020). In its original version, para. 16 of the EEAG provides that 'Environmental and energy aid may not be awarded to firms in difficulty as defined for the purposes of these Guidelines by the applicable Guidelines on State aid for rescuing and restructuring firms in difficulty...'. In its Communication dated 2 July 2020, the European Commission has however decided that undertakings which were not in difficulty

that can facilitate the development of certain economic activities within the EU, which make them relevant contributors to a 'green' recovery, at the condition that the aid they benefit from relates to the energy or environment sector and EU objectives in this area. The question may arise as to the distinction between aid measures aimed at supporting the development of a new national industry within the energy and environment sectors (industrial policy), and aid measures aimed at addressing an energy concern or reducing the impact on the environment. In practice, many types of aid may combine industrial policy objectives and environmental/energy policy objectives. To avoid any abuse and possible distortion of competition by favouring national actors, EU secondary legislation and the EEAG can define a series of safeguards, such as the mandatory use of competitive bidding process for granting the aid or the mandatory opening of capacity mechanisms to cross-border participation. It is argued that the EEAG could include assessment criteria favouring a green recovery and job creation, but that a series of safeguard should be maintain in order to preserve competition.

#### Elements to be considered in the revised EEAG:

- To date, the European Commission has not adopted joint environmental/ecological conditions under the Temporary Framework,<sup>52</sup> but would it do so, the criteria should coincide with the ones to be laid down in the revised EEAG and, possibly, in the rest of the sustainable finance framework.
- The criteria of 'resilience', which is already present in some of the Commission's State aid approval guidance documents, should be strengthened in the revised EEAG and integrated into the definition of the common objectives.

#### 1.6. Formal steps in the EEAG review process

One of the objectives of this study is to have a precise understanding of the EEAG review process led by the European Commission.

The current EEAG were valid for the period 2014-2020. The EEAG are among the State aid rules and Guidelines that were scheduled to expire on 31 December 2020. In early January 2019, the European Commission announced that it intended to prolong the validity of those rules and Guidelines for a maximum of a further two years, until 31 December 2022. In July 2020, it took the formal decision to prolong the EEAG until 31 December 2021.<sup>53</sup> The extension of the EEAG validity aimed to provide predictability and legal certainty, whilst preparing for the future update.

on 31 December 2019 but became undertakings in difficulty after 31 December 2019 should be eligible under those guidelines until 30 June 2021. A new para. 16(a) has been added in that sense in the EEAG.

Those changes to the EEAG (2014-2020 are made in the Communication from the Commission concerning the prolongation and the amendments of the Guidelines on Regional State Aid for 2014-2020, Guidelines on State Aid to Promote Risk Finance Investments, Guidelines on State Aid for Environmental Protection and Energy 2014-2020, Guidelines on State Aid for rescuing and restructuring non-financial undertakings in difficulty, Communication on the 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 - Framework for State aid for research and development and innovation and Communication from the Commission to the Member States on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to short-term export-credit insurance, C(2020) 4355, 02.07.2020.

<sup>&</sup>lt;sup>53</sup> 'State aid: Commission prolongs EU State aid rules and adopts targeted adjustments to mitigate impact of coronavirus outbreak', European Commission, Press Release IP/20/1247, 02.07.2020. Communication from the Commission concerning the prolongation and the amendments of the Guidelines on Regional State Aid for 2014-2020, Guidelines on State Aid to Promote Risk Finance Investments, Guidelines on State Aid for Environmental Protection and Energy 2014-2020, Guidelines on State aid for rescuing and restructuring non-financial undertakings in difficulty, Communication on the 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 - Framework for State aid for research and development and innovation and Communication from the Commission to the Member States on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to short-term export-credit insurance, C(2020) 4355, 02.07.2020.

As well as the fact that the revision process officially started from January  $2019,^{54}$  there are still some doubts as to the scope of the revision and the manner in which the Commission will lead the process itself.

It follows from the analysis above that there will be necessary targeted modifications of the Enabling Regulation, 'de minimis' Regulation and the GBER. Ideally, these should take place - at the latest - at the same time as the revised EEAG are adopted, due to their close interlinkages. However, the amendment of the GBER in the light of the European Green Deal, which was originally scheduled for adoption during the second half of 2021, has now been postponed until the end of 2023 due to the prolongation of the GBER, bringing additional uncertainty to the process.<sup>55</sup>

The revision process has started, but is not listed in the Commission Work Programme 2020.56 This indicates that 2021 will be a crucial year for the finalisation of the revised EEAG, with a public consultation scheduled for the first half of 2021 and the adoption of the revised EEAG scheduled for the second half.57

As several new legislative acts, such as the RED II Directive, must be transposed into national legislation by 30 June 2021, this may provide useful information on the approach to follow and priority areas in the revised EEAG.

Other revision processes have started, such as the revision of the EU ETS State aid guidelines. The question will be to know to the extent to which the revised EEAG need to align on those other recently revised guidelines.  $^{58}$ 

#### 1.7. Objective of the report

This Report aims to identify how the revised EEAG can contribute to fast-tracking the transition towards low carbon energy systems in a cost-efficient way, consistent with internal market principles.

The Report examines the EEAG review process and its scope, focusing on the possible areas of change. It examines the interaction between the EEAG and State Aid rules relevant for the energy sector, including the most recent interpretation of the definition of aid given by the Court of Justice. It studies the impact of the newly adopted Clean Energy Package for All Europeans on key activities of the energy sector and the level of coherence between the different legal provisions. The Report intends to contribute to the review process by making concrete proposals for revision.

#### 1.8. Methodological approach and scope

The methodology used throughout the report is a classical legal method, based on desktop analysis consisting in analysis and interpretation of primary and secondary EU legislation, soft law instruments, case law and literature review. The Report has benefited from feedback received from the sponsors and a peer reviewer, although the author retains full responsibility for, and ownership of, the ideas developed.

The report focuses on central issues for the review of the EEAG, with an emphasis on energy-related measures. It does not cover all aspects of the EEAG scope of application. For example, considerations relating to assisted areas or remediation of contaminated sites are not examined. The Report touches

<sup>&</sup>lt;sup>54</sup> See details of the review process in Section 1.2 above.

<sup>&</sup>lt;sup>55</sup> State aid: Commission prolongs EU State aid rules and adopts targeted adjustments to mitigate impact of coronavirus outbreak', European Commission, Press Release IP/20/1247, 02.07.2020.

<sup>&</sup>lt;sup>56</sup> Commission Work Programme 2020, 'a Union that strives for more', COM(2020) 37 final.

<sup>&</sup>lt;sup>57</sup> Timeline for State aid policy reviews: https://ec.europa.eu/competition/state\_aid/legislation/timeline\_table\_SA\_final.pdf <sup>58</sup> See Public hearing:

https://ec.europa.eu/competition/consultations/2020 ets stateaid guidelines/index en.html

upon some aspects of the reform of the EU State aid regime,<sup>59</sup> but does so only through the lance of the EEAG and does not address it in detail. The Report does not address either energy measures which can fall under the definition of important projects of common European Interest (IPCEIs) or services of general economic interest (SGEIs).

Work on the Report began before the occurrence of the COVID-19 pandemic and the subsequent economic turndown. The effects of this on State aid practice have been extensive, and some lessons are drawn for the revision of the EEAG, as the energy sector will be central to ensuring a green recovery. However, it is not the purpose of this Report to provide a detailed analysis of State aid control in the post-COVID-19 context. Following a period of unprecedented events, which required extraordinary measures, this Report aims to bring the discussion back to the fundamentals of State aid control and implementation, in the light of the guidelines and related legal framework.

#### 1.9. Structure of the report

The report begins with a review of the role played by the EEAG in the broader framework of State aid control and energy and climate policy (Section 2). The scope of the review (Section 3) and the alternative ways of structuring the new EEAG (Section 4) are discussed thereafter. A large part of the report is then dedicated to the guiding principles on which to base the new EEAG on, as well as recommended priority areas (Section 5). Finally, it draws and makes recommendations (Section 6).

<sup>&</sup>lt;sup>59</sup> On calls for a reform on the EU State aid regime, see notably: J. Temple Lang, 'EU State Aid Rules – The Need for Substantive Reform', European State Aid Law Quarterly, 3/2014 (Vol. 13), pp. 440-453.

# THE ROLE OF EEAG IN THE BROADER FRAMEWORK OF STATE AID CONTROL AND ENERGY AND ENVIRONMENTAL POLICY

# 2. The role of EEAG in the broader framework of State aid control and energy and environmental policy: practice and interpretation of the Guidelines

Following a short reminder of the State aid control regime, this section examines the question of the legal status and legal effects of the Guidelines (Section 2.1). It examines their interaction with GBER and secondary legislation (Section 2.2), before looking at the evolution of Commission's practice and case law on the definition of State aid and consequences for the use of the EEAG (Section 2.3). The Section ends with a review of the recent case law from the EU Court of Justice of relevance for the energy sector (Section 2.4). It should be noted that the intensity of judicial review performed by the Court has been on the increase during the past few years, including in cases involving Commission decisions based on the application of the EEAG.

# 2.1. General legal framework for State aid control and use of State aid Guidelines

#### 2.1.1. Short recap of the State aid control regime

Article 107(1) TFEU both defines what constitutes a state aid and provides for a prohibition against it. It provides that:

'Save as otherwise provided in the Treaties, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market.'

The four criteria of Article 107(1) TFEU must be fulfilled concomitantly, where the aid:

- 1. is granted by the state or through state resources
- 2. is selective, and provides an advantage
- 3. distorts, or threatens to distort competition
- 4. may affect trade between Member States.

The interpretation of these criteria has been subject to extensive case law in the Court of Justice of the EU. The European Commission services have attempted to summarise it in the Commission Notice on the notion of State aid pursuant to Article 107(1) TFEU.<sup>60</sup>

Even if those criteria are fulfilled, and the aid is in principle prohibited, derogations to the general prohibition are possible under:

- Art. 107(2) TFEU, which sets a list of aid measures which are always exempted ('shall be compatible with the internal market') (automatically exempted aids);
- Art. 107(3) TFEU, which sets a list of aid measures which can be exempted ('may be considered to be compatible with the internal market'), subject to the discretion of the European Commission (aid subject to discretionary compatibility);

<sup>&</sup>lt;sup>60</sup> Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union, C/2016/2946, OJ C 262, 19.7.2016, p. 1–50.

- $_{\odot}$  First, it must be recalled that while the Commission has the power to exempt certain types of aid from the general prohibition, it has no obligation to do so, as clarified by case law. $^{61}$
- Then, State aid Guidelines adopted by the Commission can define compatibility criteria.
- Article 107(3)(e) TFEU and Article 108(2), subparagraph 3. TFEU, providing both the Council with the competence to adopt derogations;
  - Under Article 107(3)(e) TFEU, the Council can, on a proposal from the Commission, adopt additional possible exemption categories than the ones mentioned in Article 107(3) (a) to (d);
  - Under Article 108(2), subparagraph 3 TFEU, the Council can approve individual aid measures itself.
- Article 109 TFEU, providing the Council with the competence to adopt regulations for the application of Articles 107 and 108, enabling notably the adoption of block exemptions;
  - o 'de minimis' thresholds for notification apply through the de minimis Regulation;
  - The General Block Exemption Regulation (GBER), is the most important of the block exemption, and gives automatic approval for a range of pre-defined aid measures deemed by the Commission to be less distortive of competition, under a certain threshold;
  - If the aid is not covered by one of the block exemptions and notably the GBER –, the Commission may apply one of its State aid guidelines to assess whether the aid measure which in this case has been subject to **notification** can still be approved.
  - It must be noted that, when an aid falls outside of or is not covered by any guidelines, the Commission will have to assess the compatibility of the measure directly under Article 107(3) TFEU.<sup>62</sup>
- Article 106(2) TFEU, which provides for exemption for undertakings delivering services of general economic interest (SGEIs);
- Aid granted under an aid scheme already authorised by the European Commission.

The derogations provided for in Articles 107(2) and Article 107(3) TFEU, because they constitute exemption to a general prohibition, are **to be interpreted narrowly**.<sup>63</sup> As a consequence, the **burden of proof** lies on the person invoking the derogation, which is the beneficiary or the Member State notifying the aid.

In the EEAG, the Commission sets out the conditions under which aid for energy and environmental protection may be considered compatible with the internal market under Article 107(3)(c) TFEU. The EEAG provide the compatibility criteria for both individual aid and aid schemes for environmental protection and energy objectives which are subject to the notification obligation pursuant to Article 108(3) TFEU.

62 K. Bacon, *European Union Law of State Aid* (Oxford, 2017, 3<sup>rd</sup> ed.), p. 99.

<sup>61</sup> Case C-409/00, Spain v Commission [2003] ECR I-1487, para. 94.

<sup>&</sup>lt;sup>63</sup> Case C-156/98 Germany v Commission [2000] ECR I-6857, para 49; Case T-171/02 Regione autonoma della Sardegna v Commission [2005] ECR II-2123, para. 165; Case T-282/08 Grazer Wechselseitige Versicherung v Commission.

In terms of **temporal application**, a notified aid measure which has not yet been paid will be assessed under the rules in force on the date of the Commission's decision.<sup>64</sup> However, if the national aid, qualified as state aid, has already been paid without prior notification, it will be assessed under the rules in force when the aid was granted. This means that new guidelines do not apply to existing aid measures, unless Member States decide themselves to revise them. In case of new notification/revision, the new guidelines apply. Likewise, new State aid guidelines have no effect on aid paid to the owners of existing installations. The latter continue to receive aid based on existing approved state aid schemes. This means that the guidelines have in principle no retroactive effect, unless they explicitly provide for it.<sup>65</sup> The 2014 EEAG contain such an exception and provide that the new guidelines will apply retroactively for the assessment of reductions in the financing of renewables for energy-intensive users.<sup>66</sup>

#### 2.1.2. The extent of the Commission's discretion in State aid control

The Commission has been granted strong powers of enforcement in competition law matters under the Treaties. Pursuant to Article 3(1)(b) TFEU, the EU has exclusive competence in establishing the rules of competition required for the internal market to function. Rules on competition policy are encompassed in Title VII, Chapter 1 of the TFEU, and include State aid rules in Articles 107-109. Then, Article 108 TFEU confers to the European Commission enforcement powers for competition rules, including keeping State aid under review of existing and planned aids (Articles 108(1) and 108(3)), and taking a decision against a Member State in case of non-compliance requiring the abolishment or alteration of the aid (Art. 108(2)). In addition, if the Commission's decision is not followed by the Member State, the matter can be referred to the CJEU (Art. 108(2)). Aid measures can only be implemented after Commission approval. Once adopted, the Commission's decisions are binding on both the companies and national authorities covered by the decision. In the event an aid measure is implemented before approval and the aid is deemed unlawful, the Commission has the power to recover the amounts granted through the aid. The consequences from a negative decision from the Commission could therefore have extensive consequences for the Member States and the beneficiary of an unlawful national measure.

Pursuant to Article 108 TFEU, the assessment of the compatibility of the aid measures with the internal market under Article 107(3) TFEU is an exclusive competence of the Commission. The Commission enjoys broad discretion when exercising that competence, which presupposes complex economic and social assessments that must be made in a Community context.<sup>67</sup>

While the assessment of compatibility of a State aid measure remains the exclusive competence of the Commission under Article 107 TFEU, national competition authorities and national courts<sup>68</sup> play a 'complementary' role in enforcing State aid rules.<sup>69</sup> The decisions made by the Commission in State

<sup>&</sup>lt;sup>64</sup> Case C-334/07 P Commission v Freistaat Sachsen [2008] ECR I-9465, paras. 50-3; Case T-3/09 Italy v Commission [2011] ECR II-95, para 60; Case T-92/11 Anderson v Commission, para. 39.

 <sup>&</sup>lt;sup>65</sup> Commission notice on the determination of the applicable rules for the assessment of unlawful State aid [2002]; Common methodology for State aid evaluation SWD(2014) 179 final, 28.5.2014.
 <sup>66</sup> EEAG, point 3.7.

<sup>&</sup>lt;sup>67</sup> See as well settled case law in see Joined Cases C-75/05 P and C-80/05 P *Germany and Others v Kronofrance* [2008] ECR I-6619, paragraph 59; Case 310/85 *Deufil v Commission* [1987] ECR 901, para. 18; C-667/13, *Banco Privado Português and Massa Insolvente do Banco Privado Português*, para. 67.

<sup>&</sup>lt;sup>68</sup> In particular, national courts can rule on whether the measure amounts to aid in the first place, and can request opinions from the European Commission or refer questions to the Court of Justice for a preliminary ruling (under Article 267 TFEU). National courts are also expected to use all appropriate measures and provisions of national law to implement the direct effect of Article 108(3) prohibition on implementation of unauthorized state aid.

See Art. 108 TFEU, Council Regulation (EU) 2015/1589 of 13 July 2015 laying down detailed rules for the application of Article 108 TFEU. See as well the case law in: Case C-368/04 Transalpine Ölleitung in Österreich, judgment of 5 October 2006, para. 47; Case C-199/06 CELF and Ministre de la Culture et de la Communication, judgment of 5 October 2006, para. 4; C-284/12, Deutsche Lufthansa, paras 28-38.

<sup>&</sup>lt;sup>69</sup> On the complementary but separate role of national courts in state aid rules enforcement with respect to the European Commission, see C-284/12 Deutsche Lufthansa, para. 27 and the referred case law.

aid cases can also be appealed to the EU's General Court (Article 263 TFEU) and further to the Court of Justice (on points of law only for the latter).<sup>70</sup>

# 2.1.3. Guidelines, an instrument of administrative governance in State aid policy enforcement

In practice, during its assessment, the Commission will not only take into account primary and secondary EU State aid law, but also the State aid guidelines adopted on the matter and which lay down the possible exemptions to the principle of State aid prohibition.

#### (i) An instrument of good administrative governance

State aid Guidelines aim to inform on criteria that the Commission will apply when assessing the compatibility of a national State aid measure with the internal market. They announce how the Commission intends to make use of its discretion in regard to new or existing systems of aid,<sup>71</sup> and which of the 'principles' defined in the guidelines will 'guide the future enforcement of EU State aid rules', as set by the Commission itself.<sup>72</sup> The publication of assessment criteria in the form of guidelines are therefore justified by the need to ensure **transparency**, **equal treatment** and **legal certainty**.<sup>73</sup> These requirements closely relate to the **general principles of EU administrative procedural law**.<sup>74</sup>

The need for Guidelines raises a more general question of regulatory approach within the EU. Indeed, guidelines aim to clarify the application of Treaty and secondary EU law, which implies that there is uncertainty, or at least room for interpretation in the legislation. This is particularly obvious with sectoral Guidelines and the need to adjust, as much as possible, to the specificities of the sector. Complementing the legislation with soft law instruments raises some fundamental questions over limitation of the discretion given to the Commission in competition law enforcement, and so, even if the Member States agree to give the Commission such broad competence in the Treaty. Some of those limits have been clarified by case law as reviewed below.

Guidelines are adopted by the Commission in the context of the discretion given to it. The Court has expressly and consistently endorsed the Commission's right to use Guidelines, holding that the Commission's adoption and use of such documents does not exceed the limits of its discretion, nor waive that discretion.<sup>75</sup>

#### (ii) Guidelines as internal rules of conduct binding upon the Commission

The Guidelines are 'adopted' by the Commission in the form of a Communication. The Commission's Communication adopting the Guidelines is not a legislative document and the Guidelines cannot be regarded as rules of law<sup>76</sup> and do not have the value of a legally binding act.<sup>77</sup> As noted by the Court, in addition they are published in the 'C' series of the Official Journal, distinguishing them clearly from

<sup>&</sup>lt;sup>70</sup> Art. 58 Statute of the Court of Justice of the European Union.

<sup>&</sup>lt;sup>71</sup> Case C-242/00 Germany v Commission [2002] ECR I-5603, para 27.

<sup>&</sup>lt;sup>72</sup> European Commission, 'Questions and Answers: EU Commission: Guidance for state intervention in electricity', MEMO/13/948, 5.11.2013.

<sup>&</sup>lt;sup>73</sup> See Opinion of Advocate General in Case C-526/14, Kotnik and Others, para. 38.

<sup>&</sup>lt;sup>74</sup> See Right to good administration embedded in Article 41 Charter of Fundamental rights of the European Union; the principle of an open, efficient and independent European administration enunciated in Article 298 TFEU. On the general principles of EU procedural administrative law, see: 'The General Principles of EU Administrative Procedural Law', In-depth analysis for the Committee on Legal Affairs (JURI), European Parliament, PE 519.224, 2015.

 $<sup>^{75}</sup>$  Case C-288/96 Germany v Commission [2000] ECR I-8237, para 62; Case T-349/03 Corsica Ferries France v Commission [2005] ECR II-2197, para 140; Case T-11/07 Košice v Commission [2010] ECR II-5453 para 228; Case T-319/11 ABN Amro v Commission EU:T:2014:186, para 28

<sup>&</sup>lt;sup>76</sup> Joined cases C-465/09 P to C-470/09 P, *Diputación Foral de Vizcaya and Others* v *Commission*, para 120.

 $<sup>^{77}</sup>$  See as a matter of example, the wording used by the Commission in MEMO/13/948: `The Communication published today is not a legally binding act.'

the L series related to binding measures.<sup>78</sup> Communications will follow the legal regime of recommendations and opinions, which, pursuant to Article 288 TFEU, have no binding force.

Meanwhile, the Guidelines are more than purely internal instruments of administrative governance; the case law of the Court has qualified them as 'rules of conduct' for the European Commission.<sup>79</sup> As a consequence, the Guidelines bind the Commission as to its assessment, and the Commission cannot depart from them. Case law has determined that the adoption and publication of guidelines signals that the latter will apply in the cases to which they relate. The Commission imposes a limit on the exercise of its discretion and cannot, 'as a general rule', depart from those guidelines at the risk of being found in breach of general principles of law, and in particular legal certainty, equal treatment or the protection of legitimate expectations.80 If a Member State notifies the Commission of a proposed State aid that complies with the Guidelines, the Commission, as a general rule, must authorise the proposed aid.81 If the Commission does not apply the same criteria and methodology as those defined in the Guidelines, its decision may be declared null and void if it fails to justify why it has deviated from the Guidelines.<sup>82</sup> The situation is different, however, for discussion documents such as working papers.83

The case law of the CJEU has progressively developed five limitations to the discretion given to the Commission when applying the Guidelines.

First, the Guidelines bind the Commission in the cases to which they relate to the extent that they do not depart from the rules in the TFEU, including Article 107(3)(b) TFEU.84 The Commission cannot waive, by the adoption of Guidelines, to the exercise of the discretion that 107(3) TFEU confers on it.85

Second, the Guidelines bind the Commission to the extent that their application is not in breach of general principles of law, such as equal treatment, in particular where exceptional circumstances, different from those envisaged in those guidelines, distinguish a given sector of the economy of a Member State.86

Third, if the Commission should refuse to examine the specific circumstances relied upon by a Member State and to review the measure directly under Article 107(3)(b) TFEU, the Commission is obliged to provide reasons for its refusal, including a review of the Treaty provisions.87

Fourth, the Commission must keep the Guidelines under continuous review for the purposes of anticipating any major developments not covered by those measures.<sup>88</sup> Alternatively, this implies that the Commission can amend or repeal its Guidelines. 89 The practice has been to adopt guidelines for a set time period, which ensures that the Guidelines will be regularly reviewed.

<sup>&</sup>lt;sup>78</sup> Case C-410/09 *Polska Telefonia Cyfrowa* (PTC), para 35.

<sup>&</sup>lt;sup>79</sup> See T-219/14 - Regione autonoma della Sardegna (Italy), v Commission, para. 177 + other cases

<sup>80</sup> C-526/14, Kotnik and Others, para. 40; C-464/09 P - Holland Malt BV v European Commission, para 46; Joined Cases C-75/05 P and C-80/05 P, Germany and Others v Kronofrance [2008] ECR I-6619, para. 60.

 <sup>81</sup> C-526/14, Kotnik and Others , para. 43.
 82 Case T-73/98 Prayon Rupel v Commission [2001] ECR II-867.

<sup>83</sup> K. Bacon QC, European Union Law of State Aid (Oxford University Press 2017), 3rd ed. p 103. See judgment in Case T-162/13 Magic Mountain Kletterhalen, para 56-57.

<sup>&</sup>lt;sup>84</sup> C-464/09 P - Holland Malt BV v European Commission, para 47.

<sup>85</sup> Case C-431/14 P, Hellenic Republic v European Commission, para 71. 86 Case C-431/14 P, Hellenic Republic v European Commission, para 70; C-526/14, Kotnik and Others.

<sup>87</sup> Case C-431/14 P, Hellenic Republic v European Commission, para 72; Joined cases C-465/09 P to C-470/09 P, Diputación Foral de Vizcaya and Others v Commission, para 120. In Case C-431/14 P, the Court also made clear that Member States bear the burden of proof when they claim that Article 107(3)(b) TFEU is to be applied directly to the facts of the case (para 75 of the iudament).

<sup>88</sup> Case C-431/14 P, Hellenic Republic v European Commission, para 71.

<sup>89</sup> Cases T-254, 270 and 270/00 Hotel Cipriani v Commission [2008] ECR II-3269, para 293, upheld on appeal in Cases C-71/09 P [2011] ECR I-4727.

Fifth, the Commission cannot use the Guidelines to adopt 'quasi legislation' that would contradict Treaty rules or secondary legislation. This would go beyond the competence attributed to the Commission, even although it possesses broad discretion in the matter. In this field, the Commission has no general legislative power and only the Council is empowered, under Article 109 TFEU, to adopt any appropriate regulations for the application of Articles 107 and 108 TFEU, on a proposal from the Commission and after consulting the European Parliament. Soft law instruments cannot create new obligations for third parties.

There are consequently specific circumstances where the Commission can and should depart from the adopted Guidelines (general principles of EU law, specific circumstances, primary and secondary law). The Guidelines do not have absolute authority, as the Commission may need to consider exceptional circumstances or refer to the Treaty provisions directly. Finally, in the current transitory period pending the adoption of revised EEAG, the European Commission has argued for a 'flexible' application of the 2014 EEAG.<sup>93</sup>

#### 2.2. Interaction between GBER, EEAG and secondary legislation

In addition to the general State aid provisions of the TFEU, three sets of rules will have a direct influence on the State aid regime applicable to measures for environmental protection and energy. Those rules are set by:

- Commission Regulation (EU) N°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 (General Block Exemption Regulation, GBER).
  - The GBER entered into force on 1 July 2014. It sets thresholds for notification and evaluation. Currently, about 90% of all measures fall under the thresholds defined in the GBER. The Environmental section of the GBER is mirrored in the Energy and Environmental Aid Guidelines (EEAG).
- State aid guidelines for environmental protection and energy (EEAG) (2014-2020)
- **Secondary legislation**, and notably the Renewable Energy Directive and the Energy Efficiency Directive, the Internal market for Electricity Directive and Regulation.

A clear dynamic of a procedural and structural nature can be observed, where the guidelines are involved in a three-step, circular process consisting of the adoption of a new GBER Regulation, new State aid guidelines and new secondary legislation. In the case of the EEAG, there is a close interrelations between: (i) the adoption of binding provisions of GBER, reflecting provisions of the 2009 Third Energy Package, (ii) followed by more detailed provisions in the EEAG for the purpose of implementing the principles of the GBER, and (iii) the preparation of the revision of relevant EU secondary law as part of the Clean Energy for All Europeans package, notably the Renewable Energy Directive.<sup>94</sup>

<sup>&</sup>lt;sup>90</sup> On the term 'quasi legislation', see: G. Ganz, *Quasi-Legislation* (Sweet & Maxwell, 1987), 14,24; O. Stefan, 'European Union Soft Law: New Developments Concerning the Divide Between Legally Binding Force and Legal Effects', *The Modern Law Review*, Vol. 75, No.5 (2012), 888. The term was also used by the applicant in the action brought against the Commission in Case T-694/14, EREF.

<sup>&</sup>lt;sup>91</sup> According to Article 13(2) TEU, each institution of the Union is to act within the limits of the powers conferred on it in the Treaties, and in conformity with the procedures, conditions and objectives set out in them.

<sup>92</sup> C-366/88 France v Commission [1990] ECR I-03571

<sup>&</sup>lt;sup>93</sup> Leaked Commission Green Recovery Plan May 2020.

<sup>&</sup>lt;sup>94</sup> Banet, Catherine, Legal status and legal effects of the Commission's state aid guidelines. The case of the Guidelines on state aid for environmental protection and energy (EEAG) (2014-2020), EStAL, Issue 2/2020.

The environmental and energy sector is probably one of the best examples of the link between GBER, State aid guidelines and secondary EU law. A similar dynamic seems to appear in the sector of broadband infrastructures. Given the rapid development of the legislation in the energy sector, the described dynamic observed may be a blueprint for other sectors.<sup>95</sup>

An important objective of the Report is to examine how this interaction will determine the content of the review process for the EEAG. This close interaction between GBER, EEAG and secondary legislation is crucial to understand before making any recommendations for revision of the EEAG.

#### Issues to be considered in the revised EEAG:

- Because the EEAG play an important role in supporting Member States in their target compliance, it is recommended to link the revised EEAG closely to the compliance strategy with 2030 targets.
- The revised EEAG should reflect and build on the provisions laid down in the Clean Energy Package for All Europeans, and build on the forthcoming revised GBER. The close interaction between the GBER and the EEAG should be maintained.
- Because of ongoing and forthcoming legislative processes under the European Green Deal, including on sector integration and sector coupling, the revised EEAG should also enable the development of new technologies and measures aimed at reaching the set targets and environmental goals defined in secondary EU legislation.

# 2.3. Review of recent case law on State aid definition and consequences for the use of the EEAG

This section questions to which extent the case law of the CJEU impacts the definition of the notion of aid, taking the example of support schemes for renewable energy sources. Indeed, the active role taken by the Court in interpreting the notion of State aid may raise questions as to a possible judicialisation of the area. This is exemplified by the extensive reference made to the CJEU case law in the Commission Notice on the notion of State aid pursuant to Article 107(1) TFEU. This active role of the Court is justified by the relatively broadly formulated criteria in Article 107(1) TFEU. The features of the aid measures have also become increasingly complex, forcing the Court to expand its interpretation on the different components of the notion, such as selectivity, state resources or economic advance. Among energy cases, the notion of State resources has been a prominent one, as the source of financing of the measure may not be the state itself and may even be final consumers.

The notion of aid, pursuant to Article 107(1) TFEU, is one that both the Commission and national authorities (including national courts) have to apply in conjunction with the notification and stand-still obligation provided for in Article 108(3) TFEU. The notion of aid is an aspect not covered by the Guidelines. It is a legal concept defined directly by the Treaty and which must be interpreted on the basis of objective factors. He court carries a comprehensive review as to whether a measure falls within the scope of the Article 107(1) TFEU, having regard both to the specific features of the case and to the technical or complex nature of the Commission's assessments. He commission's assessments.

 $^{96}$  C-487/06 P British Aggregates v Commission [2008] ECLI:EU:C:2008:757, para. 111.

<sup>95</sup> Ibid.

<sup>97</sup> C-83/98 P France v Ladbroke Racing and Commission [2000] ECR I-3271, para. 25

To exemplify the argument on the evolution of the notion of State aid following the interpretation given by the Court and its effects on the scope of the EEAG, one can look at the Court's case law concerning support schemes for renewable energy sources:

- Narrow applicable in *PreussenElektra* no state resources
- Still narrow application, with some doubts on application for Commission, as to state resources and stranded costs:
  - Germany, NN 27/2000; The Netherlands, NN/30/B/2000; Denmark, N 602/2004
  - o *Iride SpA* T-25/07, 2009
- **First signs of a broader interpretation**: Essent Netwek Noord BV, C-206/06, 2008. In parallel, the national support schemes in favour of renewable energy are getting more complex, the renewable energy sector is also developing, and a new directive, Directive 2009/28/EC, is adopted.
- Commission decisions, still period of doubt on interpretation, new features in the schemes, such as in the Austrian Green Electricity Act or the Romanian Green Certificates Scheme.
  - o A parallel can be drawn with the EU ETS and energy taxation: Court decision in NOX-scheme on The Netherlands (*Commission v Netherlands*, C-279/08 P)
- Towards a broader interpretation of the notion of State aid:
  - Case C-262/12, Association Vent de Colère!
  - Case C-275/13 Elcogás
  - o Case T-47/15 Germany v Commission (appealed, Case C-405/16 P)
  - Case C-405/16 P Germany v Commission. The Court of Justice annuls the Commission decision stating that the German law on renewable energy of 2012 (the EEG 2012) involved State aid.

Some conclusions can be drawn from this quick case law review for the use and interpretation of the EEAG:

- By enlarging or restricting the interpretation of the notion of State aid, the Court **enlarges** or restrains the scope of application of the Guidelines.
- In its latest decisions, the Court has an extensive definition of, in particular state resources, which broadens in fine the notion of State aid.
- By broadening the notion of State aid, it is argued that it has increased the role for the Guidelines (control of compatibility), and in doing so has reinforced the power of the Commission and the centralised control on support schemes and measures.

It can argued that we are in a current phase of expansion of the notion of State aid and thus increased focus on the control of compatibility with the internal market, and in so doing increasing control of the Commission on national schemes.

- The focus is shifting towards the question of compatibility with internal market rules.
- State aid law and the EEAG have become **even more relevant as instruments** to control national support schemes and measures, in the hands of the Commission.

## 2.4. Review of the recent State aid case law from the CJEU with relevance for the energy sector

It is useful to recall that, in its review of notified State aid measures, the European Commission is bound by a **series of procedural rules**. 98 The assessment procedure conducted by the European Commission is in two stages: a preliminary stage and an investigation stage. 99 The Tempus Case reviewed below illustrates the extent of the Commission's duty to carry out all the requisite consultations and for that purpose to initiate the procedure under Article 108(2)TFEU.

Thereafter, the decisions by the European Commission (approval or rejection) often reflect a compromise reached between the Commission and the Member State that can be subject to judicial review before the CJEU. The lack of transparency of the process for reaching a compromise is increasing criticised by the CJEU, with negative consequences for governments and market actors in case of annulment of the Commission's approval decision.

The following sections investigate the manner in which the recent case law of the Court of Justice of the EU can influence the manner the European Commission will (i) define State aid measures encompassed by the prohibition of Article 107.1 TFEU); and (ii) follow procedural rules and assess the national measures notified to them by Member States.

#### 2.4.1 Tempus v Commission (T-793/14) (on appeal)

The case relates to the Commission's decision on the UK capacity mechanism. On 23 July 2014, the Commission decided not to raise objections to the aid scheme establishing a capacity market in the UK, on the ground that that scheme was compatible with the EU rules on State aid and the internal market. $^{100}$  In its judgment of 15 November 2018, *Tempus Energy and Tempus Energy Technology v Commission* (thereafter referred as the 'Tempus case'), the General Court annulled the decision of the Commission not to raise objections. $^{101}$ 

In 2014, the Commission decided that the first capacity market scheme of Great Britain was in line with the EU State aid rules. However, Tempus, a company which based its business model on demand side response technology, contested this decision. According to the UK and the Commission, there may soon be a shortage of electrical energy to meet the demand during moments of system stress. They pointed out that capacity suppliers encompass both electricity generators (power plants, including those using fossil fuels) and demand side response operators. On the contrary, Tempus argued that the capacity market privileges generation over demand side response (DSR) in a way that is discriminatory and disproportionate.

The General Court annulled the decision on procedural grounds. It did not consider the compatibility of the capacity market scheme itself but concluded that the Commission should have opened the formal investigation procedure laid down in Article 108(2) TFEU. The Court' judgement sheds new lights upon the concept of doubts and the extent of the Commission's duty to investigate in State aid cases.

<sup>&</sup>lt;sup>98</sup> Council Regulation (EU) 2015/1589 of 13 July 2015 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union (hereafter Procedural Regulation).
99 See Nuova Agricast, C-390/06 paras. 57 and the case law cited.

<sup>100</sup> Commission Decision C(2014) 5083 final of 23 July not to raise objections to the aid scheme for the "capacity market" proposed by the UK (State aid SA.35980 (2014/N-2))(OJ 2014 C 348, p. 5)

<sup>&</sup>lt;sup>101</sup> T-793/14, EU:T:2018:790 <sup>102</sup> T-356/15, para 55-56.

<sup>&</sup>lt;sup>103</sup> T-356/15, para 56.

In its judgement, the Court recalled the three requirements established by case law to determine whether there should be doubts as such as the Commission shall carry out all the requisite consultations and initiate the investigation procedure. First, the concept of doubt is exclusive. Second, when the Commission fails to eliminate all doubt within the meaning of that provision, it is obliged to initiate the formal investigation procedure. The Commission has no discretion in that regard. Third, the concept of doubts – as referred to in Art 4(3) and (4) of the Procedural Regulation - is an objective one. As mentioned by the Court, Whether or not such doubts exist requires investigation of both the circumstances under which the contested measures were adopted and their content'. 106

The Court recalled that the Commission has no discretion in deciding whether to open the investigation procedure. If there are any doubts about the compatibility with the internal market, the Commission must initiate the procedure of Article 108(2) TFEU.<sup>107</sup> For this, the Commission must actively research whether there are doubts. The Court emphasised that the Commission is not restricted to analysing the information contained in the notification of the measure. The Commission can and, where necessary, must, seek relevant information to find all factors that can reasonably be considered sufficient and clear for the purposes of its assessment.<sup>108</sup>

In its assessment, the General Court found several objective and consistent indications of doubt, such as the length of the discussions between the Commission and the UK and the novelty and complexity of the measure. Hereby, it did not consider that the Commission had decided to initiate a sector inquiry on capacity mechanisms, <sup>109</sup> since this decision was taken after the contested decision. However, the Court did take into consideration the length and the information shared between the Commission and the UK. <sup>110</sup> The Court also states that both generation and DSR could form a solution for the capacity adequacy problem. Therefore, the Commission should have made sure that these actors are treated equally by the aid scheme. According to the Court, the Commission did not examine this in sufficient detail. <sup>111</sup> Considering the potential of DSR, the Commission should have examined the actual appreciation of DSR for the purposes of the capacity market. <sup>112</sup> A relevant factor that was taken into account by the Court was the report of the UK's independent Panel of Technical Experts (PTE). This panel examined National Grid's <sup>113</sup> recommendations concerning the capacity to be auctioned on the capacity market. The PTE expressed its concern that generation capacity is granted a larger role than is strictly necessary. <sup>114</sup>

Overall, the Court concluded that from the objective and consistent indications of doubt it appears that the Commission took the contested decision despite the existence of doubts. Given the GC judgment annulling the 2014 Decision, the implementation of the aid in question until the GC judgment must be regarded as unlawful. The Commission should have initiated the formal investigation procedure of Article 108(2) TFEU. A few months after this decision the Commission decided to start such a procedure<sup>115</sup> and on October 2019, with the Decision C(2019) 7610 decided

 $<sup>^{104}</sup>$  T-793/14, *Tempus v Commission*, para 63. See also Deutsche Post and DHL International v Commission, T-388/03, para 90 and the case law cited; and Smurfit Kappa Group v Commission, T-304/08, para 78.

<sup>&</sup>lt;sup>105</sup> See Art 4(4) of the Procedural Regulation. T-793/14, *Tempus v Commission*, para 64. See as well British Aggegrates v Commission, C-487/06 P, para 113 and the case law cited; Smurfit Kappa Group v Commission, T-304/08, para 79 and the case law cited.

<sup>&</sup>lt;sup>106</sup> T-793/14, *Tempus v Commission*, para 65. See also see Bouygues and Bouygues Telecom v Commission, C-431/07P, para 63; and Smurfit Kapa Group v Commission, T-304/08, para 80 and the case law cited.

<sup>&</sup>lt;sup>107</sup> General Court 15 Novembre 2018, T-793/14, *Tempus v Commission*, para 62-65.

<sup>&</sup>lt;sup>108</sup> T-793/14, para 69.

<sup>&</sup>lt;sup>109</sup> Commission Decision C(2015) 2814 final of 29 April 2015 initiating an inquiry on capacity mechanisms in the electricity sector pursuant to Article 20a of Regulation No 659/1999.

<sup>&</sup>lt;sup>110</sup> T-793/14, para 111.

<sup>&</sup>lt;sup>111</sup> T-793/14, paras 125, 126.

<sup>&</sup>lt;sup>112</sup> T-793/14, para 153.

<sup>&</sup>lt;sup>113</sup> The UK transmission system operator.

<sup>&</sup>lt;sup>114</sup> T-793/14, para 156.

<sup>115</sup> Commission Decision C(2019) 1296 final of 21 February 2019, State Aid SA.35980 (2018/NN) – United Kingdom Electricity

that the aid scheme in the form of the Capacity Market implemented by the United Kingdom pursuant to the Energy Act 2013 is compatible with the internal market on the basis of Article 107(3)(c) of the Treaty.

The judgment of the General Court upon the UK capacity mechanism might affect future schemes. 116

The decision is currently under appeal.

### 2.4.2 Case C-56/18 P, European Commission v Gmina Miasto Gdynia and Port Lotniczy Gdynia Kosakowo

In this decision, dated 11 March 2020, the Court of Justice had the opportunity to further develop its case law on the application of State aid procedure rules, this time in relation to the legal basis of the Commission's assessment.

The case is not related to the energy sector, however, it illustrates once more the importance of procedural rules in State aid cases, and the recent challenges met by the Commission in that respect. In its decision, the Court of Justice considered an appeal made by the Commission against the judgement of the General Court in case T-263/15,<sup>117</sup> which partly annulled Commission Decision 2015/1586. The General Court annulled the Commission decision on the grounds that the Commission had switched the legal basis for its assessment between the moment of the opening of the formal investigation procedure (regional aid guidelines) and the moment of its closing (aviation guidelines). This change in the basis of assessment was considered by the General Court to violate the right of the applicants to submit relevant comments and to deprive them of the possibility to defend and properly explain the project in question. In its appeal, the Commission argued that the General Court misapplied the right conferred on interested parties by Article 108(2) TFEU to submit comments.

The Court of Justice concluded that the Commission had indeed committed an error and infringed the procedural rights of the interested parties, as it cannot 'base its decision on new principles introduced by a new legal regime, without inviting those interested parties to submit their comments in that regard'. However, even although the Commission committed an error, the need to annul the decision will depend on the gravity of the error, said the Court. In other words, a procedural irregularity will entail the annulment of a decision in whole or in part only if it is sufficiently grave to result in a 'substantively different decision'. The Court of Justice concludes that, in the case at stake, the General Court erred in law.

#### 2.4.3 The Montessori Case

In its judgment of 6 November 2018, Scuola Elementare Maria Montessori e.a. v Commission, thereafter the Montessori Case $^{120}$ , the Court interpreted the conditions for admissibility in State aid cases. By its judgment, the Court is arguably opening the conditions for admissibility, as it declared the claims of two competitors of the beneficiaries of the Italian State aid regime admissible.

In this state aid decision, the Commission declared the Italian rules incompatible with Article 108(3) TFEU. The Commission stated that - in view of the circumstances of the case -, it would be impossible for Italy to recover the unlawful aid and therefore, the Commission did not order it to do so.<sup>121</sup> The

Market Reform: Capacity Mechanism.

<sup>&</sup>lt;sup>116</sup> Tempus is now also contesting the legality of the Polish scheme.

<sup>&</sup>lt;sup>117</sup> T-263/15, Gmina Miasto Gdynia and Port Lotniczy Gdynia Kosakowo v European Commission.

<sup>&</sup>lt;sup>118</sup> C-56/18 P, European Commission v Gmina Miasto Gdynia and Port Lotniczy Gdynia Kosakowo, para.79.

<sup>&</sup>lt;sup>119</sup> Ibid, para. 80.

<sup>&</sup>lt;sup>120</sup> Joined Cases C-622/16 P to C-624/16 P, EU:C:2018:873.

<sup>&</sup>lt;sup>121</sup> Ibid, para. 10.

latter was contested by the complainants, who asked for annulment of this part of the Commission decision.

A central issue in this case<sup>122</sup> is the applicability of the conditions of admissibility of actions for annulment brought by natural and legal persons, as laid down in Article 263 TFEU. Here, the Court concluded that the Commission decision was a 'regulatory act', thereby making it easier for companies to meet the conditions of admissibility. It firstly ruled that all non-legislative acts of general application must be considered to be regulatory acts. Then it added that it is settled case law that Commission decisions authorising or prohibiting State aid schemes are of general application. 123 This reasoning led to the conclusion that the contested decision was a regulatory act. This means that only two criteria had to be met: (i) the decision must be of direct concern to the complainants; and (ii) it must not comprise implementing measures. The Court of Justice concluded that, in this case, these two conditions were met.

#### 2.4.4 Germany v European Commission, case C-405/16 P

In 2012, Germany, introduced by law a scheme to support undertakings producing electricity from renewable energy sources. The features of the scheme included: higher price for producers; an 'EEG surcharge' on suppliers; the possibility for certain undertakings, such as electricity-intensive undertakings (EIUs) in the manufacturing sector, to get a reduction on that surcharge in order to maintain their international competitiveness. In 2014, the European Commission found that the measure had to be considered as State aid, but could be deem compatible with EU law subject to a series of adjustments. 124

In its judgment of March 2019, the Court of Justice of the EU annulled the Commission decision and overturned the General Court judgment. 125 One of the key assessment point raised by the two Courts was whether the funds serving a public purpose were under 'constant public control'. This public control test was central in determining whether the measure involves State resources. In its judgment, the Court of Justice insisted on the difference between control by the state over resources and attribution to the state of the aid granting decision. The Court decision shone additional light on the context of State resources.

#### 2.4.5 FVE Holýšov I and Others v Commission, Case T-217/17

This case relates to the protection of legitimate expectations and legal certainty on the one hand and on the concept of state resources on the other hand.

In 2003, two Czech associations in the renewable energy sector sent a complaint to the European Commission on a draft law of the Czech Republic seeking to promote electricity generated from RES and including: a minimum purchase price set annually by the Czech Energy Regulatory Office (ERO), established on the basis of the investment and operating costs of photovoltaic installations; a green bonus in addition to the market price. The measures were financed exclusively by a special levy (RES levy), in the form of a surcharge on electricity transmission and electricity distribution tariffs, paid by electricity end-customers to the electricity TSO and the regional electricity DSOs, with the result that end customers fully bore the burden of financing of those measures. The two associations claimed that the measures were contrary to EU State aid rules. In its response in 2004, the Commission considered that the draft measures did not constitute State aid, as they did not involve

<sup>&</sup>lt;sup>122</sup> On this point of law, see also T-339/16, *Paris and others v Commission*.

 <sup>123</sup> C-284/16, Achmea, EU:C:2018:158, para 28-31.
 124 Commission Decision (EU) 2015/1585 of 25 November 2014 in State aid proceedings SA. 33995 (2013/C) (ex 2013/NN) [implemented by Germany for the support of renewable electricity and energy-intensive users]. <sup>125</sup> T-47/15, Germany v Commission, ECLI:EU:T:2016:281.

State resources. The law was enacted and the measures implemented, but revised in 2010, reducing the level of the support. As from 2011, the scheme was financed partly by means of the RES levy and partly by the State budget. The Czech Republic notified the amended scheme to the European Commission. The Commission considered the scheme to be State aid, but to fall within the exemptions covered by the EEAG. In its decision of 20 September 2019, the General Court held that the Commission did not err in considering that the initial scheme entailed the use of State resources while distinguishing the features of the Czech scheme from the ones in *Van Tiggele*, *PreussenElektra* and *Germany v. Commission*. The commission of the Czech scheme from the ones in *Van Tiggele*, *PreussenElektra* and *Germany v. Commission*.

 $<sup>^{126}</sup>$  FVE Holýšov I and Others v Commission, Case T-217/17, paras. 4-5 and 14-19.

<sup>&</sup>lt;sup>127</sup> Ibid, para. 126.

# SCOPE OF THE REVIEW: EXPECTED AREAS OF CHANGE

# 3. Scope of the review: expected areas of change (necessary/expected/possible)

As previously explained, the revised EEAG - and GBER - will need to reflect the changes in secondary legislation following the adoption of the Clean Energy Package. The EEAG - and GBER - will also be among the core instruments that can be used to implement the new European Commission's strategy based on the European Green Deal. It is also a favoured instrument, because the European Commission has extensive competence in the matter. 128

It must also be recalled that, pursuant to Article 7 TFEU, the Union has a **duty of consistency** between its policies and activities, 'taking all of its objectives into account and in accordance with the principle of conferral of powers'. The principle of consistency so defined applies both horizontally and vertically in the EU legal order, focusing on material consistency. The principle defined in Article 7 TFEU is completed by the obligation defined in Article 13(1) TEU for the Union to have an institutional framework able to ensure the consistency of its policies and actions, together with its effectiveness and continuity. The results from the combined reading of those two articles that the principle of consistency should guide the work of the European Commission also when drafting State aid guidelines, according to the competences conferred to it in this area.

Two key objectives of this section of the Report are: to identify which areas of the EEAG will most probably be subject to revision, based on the scrutiny of recent changes in secondary legislation (Section 3.1); to understand how the forthcoming policy and legislative initiatives announced under the EU Green Deal will affect the new EEAG (Section 3.2). This section also investigates how the EEAG should ensure consistency with the new legal and policy framework on sustainable finance which is currently put in place (Section 3.3.). The Section ends with some final recommendations for the revision of the EEAG on the above-mentioned points (Section 3.4).

3.1. Interaction between EEAG and secondary energy sector legislation: the relationship to the CEP and recast Renewable Energy Directive. Reflecting recently adopted secondary legislation.

The objective is to study the impact of the newly-adopted Clean Energy Package for All Europeans on State aid rules in general and EEAG in particular.

There will be a tight margin for the Commission between the newly-adopted CEP and what can be added in the EEAG.

A comparative table between the key legislative acts of the CEP and the need for revision of the EEAG will be added below.

<sup>128</sup> See above Section 2.1.

<sup>&</sup>lt;sup>129</sup> On the principle of consistency under Article 7 TFEU, see notably: Jurian Langer & Wolf Sauter, "The Consistency Requirement in EU Law" (2017) 24:1 Colum J Eur L 39-74; E. Herlin-Karnell and T. Konstadinides, 'The Rise and Expressions of Consistency in EU Law: Legal and Strategic Implications for European Integration', Cambridge Yearbook of European Legal Studies (2012-2013), pp. 139-167; C. NK Franklin, 'The Burgeoning Principle of Consistency in EU Law', Yearbook of European Law, Vol. 30, No. 1 (2011), pp. 42-85.

<sup>&</sup>lt;sup>130</sup> H.-J. Blanke and S. Mangiameli, 'Article 13 TEU', in H.-J. Blanke and S. Mangiameli (eds.) *The Treaty on European Union – A commentary*, p. 543.

Legal provision in secondary	Content	Possible effect in the revised EEAG	Comparison with EEAG (2014-2020)
legislation			
	001 of the European Parl e use of energy from ren	iament and of the Counc	il of 11 December 2018
Art. 3.3	Design of support	ewable sources	Reference to waste
Art. 3.3	schemes and respect of waste hierarchy. No support for RE produced from the incineration of waste if separate collection obligations not complied with.		hierarchy maintained as a key principle in waste management.
Art.4.2 – Support for	Support schemes for	The incentive effect of	The market-based
energy from renewable sources	electricity from renewable sources	the support scheme is emphasised ('shall provide incentives for the integration of electricity from renewable sources in the electricity market'). The support schemes shall follow a market-based approach. They shall take into account possible system integration costs and grid stability.	and market- responsive approach is confirmed.
Art. 4.3	Design of support schemes for electricity from renewable sources.	The basic principles of support schemes design are reiterated: maximisation of the integration of electricity from renewable sources in the electricity market; producers exposed to market price signals; producers maximise their market revenues.  The support 'shall' be granted in the form of a market premium, which could be sliding or fixed.	The same approach is confirmed, also the use of market premium. Exemptions for small-scale installations and demonstration projects are confirmed.

		Evenutions for any	
		Exemptions for small-	
		scale installations and	
		demonstration	
		projects are provided.	
Art. 4.4 – Tendering	General rules and	The support shall be	The same principles
	possible exemptions	granted through	are reiterated:
		competitive bidding	mandatory use of
		processes.	competitive bidding
			processes.
		Member States may	
		exempt small-scale	A similar type of
		installations and	exemptions is
		demonstration	provided.
		projects from	
		tendering procedures.	A reference to
		Implementation	`regional
		details will need to be	diversification' is
		provided in the	added.
		revised EEAG.	
		Member States lay	
		consider establishing	
		mechanisms to ensure	
		`regional	
		diversification' when	
		deploying renewable	
		electricity.	
		Implementation	
		details will need to be	
		provided in the	
		revised EEAG.	
		Notably, details might	
		be expected on the	
		nature of these	
		mechanisms.	
Art. 4.5 – Tendering	Possible technology	REDII opens for	Similar content than
	specific tenders.	technology specific	in the 2014 EEAG.
		tenders, subject to a	
		series of criteria.	
Art. 4.6	Tendering procedure	REDII contains	Minimum
		minimum general	transparency
		requirements	requirements are
		concerning the	reinforced.
		transparency of	Information on project
		tendering procedures,	realisation rates is
		and project realisation	added.
		rates.	
Art. 4.7	RE projects located in	REDII opens for	Slight addition.
	the outermost regions	adapting financial	
	and small islands	support schemes for	

		projects located in the outmost regions and	
		small islands.	
Art. 4.9	Respect of State aid rules, as laid down in Articles 107 and 108 TFEU.	Standard reference.	Standard reference.
Art. 5	Opening of support schemes for electricity from renewable sources	The same principle than in the 2014 EEAG is reiterated: Member States keep the right to decide whether they open their national support scheme to production from another Member State or not. If they open their national scheme, they can apply the conditions set in this Article (i.e. indicative shares, pilot schemes). Before opening their schemes, Member States can require proof of physical import of electricity. An agreement shall be in place between the concerned Member States.	The same principle than in the 2014 EEAG is reiterated, but new rules have been added as to the conditions of the opening of national support schemes to foreign producers from another Member State.
		will need to be integrated into the revised EEAG.	
Art. 6	Stability of financial support	The revised EEAG will need to reflect the new provisions in relation to the stability of the scheme, particularly the conditions for revising the schemes, including the level of support.	Not addressed in the 2014 EEAG.
Art.23-24	District heating and cooling		

	T	1	ı
Art. 30	Verification of		
	compliance with the		
	sustainability criteria		
	and GHG emissions		
	saving criteria –		
	Biofuels, bioliquids		
	and biomass. National		
	schemes		
Art. 31	Calculation of the		
	GHG impact of		
	biofuels, bioliquids		
	and biomass fuels		
Art. 15.8	Renewables PPAs		
	/844 of the European F	arliament and of the C	ouncil of 30 May 2018
	2010/31/EU on the en		
2012/27/EU on ene		ergy periormance or b	
Art. 2a	Long-term renovation		
Aiti Zu	strategy.		
	The use of public		
	funding to leverage		
	_		
	additional private-		
	sector investment or		
	address specific		
	market failures.		
Art. 4	Setting of minimum	Only measures	GBER to be updated.
	energy performance	exceeding the	New provisions to be
	requirements	minimum energy	added to the EEAG.
		performance	
		requirements should	
		be eligible.	
Ar. 8.1	Technical building	Only measures	GBER to be updated.
	systems,	exceeding the	New provision to be
	electromobility and	minimum system	added in the EEAG.
	smart readiness	requirements should	Link to be made to
	indicator.	be eligible,	energy
			infrastructures.
Art.8.2 to 8.5	enable the installation	Support to EV-	Clarify what is the
	at a later stage of	infrastructures should	benchmark for
	recharging points for	concern measures	support to EV-
	electric vehicles	going beyond the	infrastructures and
		minimum	recharging points, and
		requirements of the	which measures will
		Directive.	be eligible.
Art.9	Nearly zero-energy	Should serve as	<u> </u>
	buildings	benchmark. Only	
		measures going	
		beyond the minimum	
		requirements of the	
		Directive should be	
		eligible for support.	
		cligible for support.	

Art. 10	Financial incentives	Member States are	Member States are
	and market barriers.	required ('shall') to	encouraged to take
		take appropriate steps	financial measures to
		to 'consider' the most	catalyse the energy
		relevant financial	performance of
		incentives to catalyse	buildings and the
		the energy	transition to nearly
		performance or	zero-building. Those
		buildings and the	lists can serve as
		transition to nearly	benchmarks for the
		zero-energy buildings.	EEAG.
		Member States shall	
		draw up a list of	
		national existing and,	
		if appropriate,	
		proposed measures and instruments, and	
		communicate this list	
		to the European	
		Commission. This list	
		can comply with this	
		obligation by including	
		this list on the Energy	
		Efficiency Action Plans	
		referred to in Article	
		14(2) of Directive	
		2006/32/EC.	
	EU on energy efficiency	, as amended	
Art.14	Promotion of		
	efficiency in heating and cooling		
Art. 14.11	Public support to		
7 (101 2 1122	cogeneration and		
	district heating		
	generation and		
	networks shall be		
	subject to State aid		
	rules, where		
	applicable.		
	/944 of the European F		
2012/27/EU	for the internal mark	et for electricity and	amending Directive
Art.33	Integration of		
	electromobility into		
Danielia (EU)	the electricity network	Daulians and and affect	ha Causail of E. I.
	19/943 of the Europea I market for electricity	an Parliament and of t	the Council of 5 June
Art.3	Principles regarding		
	the operation of		
	electricity markets		

Art. 4	Just transition		
Art. 20	Resource adequacy		
	' '		
Art. 21	General principles for		
	capacity mechanisms		
Art. 22	Design principles for		
	capacity mechanisms		
Art. 26	Cross-border		
	participation in		
	capacity mechanisms		
Regulation (EU)	2018/1999 of the Euro	pean Parliament an	d of the Council of 11
December 2018	on the Governance of the	<b>Energy Union and C</b> l	imate Action
Art. 1.2	The 5 dimensions of		
	the Energy Union		
Art. 2(18)	the Energy Union Energy efficiency first		
Art. 2(18) Art. 2(20)	- · · · · · · · · · · · · · · · · · · ·	Possible indirect	
	Energy efficiency first	Possible indirect effects.	
	Energy efficiency first		
Art. 2(20)	Energy efficiency first "Early efforts"		
Art. 2(20) Art. 5	Energy efficiency first "Early efforts"  Renewable energy		
Art. 5 Art. 6	Energy efficiency first "Early efforts"  Renewable energy Energy efficiency		
Art. 2(20)  Art. 5  Art. 6	Energy efficiency first "Early efforts"  Renewable energy Energy efficiency Union renewable		

The list of **definitions** in the revised EEAG need to be aligned on any changes made to the definitions following the adoption of new secondary EU law.

# 3.2. Priority areas for the von der Leyen Commission and relevant legislative initiatives for the EEAG revision: the European Green Deal

#### The role of the EEAG in target compliance

The 2014 EEAG intend to assist Member States in **reaching their 2020 climate and energy targets** and to prepare the ground for achieving the objectives set in the 2030 Framework, <sup>131</sup> At the same time, they aim to retain a balance and address any **market distortions** that may result from subsidies granted under the EEAG. <sup>132</sup>

- A series of secondary EU acts contribute to implementation of the 2020 Strategy (CCS Directive, EU ETS, Fuel Quality Directive, RES Directive). However, as referred to in the EEAG (2014-2020), their implementation does not always result in the most efficient market outcome.<sup>133</sup> This calls for additional state intervention including in the form of State aid.
- As an example, the EU ETS or a CO2-tax may not fully internalise the costs of GHG emissions.
  This has motivated the Commission to include measures under the EEAG, such as Carbon
  Capture and Storage (CCS). In the EEAG, the Commission 'presumes that aid for CCS
  addresses a residual market failure, unless it has evidence that such remaining market
  failure no longer exists.' (162)

<sup>&</sup>lt;sup>131</sup> EEAG, paras (3) and (5).

<sup>&</sup>lt;sup>132</sup> EEAG, para (107).

<sup>&</sup>lt;sup>133</sup> EEAG, para (107).

If the measure has the purpose of meeting the 2020 targets, the Commission presumes that, if all other conditions met, requirements of appropriateness of aid and limited distortive effects of aid are also met.

It can therefore be expected that the revised EEAG will serve the same purpose of compliance with climate and energy targets under the 2030 Framework and the climate neutrality by 2050 goal. The possible revision of ambition level under the European Green Deal needs to be considered. So far, two targets are expected to be increased: the GHG emissions reduction targets (50-55% reduction, proposal expected by mid-2020) and possibly the renewable energy targets (potential proposal in 2021). The forthcoming **Europe Climate Law** (proposal put forward on 4 March 2020) will enshrine in law the 2050 climate neutrality objective, and possibly a mechanism for periodic review of different EU targets (GHG emissions reduction / RES targets primarily).

In this connection, the question should be asked as to the effects on the EEAG on an increase of the EU targets during the next validity period of the Guidelines. Given that the EEAG are a central instrument in reaching those targets, any increase will in principle need to be mirrored in the Guidelines.

New or revised legal act announced	Content	Possible effect on EEAG revision
European Climate Law <sup>134</sup>	Art. 1 (proposed):  'This Regulation establishes a framework for the irreversible and gradual reduction of greenhouse gas emissions and enhancement of removals by natural or other sinks in the Union.  This Regulation sets out a binding objective of climate neutrality in the Union by 2050 in pursuit of the long-term temperature goal set out in Article 2 of the Paris Agreement, and provides a framework for achieving progress in pursuit of the global adaptation goal established in Article 7 of the Paris Agreement.  This Regulation applies to anthropogenic emissions and removals by natural or other sinks of the greenhouse gases listed in Part 2 of Annex V to	Definition of `climate neutrality".  Definition of `climate neutrality objectives.  Criteria for assessing national measures (Art. 6, 7).
Energy Taxation Directive 2003/96/EC, revision	Regulation (EU) 2018/1999.'  Energy taxation is a key element in providing a price	The revision of the Energy Taxation Directive is scheduled
	signal aligned with energy and	for June 2021. This means that

<sup>134</sup> Proposal for a Regulation of the European Parliament and of the Council establishing the framework for achieving climate neutrality and amending Regulation (EU) 2018/1999 (European Climate Law), COM(2020) 80 final, 4.3.2020.

	climate policies, and thus will support the clean energy transition in a competitive and economy driven way. The taxation of energy products and fuels, together with the ETS, will be a central instrument to reach climate and energy policy goals.  The main objectives pursued with the revision of the Directive are:  • aligning taxation of energy products and electricity with EU energy and climate policies, to contribute to the EU 2030 energy targets and climate neutrality by 2050;  • preserving the EU Single Market by updating the scope and the structure of tax rates, and rationalising the use of optional tax exemptions and reductions.	the two revision processes, for the EEAG and the Energy Taxation Directive, will be conducted in parallel and can be coordinated, as it should be.  The preparation of the revision of the Directive by the Commission services is ongoing with an inception impact assessment and consultation of the stakeholders started in spring 2020. The process builds on the results from an evaluation conducted in 2019. Content wise, there is a need to further clarify the provisions related to energy taxation in the EEAG. This concerns notably differences in tax treatment, when the same energy product is subject to a different tax rate due to different production technologies.
Gas Directive 2009/73/EC, revision/recast	Expected as part of the Smart Sector Integration package (to be announced on 8 July 2020)	Alignment of definition.  Need for including more support in favour of sector integration, re-use of infrastructures such as gas distribution networks, to enable a higher share of hydrogen, or new clean or renewable gases.

In addition, the following non-legislative initiatives may have an important effect on the revised EEAG:

- The European Climate Pact
- **Strategy for Energy System Integration**

<sup>&</sup>lt;sup>135</sup> European Commission, Inception impact assessment for the revision of the Energy Taxation Directive, 4 March 2020.

<sup>136</sup> European Commission, Evaluation of the Council Directive 2003/96/EC of 27 October 2003 restructuring the Community framework for the taxation of energy products and electricity, SWD(2019) 332.

- **Hydrogen Strategy**
- **Offshore Renewable Energy Strategy**
- **Comprehensive Strategy for Sustainable and Smart Mobility**
- **Circular economy / Farm to Fork Strategy** This initiative can have important effects on the revision of the EEAG.
- **Industrial Strategy Communication on Better Regulation**

New non-legislative	Content	Possible effect on EEAG
initiative		revision
The European Climate Pact	As part of the European Green Deal, the Commission aims to involve the general public in climate policy to a greater extent. The vehicle for promoting this broad social mobilisation – bringing together people, industry, civil society and public authorities at all levels – will be the 'Climate Pact'.	The European Climate Pact is to be launched in the 3rd quarter of 2020. A public consultation was organised in the Spring 2020. The impact on the revision of the EEAG should be very limited.
Strategy for Energy System Integration <sup>137</sup>	The Strategy explicitly refers to the need to revise the EEAG to reflect to new energy system integration priorities and enable the integration potential between technologies and sectors. Pursuant to the Strategy, the revised EEAG should support 'cost-effective deployment of clean energy'.	The revised EEAG will need to consider energy system integration in the types of measures and objectives of common interest. Emphasis is expected to be put on costeffectiveness in the deployment of clean energy technologies.
Hydrogen Strategy <sup>138</sup>	In its Strategy, the Commission expresses the view that hydrogen will be essential for the EU to reach its 2050 climate neutrality objective and the commitments under the Paris Agreement to the UNFCCC. To let hydrogen contribute to those objectives, hydrogen must be deployed at a much larger scale and its production must become 'fully decarbonised', since today's	State aid rules may differentiate the type of support needed for renewable hydrogen in line with the Climate targets (produced mainly by wind and solar) and the low carbon hydrogen, as defined in the Hydrogen strategy of the European Commission.

<sup>&</sup>lt;sup>137</sup> 'Powering a climate-neutral economy: An EU Strategy for Energy System Integration', Communication from the Commission, COM(2020) 299 final, 8.7.2020.

<sup>138</sup> 'A hydrogen strategy for a climate-neutral Europe', Communication from the Commission, COM(2020) 301 final, 8.7.2020.

hydrogen production is largely based on natural gas without CCS and coal. The strategy states that the 'priority for the EU is to develop renewable hydrogen, produced using mainly wind and solar energy'. It also sets strategic objectives to install renewable hydrogen electrolysers in the EU (i.e. 40 GW by 2030) and confirms that the 'renewable hydrogen is the most compatible option with the EU's climate neutrality and zero pollution goal in the long term and the most coherent with an integrated energy system'. The strategy recognises that 'boosting demand and supply of hydrogen is likely to require various forms of support, differentiated in line with the vision of this strategy to prioritise the deployment of renewable hydrogen' and leaves some room for short and medium term for 'other forms of low carbon hydrogen (defined as 'fossil-based hydrogen with carbon capture and electricity-based hydrogen, with significantly reduced full life-cycle greenhouse gas emissions compared to existing hydrogen production') to rapidly reduce emissions from existing hydrogen production and support parallel and future uptake of renewable hydrogen. However, this last point remains vague in terms of strategic goals and support needed. Offshore Renewable Energy Public Consultation ongoing. Strategy

Circular economy – Farm to Fork Strategy <sup>139</sup>	The Farm to Fork Strategy is another cornerstone of the European Green Deal aiming to make food systems fair, healthy and environmentally-friendly.	A stronger focus on renewable gases – and bioenergy in general - can be expected. Farmers can serve as renewable energy producers and providers of energy storage services. The revised EEAG should then enable support of measures at farms.  There will be a need for consistency with other State aid guidelines applicable to the agriculture sector.
Industrial Strategy <sup>140</sup>	Confirms procedures for the revision of the EEAG in 2021. The Strategy also refers to the need to 'support industry towards climate neutrality' (Section 3.3), including the following priority areas:  • 'Modernising and decarbonising energy intensive industries must therefore be a top priority'.  • 'The European Green Deal sets the objective of creating new markets for climate neutral and circular products, such as steel, cement and basic chemicals. To lead this change, Europe needs novel industrial processes and more clean technologies to reduce costs and improve market readiness.'  • 'Needs to address the sustainability of construction products and improve the energy efficiency and environmental	Among the possible link between the EEAG and the Industrial strategy is the question to know whether criteria in favour of EU employment be inserted into the EEAG.

<sup>139</sup> Communication from the European Commission, A Farm to Fork Strategy for a fair, healthy and environmentally-friendly food system, COM(2020)381 final, 20.05.2020.

140 Communication form the European Commission, A New Industrial Strategy for Europe, COM(2020) 102 final, 10.3.2020.

	performance of built assets.'  • 'Reducing emissions across industry will depend on an 'energy efficiency first' principle.'  • 'All carriers of energy, including electricity, gas and liquid fuels will need to be used more effectively by linking different sectors.'  • 'A special focus on sustainable and smart mobility industries'	
Communication on Better Regulation	<ul> <li>Better Regulation         Guidelines</li> <li>Better Regulation         Toolbox</li> </ul>	Influence on the level of regulatory detail, the need to respect of the subsidiarity and proportionality principles and emphasis on market-based approach.

#### 3.3. Need for consistency across sustainable finance instruments

There is a need for greater consistency within the legal framework application to sustainable finance, across the different instruments and principles defined therein, and mainly:, Sustainable Europe Investment Plan (SEIP), Multi Annual Financial Framework (MFF), Sustainable Financing Taxonomy and benchmarking the Union renewable energy financing mechanism (of the REDII Directive).

#### Harmonised definitions for sustainable finance

In its Progress report on Accelerating Clean Energy Innovation 2018,<sup>141</sup> the European Commission has already advanced some principles for ensuring consistency between some financing instruments:

"In relation to two specific types of projects that have the potential to stimulate innovation across sectors, including for clean energy technologies, the Commission intends to introduce further simplifications and synergies. In this respect under certain specific conditions, research and innovation projects, independently evaluated and selected by independent experts in line with the Horizon Europe rules will not require additional evaluation or approval under EU State Aid Rules." 142

The proposed Regulation on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088, the so-called 'Taxonomy Regulation', aims to define a common classification system (taxonomy) to encourage private investment in sustainable growth

 <sup>141</sup> Commission Staff Working Document, Progress in Accelerating Clean Energy innovation 2018, SWD(2019) 157 final, 9.4.2019.
 142 Commission Staff Working Document, Progress in Accelerating Clean Energy innovation 2018, SWD(2019) 157 final, 9.4.2019, p.4.

and contribute to climate neutrality of the economy. The future framework will be based on six EU environmental objectives:

- 1. climate change mitigation;
- 2. climate change adaptation;
- 3. sustainable use and protection of water and marine resources;
- 4. transition to a circular economy;
- 5. pollution prevention and control;
- 6. protection and restauration of biodiversity and ecosystems.

The taxonomy for climate change mitigation and climate change adaptation should be established by the end of 2020 in order to ensure its full application by end of 2021. For the four other objectives, the taxonomy should be established by the end of 2021 for application by the end of 2022.

Article 3 of the Proposal for Regulation (as adopted by the Council),<sup>143</sup> defines criteria for environmentally sustainable economic activities. For the purposes of stabilising the extent to which an investment is environmentally sustainable, an economic activity shall qualify as environmentally sustainable where that economic activity:

- (a) contributes substantially to one or more of the environmental objectives set out in Article 9 in accordance with Articles 10 to 16;
- (b) does not significantly harm any of the environmental objectives set out in Article 9 in accordance with Article 17;
- (c) is carried out in compliance with the minimum safeguards laid down in Article 18; and
- (d) complies with technical screening criteria that have been established by the Commission in accordance with Article 10(3), 11(3), 12(2), 13(2), 14(2) or 15(2).

The Taxonomy Regulation applies primarily to private investments, and there is no direct legal link to the State aid regime application to energy and the environment. However, there could be some indirect effects, where the definitions adopted under the Taxonomy Regulation could also be used in other legal frameworks. However, there are no direct legal links between the frameworks.

Member States should avoid inconsistencies and distortion to competition in the EU market. In particular, any subsidy given to power plants and in general to market operators that are already incentivised to change their behaviour by market dynamics, e.g. by the ETS price and, after the implementation of the Energy Taxation Directive, by the fossil fuels taxes – would unduly distort competition in the EU energy market. Non-profitable plants cannot receive compensation for being shut down.

<sup>&</sup>lt;sup>143</sup> Text as adopted by the Council in first reading: https://data.consilium.europa.eu/doc/document/ST-5639-2020-INIT/en/pdf

#### **Cumulation of aid**

The question of consistency across financing instruments also raises the question of **cumulation of aid**. The EEAG traditionally set rules on cumulation of aid that need to be updated in the light of, inter alia, new notification thresholds, type of costs supported, source of funding.

Support in the form of State aid may also interact with **taxation measures**, **including tax exemption**. The 2014 EEAG , as previous guidelines, include State aid in the form of reductions or exemptions from environmental taxes, but also provide for reductions in electricity surcharges to energy intensive users (EIUs). The future regime under the revised EEAG of reductions or exemptions for electricity surcharges to EIUs needs further attention, not least to reflect the recent case law of the CJEU. As part of the European Green Deal, the European Commission has also announced a revision of the Energy Taxation Directive. To ensure a level playing field, taxation matters should, as a preferred option, be harmonised at EU level. When agreement on harmonisation is not possible, the EEAG can provide useful guidance in the perspective of avoiding distortion of competition. There is indeed a dual risk that, in the lack of harmonised EU legislation on the matter: (i) Member States may practice reductions or exemptions in different fashions; (ii) only a certain part of the population – electricity consumers – bears the costs, which creates further discrimination between consumer categories and between national regimes. There are some important elements of **competitiveness** and **fairness** to be preserved through the EEAG in relation to reductions or exemptions from surcharges.

#### 3.4. Recommendations

- The validity period for the guidelines should be aligned on the 2030 targets;
- To fulfil the obligation of consistency between Union's policies and activities, there should be
  a process of harmonisation between the EEAG and the other legal acts as to: the minimum
  requirements, energy market design and general definitions. There is a clear need to update
  the EEAG on sectoral measures related to, inter alia: EV recharging infrastructure; batteries;
  RES repowering/revamping; energy networks/smart grids investments; long term
  mechanism to support generation adequacy investments and flexibility);
- Although there is a need for consistency within sustainable finance between the private and public sector, the possible indirect impacts for the public action of the definitions for sustainable finance adopted in the private sector should be closely assessed.

Section 5 of the Report elaborates further on types of measures of specific importance and need for revision, without covering the full list of measures referred to in the table above.

# ALTERNATIVE WAYS TO STRUCTURE THE EEAG

#### 4. Alternative ways of structuring the EEAG

There is a close link between the GBER and the EEAG. The EEAG build on the provisions of the GBER and complement them. Therefore, it is necessary to enshrine in the GBER the key principles and criteria for eligibility that the EEAG can build on.

During the previous revision process, an important improvement was made concerning the structure of the Guidelines, with a first part of the EEAG being dedicated to common assessment objectives. Through that change, a common methodological framework for the application of the EEAG was defined, with presumed great benefits for consistency and transparent application. This should be reiterated in the revised EEAG.

#### 4.1. Three possible approaches

The next is to know whether there is a need to change the structure and scope of the EEAG, where three main approaches appear: a first alternative focusing on objectives (4.1.1); a second alternative focusing on specific measures (4.1.2); and a third way consisting in a combined approach (4.1.3).

#### 4.1.1 A first alternative focusing on objectives

These objectives could be **formulated in terms of benefits** for example for the environment, climate, system adequacy or flexibility.

With the implementation of the European Green Deal, the objective of climate neutrality in 2050 must guide the action of the Commission in the revision of the competition rules. Thus, concerning the 2014 EEAG, the reference to the 2020 objectives for renewable energy and efficiency energy presented as being 'of particular importance for these guidelines' should be replaced by the objective of climate neutrality.

It should also reflect other principles such as the **energy efficiency first principle and the waste hierarchy principles**. Those come in addition to general competition law principles, including cost efficiency and non-discrimination.

Those objectives would need to be consistent with other EU policy objectives, and should be aligned on the proposed Taxonomy for sustainable finance. The Taxonomy provides an objective measurement framework for environmental sustainability for a number of economic activities (including those of the energy sector). The Taxonomy is a tool for climate transition and - just like State Aid Guidelines on Environment Protection and Energy - will be an enabler of the European Green Deal. It would seem appropriate to use the measurement framework provided by the Taxonomy Regulation for assessing to what extent certain companies and activities, through State Aid, may concretely contribute to climate targets in the long term. In this context, the revised EEAG could make a clear reference to Taxonomy-alignment as a facilitator in State aid approval processes and assessments to fast-track the green transition.

Each individual measure would then need to pass the test of complying with this set of objectives. Specific criteria should be defined to make this assessment easier. For example, as part of the Clean Energy Package, it has already been adopted that power plants cannot get support if they emit more than 550 grams of  $CO_2$  per kilowatt hour. This criteria-based approach could apply to some specific questions or to broad issues.

The GBER and EEAG already contain references to certain general common objectives. For example, 'Environmental protection' is defined in the GBER as 'any action designed to remedy or prevent damage to physical surroundings or natural resources by a beneficiary's own activities, to reduce risk of such damage or to head to a more efficient use of natural resources, including energy-saving measures and the use of renewable sources of energy'.<sup>144</sup>

The criteria of **'resilience'**, already present in some State aid guidance documents, should be reinforced in the revised EEAG.

Life cycle assessments (LCAs) could prove useful tools for the purpose of assessing the extent to which the proposed measure could reach the environmental objective. LCA could be reinforced as eligibility criteria. The REDII Directive already provides elements of LCA calculation as well as emissions measurement and verification. LCA could also be used to assess different forms of hydrogen production.

This first approach could support the idea to focus on **environmental performance and climate neutrality** as an objective.

Some NGOs have proposed a 'carbon contract for difference' (CCfD), which has retained some attention from the European Commission, in its Hydrogen Strategy.<sup>145</sup>

#### 4.1.2 A second alternative focusing on specific measures

A second alternative could consist of an approach focused on a series of specific measures (renewable energy, flexibility, capacity mechanisms, CCS, etc.) after the definition of common analytical principles, reproducing the same structure than the current EEAG (2014-2020).

#### 4.1.3 A third way: a combined approach

This third alternative would be a combined approach, and may be the easiest one to apply, for both Member States and the European Commission services.

Under this combined approach, it would be important to define assessment criteria to measure to which extent the measure contributes to an **'objective of common interest'**. The objectives referred to in the first approach should serve as basis for defining those objectives of common interest.

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<sup>&</sup>lt;sup>144</sup> GBER, Art.2(101).

<sup>&</sup>lt;sup>145</sup> According to that proposal: "Recent studies have proposed financing policy instruments for decarbonizing the industry sector – e.g. Carbon Contracts for Difference (CCfDs – covered in Part II) – via a climate contribution based on the carbon intensity of basic materials or a carbon price on end-products. Where these instruments would be implemented on a national basis and exemptions were granted to specific industries – instead of EU-wide with exemptions granted via free-allocation and indirect cost compensation under the EU ETS – these would have to go through separate state aid approval."

<sup>&</sup>quot;CCDs can be used to provide project-specific support for operational expenditures for breakthrough technologies needed for the long-term greenhouse gas reduction of heavy industry (eg. Steel, Cement, Chemicals), while orienting the support towards the EU ETS price. CCfDs are contracts between national governments and companies developing a low-carbon project, which reimburse the difference between the yearly average price of EU ETS emission allowances (EUAs) and an agreed strike price per ton of emission reduction. In turn, companies are obliged to pay back the previously received funding in case ETS prices exceed the strike price. Project-based CCfDs create lead markets for innovative low-carbon production processes and materials at national and European scale. By determining a fixed project-based strike price, a CCfD provides a guaranteed carbon price, thus ensuring that that the incremental operating costs of the project are covered so that the project can continue to operate even if the EU ETS allowance prices decline. CCfDs can help stabilize revenue streams enough for investors to secure lower financing costs and ensure commercial viability." Source: ClienthEarth.

#### 4.2. Elements to consider when selecting the approach

The choice between the three alternatives has considerable consequences for:

- The margin of appreciation left to the Member States. The first alternative will leave more and arguably too much room for appreciation to the Member States. It can make the application of the proportionality test particularly challenging (on the proportionality test, see Section 5.1.1 below).
- More flexibility for Member States and the European Commission in their dialogue around State aid approval. An objective-based approach could help adjust the long duration of the EEAG. Any conclusions to draw from the Tempus case judgment in terms of approval procedure?
  - The European Commission has previously mentioned that it could apply a 'flexible approach' to the applicable of state rules (in general, i.e. not only EEAG), when the measures aim at reaching the climate neutrality objectives. However, a more flexible approach may entail risks of legal uncertainty for actors (government entities and companies), but also risks of a negative decision in case of judicial review by the CJEU.
- The importance of guiding principles. If the objective-based approach is chosen, it should be supported by a clear definition of the guiding principles that support it. For example, technology neutrality principles. If the new EEAG follow an objective-based approach with climate neutrality as its cornerstone, this will entail a stronger focus on technology neutrality and environmental performances, and therefore all technologies must be taken into account, not only RES but also EE, etc. It will cover a wide range of decarbonisation technologies, including CCS, demand response, nuclear, etc. It will be consistent with sector integration and sector coupling.
  - o However, it will require a strong benchmark in terms of environmental performance.
  - $_{\odot}$  One can look at the assessment performed by the European Commission in decisions taken directly under Article 107.3(c), more precisely the assessment of the 'common objective'.  $^{146}$

In that context, it should be reminded that, to be compatible with the State aid rules, measures must contribute to a well-defined common interest objective, referred to as 'policy objective'. Some measures may have overlapping objectives, but the compatibility assessment will be based on the identification of at least one clear objective.

- **Judicial review by the courts**: a lack of detail in the assessment criteria of the EEAG may reinforce the risk of seeing the approval decision recognised illegal by the Court, increasing the lack of legal certainty and the economic risks for the beneficiaries. As a reminder, the use of guidelines by the Commission aims to contribute to legal certainty and transparency.
- Need for level playing field and harmonisation between Member States. If the content of
  the EEAG remain too vague, Member States may take differing approaches when designing
  aid measures, although they contribute to the same objective. This may raise barriers to
  trade, affect competition between undertakings in different Member States and jeopardise
  the further integration of the internal energy market.

<sup>&</sup>lt;sup>146</sup> See for example the Lignite decision (SA.42536).

- **Consequences for the regulatory approach**. It would be necessary to assess to what extent state intervention, would remain compatible with this new framework, and which forms of regulatory intervention would be acceptable.
- Consequences in terms of implementation. An objective-based approach raises some important issues of implementation that may be subject to much greater discretion, but also increase the risk of legal uncertainty for the governments and the beneficiaries, with the above-mentioned risk of judicial review.
- Lessons learned from the application of State aid rules in response to the COVID-19. Some lessons could be learned from the Temporary Framework applied to State aids in relation to the COVID-19 outbreak and following economic downturn, which could confirm or affirm the choice for a different approach. Some of those lessons have been drawn in Section 1.5 above.

#### Recommendations:

• Based on the review of the advantages and disadvantages of the three different alternatives, this Report concludes in favour of the third alternative, consisting of a combined approach.

# GUIDING PRINCIPLES AND RECOMMENDED PRIORITY AREAS FOR THE EEAG REVISION

## **5. Guiding principles and recommended priority areas for the EEAG revision**

#### 5.1. Guiding principles: methodology and assessment criteria

#### 5.1.1. Common assessment principles

#### **Definition of common assessment principles**

The inclusion of **'common assessment principles'** in State aid guidelines, including the EEAG (2014-2020), answered the call made in the 2012 Communication on State aid modernisation<sup>147</sup> for the identification and definition of common principles applicable to the assessment of compatibility of all aid measures carried out by the Commission. It reflects the goal of developing **'a common approach'** in the revision of the different Guidelines and State aid frameworks in general.

The definition of common assessment principles follows the previous reliance on a **'balancing test'**, as introduced in the State Aid Action Plan (SAAP).<sup>148</sup> A key characteristic of this new common approach promoted in the SAAP and the SAM programmes was the reinforced use of economic and financial tools to assess whether the notified state aid measures could be authorised. This was reflected in the balancing test, based on criteria such as **market failure**, **incentive effects** and **proportionality**. Those criteria were maintained as part of the common assessment principles, and have been integrated into several State aid guidelines.<sup>149</sup> The emphasis put on economic analysis is obvious in recent notified aid measures, such as the Hinkley Point C case<sup>150</sup> or the various decisions on capacity mechanisms.<sup>151</sup>

Under the 2014 EEAG, the Commission will consider a State aid measure compatible with the internal market only if it satisfies each of the following criteria<sup>152</sup>:

- a) contribution to **a well-defined objective of common interest**: a State aid measure aims at an objective of common interest in accordance with Article 107(3) of the Treaty;
- b) **need for State intervention**: the State aid measure is targeted towards a situation where aid can bring about a material improvement that the market alone cannot deliver, for example by remedying a well-defined market failure;
- c) **appropriateness of the aid measure**: the proposed aid measure is an appropriate policy instrument to address the objective of common interest;
- d) **incentive effect**: the aid changes the behaviour of the undertaking(s) concerned in such a way that it engages in additional activity which it would not carry out without the aid or which it would carry out in a restricted or different manner;

<sup>&</sup>lt;sup>147</sup> `EU State Aid Modernisation (SAM)', Communication from the European Commission, COM(2012) 209 final, 8.5.2012, para. 18(a)

<sup>&</sup>lt;sup>148</sup> State Aid Action Plan: Less and better targeted State aid: a roadmap for State aid reform 2005-2009', European Commission, COM(2005) 107, paras. 11 and 19-20). In its Communication, the Commission summarises the balancing test as follows: 'In assessing whether an aid measure can be deemed compatible with the common market, the Commission balances the positive impact of the aid measure (reaching an objective of common interest) against its potentially negative side effects (distortions of trade and competition).' (para.19).

<sup>149</sup> K. Bacon, European Union Law of State Aid (Oxford, 3rd. ed, 2017), pp. 6-7.

<sup>&</sup>lt;sup>150</sup> Decision (EU) 2015/658 Hinkley point C [2015] OJ L109/44.

<sup>&</sup>lt;sup>151</sup> See for example, the Commission Decision in France – Country-wide capacity mechanism – SA.39621.

<sup>152</sup> EEAG, para. (27).

- e) **proportionality of the aid** (aid kept to the minimum): the aid amount is limited to the minimum needed to incentivise the additional investment or activity in the area concerned;
- f) avoidance of undue negative effects on competition and trade between Member States: the negative effects of aid are sufficiently limited, so that the overall balance of the measure is positive;
- g) **transparency of aid**: Member States, the Commission, economic operators, and the public, have easy access to all relevant acts and to pertinent information about the aid awarded thereunder.

Further details are provided for each on these general compatibility criteria in Section 3.2 of the 2014 EEAG, while specific criteria are defined for specific aid measures in Sections 3.3 to 3.11 of the Guidelines.

It can also be recalled that it is settled case law that, as regards the application of Article 107(3) TFEU, the Commission enjoys a wide discretion, the exercise of which involves assessments of an economic and social nature which must be made **within a European rather than national context.**<sup>153</sup>

#### Identified issues with the application of common assessment principles

**Market failure and need for State intervention** - In the 2014 EEAG, the Commission take the view that the EU ETS and CO2 taxes do not yet fully internalise the costs of GHG emissions, and do not provide sufficient incentives to achieve the Union objectives for renewable energy. As a consequence, it will 'presume' that a residual market failure remains when assessing notified aid measures for renewable energy. As a explained in Section 1.2 of this Report, the need for support has changed since the adoption of the 2014 EEAG, but there is a **remaining financing gap** for measures necessary to fast-track decarbonisation and **remaining market failures** need to be addressed in the revised Guidelines.

As a general rule, secondary harmonised legislation should be designed to ensure a level playing field and a good market design. It is only when the implementation of harmonised legislation has not been able to deliver the most efficient market outcome and when residual market failure exist, that State aid should be considered. Interaction between energy market design rules and need for State intervention should also guide the revision of the EEAG.

**Definition of objectives of common interest** - **The definition of the Objective of Common Interest**, which is the first of the common assessment principles defined in the EEAG, needs to be updated. A revised definition of the conditions for contributing to an objective of common interest can be the opportunity to integrated elements of the objective-based approach referred to above (in Section 4.1). The definition should refer to the latest EU law and policy framework for environmental and energy policy.

In its report to the European Parliament and the Council on the performance of support for electricity from renewable sources granted means of tendering procedures in the Union, the Commission included the following criteria which will need to/could be reflected in the revised EEAG<sup>155</sup>:

Achieve cost-reduction;

 <sup>153</sup> See inter alia Case C-225/91 Matra v Commission [1993] ECR I-3203, paras 23-5; Case C-303/88 Italy v Commission [1991]
 ECR I-1433, para. 34;
 154 EEAG, para (115).

<sup>155</sup> Directive (EÙ) 2018/2001, Art. 4.8. Report from the Commission to be submitted every three years, and for the first time by 31 December 2021.

- Achieve technological improvement;
- · Achieve high realisation rates;
- Provide non-discriminatory participation of small actors and; where applicable, local authorities;
- Limit environmental impact;
- Ensure local acceptability;
- Ensure security of supply and grid integration.

#### Incentive effect and cost-effectiveness- Ex ante scrutiny and ex post evaluation of results

- It is notable that the EU state aid regime lays down detailed rules for ex ante assessment criteria for aids subject to the notification obligation under Article 108(3) TFEU (ex ante scrutiny), but that ex post evaluation of the incentive effect of the aid provided has been a more recent focus area for the European Commission's action. A stronger focus on ex ante scrutiny on cases with the biggest impact was one of the objectives pursued by the European Commission in the SAM reform. This approach is therefore enshrined in the strategy for the modernisation of State aid control, where cooperation with Member States is foreseen at the level of State aid enforcement. In addition, the European Commission services have been conducting studies on the matter when the validity period of Guidelines is ending, in order to collect feedback on the effects of the support provided, but otherwise rely on transparency requirements to promote accountability of granting authorities and to reduce asymmetries on the market for state aid.<sup>156</sup>

There is a necessary balance to keep between increased notification/reporting obligations and efficient state aid control regime. The SAM reform was definitely a step towards a more flexible approach to state aid control. However, the question has also been raised to know whether requirements for increased **reporting and transparency in measuring the incentive effect of the aid** provided could be beneficial. In order to better appreciate the incentive effect and cost-effectiveness of the support measures, and to better target EEAG rules, the revised Guidelines could envisage to reinforce the ex post evaluation of the measures which is covered in Chapter 4 of the 2014 EEAG.

**Application of the proportionality test** - When assessing the compatibility of the aid, the Commission will perform a proportionality test where the potentially negative effects of the measure will be weighed against its contribution to an objective of common interest. The proportionality test under the 2014 EEAG is applied differently for different measures, not least to take the specificities of the cases into account. This may create confusion for national governments and raise implementation issues for the Commission services. In the perspective of a more integrated energy system, there is also a need to ensure a level playing field, including at the level of the assessment of notified State aids. All actors involved in State aid design and control would benefit from a more streamlined approach to the proportionality test.

<sup>&</sup>lt;sup>156</sup> As of 1 July 2016 the new transparency requirements for state aid enter into force and become mandatory based on Article 9 and annex III of GBER and where provided for in notifications and decisions. The state aid transparency public search gives access to state aid individual award data provided by Member States in compliance with the European transparency requirements for state aid. Citizens and companies can easily access information about awarded aid: name of the beneficiary, amount, location, sector and objective.

#### Recommendations for the revision of the EEAG

It is recommended to reiterate the common approach promoted in the EEAG (2014-2020) in the revised EEAG, and to update the common assessment principles in the view of the following:

- The notification threshold should be updated (currently paras. 20 and 21 of the EEAG).
- The definition of the Objective of Common Interest, which is the first of the common assessment principles defined in the EEAG, needs to be updated. A revised definition of the conditions for contributing to an objective of common interest can be the opportunity to integrated elements of the objective-based approach referred to above (in Section 4.1). The definition should refer to the latest EU law and policy framework for environmental and energy policy. Importantly, the definition of objectives of Common Interest with an environmental or energy perspective should be common to the state aid framework, and should not only be stated in the EEAG, but also in the GBER, which is binding on Member States. The goal is to ensure consistency in assessing those measures which fall both under the scope of application of the EEAG and those which fall outside.
- There is a **remaining financing gap** for measures necessary to fast-track decarbonisation and **remaining market failures** need to be addressed in the Guidelines.
- Distortions of competition may also relate to regulated market (natural monopolies) where market failure concept cannot be applied (e.g. electrical infrastructure), which also need to be addressed in the Guidelines.

#### 5.1.2. Technology neutrality

Technology neutrality rules should neither require nor assume any specific technology; in addition, they should not hinder the use or development of technologies in the future. 157

Several provisions in the 2014 EEAG refer to technology neutrality, either in substance or directly: on auctioning (paras. 109 and 126); on no differentiation in support levels through green certificates (para. 137). Technology neutrality is also referred to as a principle in the 2014 GBER (Art. 52.4). The Renewable Energy Directive (REDII) does not mention the 'principle' of technology neutrality, but applies it in several provisions, which give the priority to those measures open to all technologies and operators, as reflected in the 2014 EEAG. Directive (EU) 2015/1513 relating to the quality of petrol and diesel fuels (Fuels Quality Directive) makes several references to a technology-neutral approach to emissions reduction and energy efficiency in transport, for electric transportation and for renewable energy sources in transport. <sup>158</sup>

The technology neutrality principle has been a difficult one to agree on during the negotiations of the 2014 EEAG. Not all Member States were satisfied with the outcome or the wording of the EEAG.

In the preliminary phase, a major challenge with the implementation of the technology neutrality principle is that it has been granted many exemptions, including under the Renewable Energy Directive and the EEAG. There are some examples: size of installations, installed capacity, vintage, etc. The application of the new provisions of the EEAG on auctioning has also revealed that the

<sup>&</sup>lt;sup>157</sup> The neutrality technology principle has been discussed and elaborated out from the information, communication and telecommunication sector. One of the first definitions of the principle is to be found in the 'Framework for Global Electronic Commerce' of July 1997, by the U.S. Government. The European Commission starting referring to technology neutrality in the 1990s in its communications on electronic communications.

<sup>&</sup>lt;sup>158</sup> Directive (EU) 2015/1513 of the European Parliament and of the Council of 9 September 2015 amending Directive 98/70/EC relating to the quality of petrol and diesel fuels and amending Directive 2009/28/EC on the promotion of the use of energy from renewable sources, Recitals (10) (35), Article 3.

auctions that should have been technology neutral, have in practice relied on the exemption clauses of the 2014 EEAG, and were all technology specific in practice.<sup>159</sup>

Because the EU needs to engage in a rapid and deep decarbonisation, and that technology innovation must be fostered, the EU State aid regime, including the EEAG, must promote further a technology neutral approach. In order to preserve a level playing field and avoid market distortions, strict application of the technology neutrality principle across sources and sectors should be further promoted in the revised EEAG, in particular for those technologies with similar costs.

Also, the application of the technology neutrality principle can serve as guiding principle, but it will need a benchmark, for example in terms of GHG footprint and resilience. This could be applied in the context of the third alternative way of structuring the EEAG, as proposed in Section 4.1 above.

It may lead to the conclusion that all forms of low-carbon technologies should be included. Some examples are mentioned below:

- This is the case for Combined Heat and Power (CHP), which can make an important
  contribution to decarbonisation, but must be exposed to market signals to a greater extent,
  as is the case for renewables. The different sources of CHP generation (renewable sources
  vs. fossil fuels) must be taken into account in a benchmark exercise. The same applies to
  bioenergy.
- New technologies such as **batteries** will provide further services and flexibility. Similarly, competition between **demand response technologies** must be ensured.
- According to the same principle, it may lead to the inclusion of nuclear energy. The question
  of the inclusion or exclusion of nuclear energy within the EEAG is further discussed in Section
  6.2.3.
- Similarly, there may be a need to revise the application of State aid rules to **hydropower** and to further distinguish between hydropower technologies (pumped storage and storage in general).<sup>160</sup>

#### Recommendations for the revision of the EEAG:

- Because the EU needs to engage in a rapid and deep decarbonisation, and that technology innovation must be fostered, the revised EEAG must promote further a technology neutral approach.
- In order to preserve a level playing field and avoid market distortions, strict application of the technology neutrality principle across sources and sectors should be further promoted in the revised EEAG, in particular for those technologies with similar costs.

#### **5.1.3.** Eligible costs

This section discusses the types of costs that need to be supported, and the traditional distinction between **investment and operating costs**. The industry faces important investment costs (capital/CAPEX) that can be difficult to cover. The current market design is not always suitable for investment decisions for capital-intensive assets (such as offshore wind, nuclear energy, energy storage, etc.) because the market, which is often short term, does not give adequate signals.

<sup>&</sup>lt;sup>159</sup> Jerrentrup et al., 'Technology-Neutral Auctions for Renewable Energy: EU Law vs. Member State Reality', Journal for European Environmental & Planning Law 16(2019) 386-406.

<sup>&</sup>lt;sup>160</sup> See below Section 5.2.6.

The European Commission has previously said that it could look at potential 'funding gaps' when assessing aid to decarbonise industry, rather than the typical extra costs compared with a theoretical alternative investment that may not be in line with the EU climate neutrality goal.

Certainly, the European Commission grants State aid authorisations, but that does not solve the structural problem. Authorisations are granted on a case-by-case basis, for limited volumes / durations, in the hope that the functioning of the market will improve sufficiently to one day give the right signals. However, with massive investment in technologies with zero or almost zero-variable costs, there is no reason to anticipate market prices that will allow the fixed and capital costs to be recovered.

The principles for granting State aid should therefore provide for motivation by: any technology which contributes to the transition to carbon neutrality must be eligible, as well as carbon-free final energy consumption equipment with criteria that are not limited to examining the short-term market effects, but also the long-term effects, such as permanently avoided CO2 emissions or the decline of the full cost that can be obtained by lowering the cost of capital through a reduction for the investors risks.

Similarly, grid operators - both at transmission and distribution level - face new investment challenges and need to invest quickly in the entire national territory within a short timeframe. The financing may involve State aid elements, as addressed in Section 5.2.3 below.

Consideration should be given to various investment incentive mechanisms that give investors visibility and appropriate risk sharing. Several forms can be discerned and should be indicated in the measures falling under (art.1.2)

- Participation in investment by public authorities;
- Financing of part of the costs (e.g. development costs, cost of maintaining skills);
- Transfer of certain risks between the investor and the community;
- Regulation of the Regulated Assets Base type (BAR);
- Income corridor;
- Compensation for electricity production capacity.

These different mechanisms are well integrated into the architecture of the European market, since they do not damage the short-term efficiency that the wholesale market allows and its short-term prices. This in particular can be obtained by 'for difference' clauses or 'tolling' contracts, that is to say clauses that maintain all incentives to optimise the functioning of an asset, thanks to the market price signal.

In addition, in order to promote all low-carbon technologies able to contribute to target compliance, the methodology to assess the proportionality of the aid should not be based solely on the LCOE but should take into account the total cost of the system, including the network and back-up to guarantee security of supply. The Cost-Benefit Analysis methods developed within the TEN-E Programme projects of common interest therefore provide an interesting framework.

#### 5.1.4. Stability of the schemes: long-term visibility

There have been a series of arbitration cases on retroactive changes to support schemes. As a reaction to intra-EU disputes involving retroactive changes to support schemes in favour of renewable energy, the need to ensure the stability of national support schemes has been addressed in EU harmonised legislation, and a requirement of stability is now inserted in Article 6 of the Renewable

Energy Directive (REDII). The revised EEAG should reflect the requirement of support scheme stability, while continuing to limit the duration of the schemes in time (usually limited to a period of 10 years).

To illustrate the accuracy of the debate of intra-EU dispute in relation to support schemes in favour of renewables, two recent judgments should be highlighted:

#### Judgment of 6 March 2018, Achmea (C-284/16, EU:C:2018:158) on the legality of arbitration procedures intra-EU bilateral investment treaties

The case concerns the autonomy of EU law in the context of a preliminary ruling under Article 267 TFEU. In 1991, the former Czech and Slovak Federative Republic and the Kingdom of the Netherlands entered a bilateral agreement on the encouragement and reciprocal protection of investments (the BIT). On 1 January 1993, the Slovak Republic succeeded the rights and obligations under the BIT, and on 1 May 2004, the State acceded to the EU. When the Slovak Republic partly reversed liberalisation of its private sickness insurance market, Achmea, a Dutch undertaking that had set up a subsidiary in Slovakia, claimed to have suffered damages. Achmea brought arbitration proceedings against the Slovak Republic on the grounds of Article 8 of the BIT, which provides that disputes between the contracting parties should be settled in an arbitral tribunal of a third State, in this case Germany. The Slovak Republic raised an objection to lack of jurisdiction of the arbitral tribunal. It submitted that, as a result of its accession to the European Union, recourse to an arbitral tribunal was incompatible with EU law.

The CJEU reached a different conclusion than its Advocate General<sup>161</sup> and concluded that a bilateral treaty between two Member States, containing an arbitration clause, is contrary to EU law.

The ruling has far reaching consequences for investment trade and other existing investment treaties. As a consequence of the case, the Commission published a Guidance on the protection of cross-border EU investments, in order to ensure the protection of investors within the EU. $^{162}$  Moreover, this ruling has set the scene for ensuing cases concerning bilateral agreements. $^{163}$ 

#### Micula judgment, Cases T-624/15, T-694/15 and T-704/15 (under appeal)

In its Judgment of 18 June 2019, the General Court of the European Union annulled the decision of the European Commission of 30 March 2015 (the so-called "Micula Decision" or the "Commission Decision") declaring that the Commission had no competence to apply EU State aid rules prior to Romania's accession to the EU.

#### 5.2. Specific aid measures

To ensure a level playing field between countries and technology solutions, there is still a need to provide detailed rules on specific aid measures.

The 2014 EEAG set a **list of environmental and energy measures** for which State aid under certain conditions may be compatible with the internal market under Article 107(3)(c) TFEU. This list

<sup>&</sup>lt;sup>161</sup> Opinion of Advocate General Wathelet in *Achmea*, C-284/16, EU:C:2017:699<sup>,</sup> p<sup>aras 229-237.</sup>

<sup>162</sup> European Commission - Fact Sheet, 'Commission provides guidance on protection of cross-border EU investments - Questions and Answers', http://europa.eu/rapid/press-release\_MEMO-18-4529\_en.htm, 19 July 2018.

<sup>163</sup> See also judgment of 18 June 2019, European Food and Others v Commission, T-624/15, T-694/15 and T-704/15, EU:T:2019:423.

is found at the beginning of the Guidelines, and provides visibility in terms of priority areas and assessment criteria. Such approach should be kept in the revised EEAG.

The Report argues in favour of the need for detailed provisions in the revised EEAG, which also corresponds to the third alternative for structuring the Guidelines.

#### 5.2.1. Support to renewable energy, particularly for electricity production

#### Coverage under the 2014 EEAG

The extent to which the renewable energy sector needed to be supported and the conditions under which the support could be provided were among the key topics discussed ahead of the 2014 EEAG. Under the previous State Aid Guidelines for Environmental Protection (EAG) (2008-2014), most part of the support approved was aimed to support renewable energy and CHP. <sup>164</sup> As summarised by the former Commissioner in charge of competition policy, J. Almunia, when presenting the 2014 EEAG, 'It [was] time for renewables to join the market. <sup>165</sup> This resulted in **increased exposure to market price risk** for renewable energy solutions, with **gradual move to market-based support**. To pursue the market integration of energy from renewable energy, the Commission considered it important that energy producers receiving aid – particularly electricity producers - **sell their electricity directly to the market** and are subject to **market obligations**. <sup>166</sup> By changing the rules applicable to renewable energy, the Commission also intended to **address the market distortions created by previous support schemes**, which were not considered as cost efficient and were varying between Member States and technologies.

The long-term objective defined in the 2014 EEAG was to **reduce subsidies to renewable energy to a minimum in the view of their complete phase out.**<sup>167</sup> This intention was also made clear in the Communication from the Commission on the 2020-2030 policy framework for climate and energy: 'subsidies for mature energy technologies, including those for renewable energy, should be phased out entirely in the 2020-2030 timeframe. Subsidies for new and immature technologies with significant potential to contribute cost-effectively to renewable energy volumes would still be allowed.'<sup>168</sup>

At the same time, the 2014 EEAG identified **'a residual market failure'** that remained besides the adoption of secondary EU legislation. Indeed, a series of secondary EU acts aimed to implement the 2020 Strategy (notably the RES Directive, the EU ETS Directive and the Fuel Quality Directive), but their implementation, according to the Commission, did not always result in the most efficient market outcome. This called for additional state intervention including in the form of State aid. The 2014 EEAG take the example of the EU ETS and  $CO_2$  tax, which may not fully internalise the costs of GHG emissions. Therefore, the EEAG observe that 'a residual market failure remains, which can be addressed through aid for RES.'  $^{169}$ 

This results in a balancing exercise, between the goal of phasing out subsidies in the long term and the need to address a residual market failure by providing support in the short to medium term. This is translated in two sets of rules in the 2014 EEAG related to, on the one hand, more exposure to market price, and, on the second hand, derogations providing flexibility.

<sup>167</sup> EEAG, paras. (108) and (109).

<sup>&</sup>lt;sup>164</sup> Out of the 10 million Euros awarded under the 2008 EAG in the period 2008-2012, 8 million Euros related to support in favour of RES and CHP.

<sup>&</sup>lt;sup>165</sup> ' State aid: Commission adopts new rules on public support for environmental protection and energy', European Commission, Press release IP/14/400, 14 April 2014.

<sup>166</sup> EEAG, para. (124).

<sup>&</sup>lt;sup>168</sup> 'A policy framework for climate and energy in the period from 2020 to 2030', Communication from the European Commission, COM(2014) 015 final.

<sup>169</sup> EEAG, para. (107).

First, the increased exposure of renewable energy generators to market price is reflected in the following criteria laid down in the 2014 Guidelines: 170

- Gradual replacement of feed-in tariffs by feed-in premiums by 1 January 2016 for all new aid schemes and measures;
- More **competitive bidding processes** for allocating public support. After a pilot phase in 2015-2016, Member States have been required to set up competitive processes to grant support to all new installations as from 1 January 2017. As a general rule, the competitive bidding process is open to all renewable electricity generators on a non-discriminatory basis. The GBER provides that competitive bidding is the only manner to grant operating aid for electricity production from renewable energy, subject to a threshold of EUR150 million per year, all schemes included. The term of 'competitive bidding process' is not defined in the EEAG, but it refers to tenders and auctions.
- The beneficiaries are subject to **standard balancing responsibilities**, unless there is no liquid intra-day market.
- The measures should avoid that generators generate electricity under **negative prices**.

Second, several derogations provide some flexibility: 171

- Certain types of installation are exempted from the feed-in premium requirement: small installations with a capacity of less than 500 kW or demonstration projects; for wind energy project, the threshold is of an installed capacity of 3 MW or 3 generation units.
- Certain types of installation are exempted from the competitive binding procedure, if the Member States can demonstrate that: only one or a very limited number of projects or sites could be eligible (risk of 'strategic bidding'); or that a competitive bidding process would lead to higher support levels; or that it would result in low project realisation rates (risk of 'underbidding'). Other types of exempted installations are: installations with an installed electricity capacity of less than 1 MW, or demonstration projects; for wind energy projects, the threshold is of an installed capacity of up to 6 MW or 6 generation units.
- The Guidelines open for technology differentiation. Taking into account 'the different stage of technological development of renewable energy technologies', the EEAG allow technology specific tenders, subject to a series of conditions: the aid should be provided on the basis of the longer-term potential of a given new and innovative technology; the need to achieve diversification; network constraints and grid stability; system (integration) costs; or the need to avoid distortions on the raw material markets from biomass support. 172

For aid granted by way of certificates, the 2014 EEAG contain almost no changes compared to the 2008 EAG.<sup>173</sup> The aid is considered to be compatible if the Member States can provide sufficient evidence that such support: (i) is essential to ensure the viability of the renewable energy sources concerned; (ii) does not result in overcompensation over time and across technologies, or in overcompensation for individual less deployed technologies subject to differentiated levels of certificates per unit; and (iii) does not dissuade renewable energy producers from becoming more competitive. One addition compared to the 2008 EAG is on the matter of differentiation in levels of support between the different renewable energy producers. The Commission considers that the green

<sup>&</sup>lt;sup>170</sup> EEAG, para. (124).

<sup>&</sup>lt;sup>171</sup> EEAG, para. (126).

<sup>&</sup>lt;sup>172</sup> EEAG, paras. (110) and (126). <sup>173</sup> EEAG, paras. (135)-(137)

certificates schemes should provide for no differentiation in support levels, unless a Member State demonstrates that there is such a need (with reference to the justifications in para. (126)).

#### Review of case practice under the 2014 EEAG

DG COMP commissioned a retrospective evaluation study on the EEAG and the relevant provisions of the GBER, which was published in 2020.<sup>174</sup>

Support to renewable energy, particularly for electricity production, has been one of the main focus areas for State aid notification. Many of the approved aid schemes for renewable energy in the period 2014-2019 have benefited from the exemptions referred to above, either as exemption from feed-in premium obligation (EEAG, para. (125)), from competitive bidding process (EEAG, para. 127), or under Article 43 GBER.<sup>175</sup>

According to the same data, the Member States have taken different approaches to the structuring of their bidding processes in terms of technology eligibility. The Study reveals that, for the sample of schemes studied for the period 2014-2019, Italy, Luxembourg and Malta have been implementing bidding involving one single technology. France and Germany have also to a large majority (90 per cent), used single-technology bidding processes. However, the UK has been using bidding processes involving two or more technologies, and countries like Finland, Spain, Slovenia and the Netherlands have applied, in 80 per cent of the bidding processes, at least four eligible technologies. 176

#### **Coverage under REDII**

Following the circular dynamic described in Section 2.2 above between the GBER, the EEAG and secondary legislation, REDII can be seen as a codification of the practice developed under the EEAG. In addition, new provisions have been added in the directive.

As a general note, the language between REDII and the EEAG should be streamlined. While the 2014 EEAG refers solely to 'competitive bidding procedures', REDII refers primarily to 'tendering procedures.' In several EU documents, auctions and tenders are also used interchangeably. 177

The EEAG played an important role on the legal design of national RES support schemes and the interactions between Art. 4 RED II and the EEAG. The future design of national support schemes needs to be in accordance with the provisions of REDII and with the EEAG. The basic principles of support schemes to incentivise market integration and market-based mechanisms enshrined in the EEAG have now been taken over in the new RED II framework.

Indeed, RED II aims at establishing a common European framework for promoting energy from renewable sources and must be transposed into national legislation by 30 June 2021. As well setting a binding Union target of at least 32% for the overall share of RES in the Union's gross final consumption of energy, it now also lays down all the relevant rules for financial support of RES.

The basic principles of support schemes design defined in the 2014 EEAG are reiterated: maximisation of the integration of electricity from renewable sources in the electricity market;

<sup>174 &#</sup>x27;Retrospective evaluation support study on State aid rules for environmental protection and energy', prepared for the European Commission by E.CA Economics, Centre for Competition Policy and Sheppard Mulin, Final Report, 2020. <sup>175</sup> Ibid, p. 55.

<sup>&</sup>lt;sup>176</sup> Ibid, p. 45.

<sup>&</sup>lt;sup>177</sup> The AURESII project (AUctions for Renewable Energy Support II), funded under the Horizon 2020 Framework Programme, investigates auction design options to determine their policy performance. The project provides defines an auction as 'a market mechanism with the aims of allocating goods in case of excess supply and price discovery for goods with unknown market prices from an auctioneer's perspective.' Auctions with more than one criterion are called tenders. In the context of renewables support auctions, common criteria include: price; actor diversity; geographical distribution; domestic industry development; system integration; technical specifications. See the Glossary on the AURESII project website available at < <a href="http://aures2project.eu/">http://aures2project.eu/</a> >.

producers exposed to market price signals; producers maximise their market revenues. The support 'shall' be granted in the form of a market premium, which could be sliding or fixed. Similar exemptions for small-scale installations and demonstration projects are provided.

Likewise, REDII reiterates most of the rules on competitive bidding processes, which are defined as the main rule for the allocation of support. Member States may exempt small-scale installations and demonstration projects from tendering procedures, as already envisaged by the EEAG.

Finally, REDII opens for technology specific tenders, subject to a series of criteria, which follow closely the ones defined in the 2014 EEAG.

In accordance with the table elaborated in Section 3.1 above, the key matters addressed in REDII are:

- · Harmonisation of support schemes;
- Tendering procedures;
- Cross-border participation;
- Other matters: flexibility, grid stability, stability of the schemes

As a consequence, the revised EEAG will need to align on the RED II on the following new provisions introduced by the directive:

- The market-based and market-responsible approach is confirmed, but the description of the incentive effect of the support scheme is emphasised, and may have consequences in terms of assessment methodology (Art. 4.2, REDII);
- Some additional implementation details on competitive bidding processes will need to be provided in the revised EEAG (Art. 4.3).
- Member States that consider establishing mechanisms to ensure 'regional diversification'
  when deploying renewable electricity will need guidance, in order to ensure a harmonised
  approach. Implementation details will need to be provided in the revised EEAG, notably on
  the nature of these mechanisms (Art. 4.4).
- REDII contains minimum general requirements concerning the transparency of tendering procedures, and duty to inform on project realisation rates (Art. 4.6).
- In terms of opening of the schemes, the same principle than in the 2014 EEAG is reiterated: Member States keep the right to decide whether they open their national support scheme to production from another Member State or not. If they open their national scheme, they can apply the conditions set in this Article, with new requirements on the definition of indicative shares and pilot schemes. Before opening their schemes, Member States can require proof of physical import of electricity. An agreement shall be in place between the concerned Member States. Those new provisions will need to be integrated into the revised EEAG. (Art. 5, REDII).
- The revised EEAG will need to reflect the new provisions in relation to the stability of the scheme, particularly the conditions for revising the schemes, including the level of support (Art. 6, REDII).

#### Need for review and areas of change

**Alignment with REDII** – A first priority for the revision of the EEAG should be to reflect the changes made in REDII, but also in other secondary legislation relevant to the renewable energy sector, such as the Electricity Directive and the Electricity Regulation. The latter ones lay down the common rules for electricity market design to much electricity production from renewable energy sector shall comply with.

**Continuing the integration of renewable energy into the internal energy market** – The EEAG are part of a regulatory ecosystem based on the objectives of the further integration of the internal energy market and the increased share of renewable energy into the European energy mix. Those objectives and the market-based approach promoted by both the EU legislation and the previous EEAG should be reiterated in the revised EEAG. In relation to the integration of renewable sources into the energy system, EU legislation also refers to a series of associated requirements, which could increase flexibility of the energy system, maintaining grid stability and managing grid congestions. <sup>178</sup> Those requirements should be reiterated in the revised EEAG.

On the need to further harmonise support schemes for renewable energy - The question should be raised of the need for the EEAG to influence the design of national support schemes to such a degree of details. In the past, the European Commission has made several attempts to harmonise national support schemes, 179 with the more detailed guidance contained in soft law instruments. 180 The EEAG also contain guidance as to the design of support schemes which complete the harmonised provisions contained in the Renewable Energy Directive. The question for the upcoming revision of the EEAG will be to define the level of details necessary for ensuring a level playing field and the functioning of the internal energy market. With the mandatory use of competitive bidding processes and of premium, the common elements of those two mechanisms need to be defined. Similarly, when support mechanisms are expected to be implemented in several Member States – such as green certificates or the new mechanism for regional diversification –, some common elements of definition are necessary, in respect of the principles of subsidiarity and proportionality.

Refining the rules on competitive bidding procedures (tendering, auctioning) – Renewable energy projects have experienced a considerable reduction in costs since the entry into force of the 2014 EEAG, in parallel to a rapid technology development. For the sample of schemes reviewed (in the period 2014-2019), the Retrospective evaluation support study notes that 'the weighted average price of wind capacity fell by 62% between 2015 and 2019, while the weighted average price of solar capacity fell by 51% between 2014 and 2019). Although not the only factor, the introduction of competitive bidding, notably the technology neutral ones, have contributed to the abatement of costs for renewable energy. The 2014 EEAG introduced mandatory competitive bidding for the first time. REDII has consolidated the rule and made it mandatory in secondary legislation. In the view of both the new REDII provisions and the practice, the rules on competitive bidding (tendering in particular) should be refined in the revised EEAG. Even if the level is low, the system of guaranteed price floors applied for example to auctioning systems in Spain has functioned as an implicit support providing the necessary confidence for investor in terms of risk coverage. Be Even if it is likely that an increasing number of renewable energy projects will develop outside tendering/auctioning systems in the mid-

<sup>&</sup>lt;sup>178</sup> Directive (EU) 2018/2001, Art. 3.5

<sup>&</sup>lt;sup>179</sup> See Banet, Catherine, Tradable green certificates schemes under EU law: the influence of EU law on national support schemes for renewable electricity generation, (UniPub, 2012), pp.74-85

<sup>&</sup>lt;sup>180</sup> See notably: Commission guidance for public support to the energy sector through state intervention, C(2013) 7241); Guidance for the design of renewables support schemes, European Commission, SWD(2013) 439 final.

<sup>181 &#</sup>x27;Retrospective evaluation support study on State aid rules for environmental protection and energy', prepared for the European Commission by E.CA Economics, Centre for Competition Policy and Sheppard Mulin, Final Report, 2020.182 Ibid. p. 17.

to short term, there will still be a need in the short term to ensure a minimum of support through state measures. 183 The use of tenders also enables Member States to keep track of their progression towards renewable energy targets.

**Technology neutral tenders: principle and exemptions** - The discussion on competitive bidding processes must be linked to the issue of 'technology neutrality' and the 'multi-technology tenders'. 184 Although the main rule has been and remain that bidding procedures must be open to all renewable energy generators, the 2014 EEAG have provided for exemptions to technology neutral tendering procedures, allowing single technology tenders (EEAG, para. (126). The same exemption is now enshrined in Article 4.5 of REDII. When revising the EEAG, the European Commission will need to reiterate the requirements of REDII, but, in the mid-term, the question will be to know whether the Commission may intend to have a more narrow interpretation of the criteria set in the directive (Art. 4.5, criteria (a) to (e)), based on market developments. The terms of the tenders may also need to be adapted to reflect specific concerns, such as the costs of intermittency or grid management, which will avoid a discussion on technology-specific or technology neutral tenders. Finally, the requirements applicable to tenders should take into account the fact that several technologies and energy carriers can be combined under a same project.

The growing phenomenon of zero subsidy tenders - During the past few years, a series of large scale projects, including for offshore wind, have been able to develop without subsidies. Most of these subsidy-free renewable energy projects have developed under tendering systems, but it may also develop outside a tender/auction system. 185 In some bidding procedures, like in the Netherlands, bidders are required to submit zero subsidy bids, as part of the award criteria. For example, in July 2020, the 759 MW offshore wind Hollandse Kust Noord tender was awarded to the CrossWind consortium led by Shell and Eneco under a zero-subsidy bid. 186 Under the Dutch system, if several bidders managed to submit a zero-subsidy bid, they will be ranked on qualitative criteria under a procedure referred to as a 'beauty contest'. It should be noted that most of the offshore wind subsidyfree projects awarded so far have benefited from other forms of support than to electricity generation, such as guaranteed or subsidised grid connection provided by the relevant TSO. The growing phenomenon of zero-subsidy tender should be considered when reviewing the EEAG, as other forms of financial support may be included in those bidding procedures, such as free grid connection fees, seabed concessions or guaranteed price floors, which may involve State aid elements that the EEAG may need to address to ensure legal certainty.

When it comes to deployment at large scale, the EEAG could refer to the requirement that tendering procedures should enable achieve 'a high realisation rate' (art. 4.8 (c) REDII).

Parallel and interaction with the tendering procedure proposed to the 'Union renewable energy financing mechanism.' - A short parallel with Article 33 of the Regulation on the Governance of the Energy Union can be provided here, in relation to the tendering procedure proposed to the 'Union renewable energy financing mechanism.' Article 33 provides for the possibility

<sup>&</sup>lt;sup>183</sup> Ibid, pp. 125-135.

<sup>&</sup>lt;sup>184</sup> In the case of multi-technology tenders, the most common practice has been to include two technologies with similar costs

<sup>(</sup>e.g. wind and solar, or hydro and solar, or hydro and wind).

185 Another manner to secure financing outside an auction/tender system, would for example be under a Corporate Renewable Power Purchase Agreement (PPA), which, in most cases, do not involve state aid.

<sup>186 &#</sup>x27;Shell and Eneco to build third unsubsidised Dutch offshore wind farm', Government of the Netherlands, press release, 29 July 2020, available at < https://www.government.nl/latest/news/2020/07/29/shell-and-eneco-to-build-third-unsubsidised-dutchoffshore-wind-farm >. It should be noted that this project is not limited to offshore wind technology, and include five innovative technologies developed around the wind farm installations: floating solar park; short-term battery storage; turbines that are tuned to the network to minimise the negative 'wake'-effects that wind turbines have on each other; renewable energy hydrogen made by electrolysis as another storage technique; and the coordination among those technologies to ensure a continuous power supply despite wind situations.

to complement national measures with the EU RES Financing Mechanism for those countries running below their RES trajectory.

The Implementing Act should provide further detail on the functioning of the Mechanism regarding duration of the mechanism; the eligibility and award criteria for RES projects; the coordination with other EU or national financing mechanisms (e.g. MFF 21-27 and Next Generation EU); which EU funds and programmes will finance the mechanism and by which amount; how national payment will be financed, given that any additional burden on electricity tariffs should be avoided.

The proposed EU financing mechanism should also be designed to ensure a level playing field and an efficient functioning of wholesale power markets. When designing the financing mechanism all forms of aids (e.g. repayable and/or not; investment and/or operating) any distortion to the functioning of the host member states power market and EU market design should be avoided. There could be a need of alignment of the principles developed for assessing projects under the Union renewable energy financing mechanism and the revised EEAG.

**Cross-border auctioning** – In its decisions, it is apparent that the European Commission aims to encourage cross-border auctioning. The 2014 EEAG already promote the use of co-operation mechanisms to facilitate cross-border support of renewable energy where possible and appropriate. The Danish-German cooperation and the first cross-border tenders for renewable energy provides a useful example and even a blueprint.<sup>187</sup> This pilot cooperation on cross-border tenders had to be assessed under State aid rules, particularly under paragraph 126 of the EEAG. The European Commission approved the notified aid measures for solar PV and wind electricity in two separate State aid decisions dated October 2014.<sup>188</sup> It can also be noted that the requirement of cross-border participation have been reinforced when Member States establish capacity remuneration mechanisms. While the revised EEAG will need to align on the harmonised provisions of REDII, they could also promote further cross-border auctioning.

**Prepare the grounds for new initiatives and long-term target compliance** – Several policy initiatives have been launched as part of the European Green Deal that will result in legislative proposals covering the renewable energy sector. Those concern particularly offshore renewable energy, hydrogen, energy system integration and circular economy. The revised EEAG will need to provide sufficient flexibility to accommodate for any new policy priority (eg further deployment of offshore wind and renewable energy hydrogen), but this should be done in accordance to the same common principles defined in the revised EEAG in order to maintain a level playing field and respect the technology neutrality principle.

<sup>&</sup>lt;sup>187</sup> See D. Dmitruk, Danish-German Cooperation on the first cross-border tenders for renewable energy – A blueprint for future cross-border RES projects?, in M. M. Roggenkamp and C. Banet (eds.), European Energy Law Report XII (Intersentia, 2028), pp.113-132.

<sup>188</sup> SA.36204 (2013/N) – Depmark – Aid to photovoltaic installations and other renewable supervisions and other renewable supervisions.

<sup>&</sup>lt;sup>188</sup> SA.36204 (2013/N) – Denmark - Aid to photovoltaic installations and other renewable energy installations, of 24 October 2014; SA 37122 (2013/N) – Denmark – Aid to household wind turbines and offshore wind turbines with an experimental aspect. The two decisions were subsequently rectified by the Commission on 18 December 2014.

#### Recommendations for the revision of the EEAG:

- The language between REDII and the EEAG should be streamlined. While the 2014 EEAG refers solely to 'competitive bidding procedures', REDII refers primarily to 'tendering procedures.'
- The wording of the EEAG should be revised to reflect that renewable energy sources could contribute to the internal energy market through different energy carriers (electricity, gas, CHP).
- In accordance with the technology neutrality principle, the revised EEAG should set general, common eligibility conditions for investment and operating aid to energy from renewable sources, as the 2014 EEAG did.
- The rules on competitive bidding procedures (auctioning/tendering) should be refined. The
  requirements applicable to tenders should take into account the fact that several technologies
  and energy carriers can be combined under a same project. They should also consider that
  zero-subsidy tenders could include other forms of support which could represent State aids.
- The EEAG should reflect on the opportunity of further promoting cross-border auctioning.

#### 5.2.2. Resource adequacy and capacity mechanisms

#### Review of practice under the 2014 EEAG

In recent years, several Member States have implemented capacity remuneration mechanism (CRM) schemes. Pursuant to the Electricity Regulation, a 'capacity mechanism' is a temporary measure to ensure the achievement of the necessary level of resource adequacy by remunerating resources for their availability, excluding measures relating to ancillary services or congestion management (Regulation (EU) 2019/943, Art. 2).

The 2014 EEAG addressed capacity mechanisms for the first time.

The 2016 Final Report of the Sector Inquiry on capacity mechanisms reflects some of the experiences gained; it contains further guidance on how to design capacity mechanisms. The focus of the Final Report was improvement of capacity mechanisms design in order to avoiding distortion of competition. For example, many of the existing capacity mechanisms do not have a clear objective or only a vague objective (for example in terms of security of supply, or generation adequacy problem). In this report, the Commission calls for more stringent rules about how to assess 'generation adequacy'. The Commission argues that, for long-term adequacy problems, a marketwide mechanism (such as the Italian and Irish Reliability Option-based CRM) is likely to be the most appropriate. Temporary adequacy concerns are better addressed through more transitional measures such as strategic reserves. These keep certain capacity outside the electricity market for use only in emergencies. Where the generation adequacy issue is constrained to a limited area, improved grid connections and the definition of more appropriate geographical boundaries of bidding zones are likely be better suited to solving underlying adequacy concerns. The price paid for capacity must be determined in a competitive process. When set by an administrative procedure, there is a risk of over-compensating the beneficiaries or failing to deliver security of supply. Capacity mechanisms should be open to providers in other Member States. This will provide incentives for investment in interconnectors and generation capacity in other Member States and reduce system costs.

<sup>&</sup>lt;sup>189</sup> See generally on this Hancher, Hauteclocque and Sadowska (eds.), *Capacity Mechanisms in the EU Energy Markets: Law, Economics & Policy* (Oxford University Press, 2015).

Following on from the Sector Inquiry, and as part of the electricity market design elements of the Clean Energy Package, the Electricity Regulation contains several provisions relevant for the design of national capacity mechanisms that the revised EEAG must reflect, and which are closely linked to the need to **reduce residual adequacy concerns**:

- Art. 21 General principles for capacity mechanisms;
- Art. 22 Design principles for capacity mechanisms;
- Art. 23-24 Resource adequacy assessments (European / national);
- Art. 25 Reliability standard;
- Art. 26 Cross-border participation in capacity mechanisms.

The Commission has approved six of these mechanisms, namely for the UK, Germany, France, Belgium, Poland, Italy and Greece. The General Court recently ruled upon the capacity mechanism of the UK that also might affect future schemes.<sup>190</sup>

Commission decisions on capacity mechanisms:

- Belgium strategic reserves SA.48648;
- France Country-wide capacity mechanism SA.39621;
- France Tender for additional capacity in Brittany SA.40454;
- France Demand response scheme SA.48490 ;
- Germany Interruptibility scheme AbLaV SA.43735;
- Germany Network Reserve SA.42955;
- Germany German capacity reserved SA.45852;
- Germany strategic reserves SA.45852;
- Greece Transitory electricity flexibility remuneration mechanism (FRM) SA.38968;
- Greece Demand response scheme SA.48780;
- Italy Market-wide capacity mechanisms SA.42011;
- Italy Introduction of stringent CO2 emission limits in the Italian capacity mechanism -SA.53821;
- Poland Market-wide capacity mechanisms SA.46100;
- United Kingdom Capacity Market SA.35980;
- United Kingdom Supplementary Capacity Auction SA.44475.

# Recommendations: need to design mechanisms compliant with EU competition and market design rules

In terms of scope of application and design of the CRM, the case practice from the Commission reveals that the capacity mechanisms can be made more market friendly by for example moving towards cross-border participation. With the same objective, the revised EEAG should further reward flexibility (e.g. demand response, aggregation) as part to the system adequate offer.

<sup>&</sup>lt;sup>190</sup> Tempus is now also contesting the legality of the Polish scheme.

With the multiplication of national capacity mechanisms, the 2014 EEAG had the task of ensuring a level playing field and more transparency in assessment criteria. They also aim to ensure good practice when designing capacity mechanisms. However, the inclusion of capacity mechanisms in the EEAG may have overlooked the fact that market-based capacity mechanisms also exist.

In the coming years, the discussion on capacity mechanism regulation should focus on "product design". Appropriate product design is essential to create a common level playing field and allow a fair competition (meant as same rights and obligation framework) between the relevant adequacy providers. In fact, a proper product design enables the correct evaluation of adequacy contribution of different resource (different technologies, different country of location, etc) with efficient market outcomes. For instance, cross border participation should foresee the same responsibilities and delivery incentives on foreign and domestic capacity, in order to guarantee the correct cost allocation in the event of unavailability.

Market-wide based CRM could be considered as an integrated part of the electricity market (and not as a form of public support). Therefore, the future regulation should not evaluate these market-based mechanisms as State Aid, thus not including them in the scope of EEAG.

#### 5.2.3. Energy infrastructures

#### Coverage under the 2014 EEAG and associated framework

Among the changes made compared to the previous Guidelines (2008 EAG), the 2014 EEAG include new provisions on aid to energy infrastructures. The definition of energy infrastructures is provided for in the GBER and the 2014 EEAG.

Support to energy infrastructures under the 2014 EEAG aimed to contribute to the completion of the internal energy market, including cross-border energy infrastructures.

In addition to the 2014 Guidelines, some additional assessment criteria are provided in the Commission's 'Analytical grid for energy infrastructure', a guidance document released by the Commission services covering the financing of the construction, replacement or upgrade, as well as the operation and use of energy infrastructure.

#### **Need for review**

Electricity distribution infrastructures are not sufficiently addressed by the 2014 EEAG compared to the central role they will play in the future energy system. Energy distribution infrastructures are one the most relevant and decisive enabling factor to achieve European and national objectives - in line also with the EU PNIECs targets - in terms of energy transition. In this context, purposes such as electrification, green economy, distributed generation, electromobility, smart city and, above all, achieving a higher share from renewable sources, would not be achieved without support measures dedicated to reinforce the electricity distribution infrastructures. The need to promote these interventions throughout the national territory becomes a crucial factor in achieving the aforementioned European / national objectives. The European Commission has recently recognised a  $10 \in Bn/yr$  investment gap in power grids to deliver the green transition and digital transformation by  $2030^{191}$ . The International Energy Agency (IEA) estimates  $\sim 1-1.7\$Tn$  of investment in network in Europe over 2019-2040, depending on the scenarios.  $^{192}$ 

<sup>&</sup>lt;sup>191</sup> See Sectoral breakdown of green transition investment gaps Table 1 COM(2020) 456 final

 $<sup>^{192}</sup>$  IEA WEO 2019: Current Policy Scenario 1\$Tn Scenario; Sustainable Development Scenarios 1.75\$Tn (Table A% Energy Investment.

Investment aid for energy infrastructures, provided by the GBER in Article 48, are granted for energy infrastructures located in assisted areas only. 193

Considering that the definition of the next 2021-2027 MFF and of the Recovery Plan has only just started, an assessment aiming at simplifying and removing the limitations to only grant aid to assisted areas is needed, based on technical aspects of electricity grids and the need to avoid socially unacceptable increase in tariffs, which are set at national level without regard to assisted areas.

With regards to the prospects for the revision of the GBER and the EEAG Guidelines, the following changes should be considered:

- Article 48.2 of the GBER, which limits aid to energy infrastructures located in assisted areas, is now out of date and in contrast with the ratio of this type of aid.
  - Recital 33 of the GBER states that regional aid and aid for energy infrastructures have very different purposes. If, in fact, regional aid is intended to encourage the development of the least economically developed areas of the European Union, the ratio of aid to energy infrastructure is to allow the development and modernisation of these networks, avoiding excessive costs for consumers. In the absence of such aid, in fact, the investments on the network would be transferred to the electricity bills. It is therefore clear that the parameter of the assisted areas is inadequate; proof of this is the fact that currently in the assisted areas are found to have more technologically advanced infrastructures than those located outside these areas. The best solution would certainly be a horizontal application, making it possible to use such aid in any area.
- The same considerations apply as regards the section on infrastructure aid of the Guidelines (Section 3.8), even where in reality these do not expressly exclude aid for infrastructure in non-assisted areas, but only introduce presumptions for aid in the areas assisted. If a criterion was chosen in order to identify the areas of intervention, one could consider modulating this differently between the GBER and the Guidelines, in order to cover different types of investment.
- In line with the above considerations, for the future investment in electricity infrastructure networks, we need to go beyond the condition set in paragraph 2 of Article 48 (assisted areas only), in order to make eligible networks projects located in all national territory (in line with Regional Aid Map). This would align the geographical coverage of such aid (currently limited to assisted areas) to that provided for other types of aid such as renewable energies sources.
- In recent Commission decision, a determining element for the qualification of a measure financed by infrastructure tariffs as State aid has been the imputability and the involvement of State resources. As confirmed by the case law of the Court and as reiterated in recent Commission decisions, the financing of a measure via increased network tariffs levied on the electricity consumers will be considered to involve state resources in so far as the State can

<sup>&</sup>lt;sup>193</sup> Article 48 reads as follows (Investment aid for energy infrastructure):

<sup>1.</sup> Investment aid for the construction or upgrade of energy infrastructure shall be compatible with the internal market within the meaning of Article 107(3) of the Treaty and shall be exempted from the notification requirement of Article 108(3) of the Treaty, provided that the conditions laid down in this Article and in Chapter I are fulfilled.

<sup>2.</sup> Aid shall be granted for energy infrastructure located in assisted areas.

<sup>3.</sup> The energy infrastructure shall be subject to full tariff and access regulation according to internal energy market legislation.

<sup>4.</sup> The eligible costs shall be the investment costs.

<sup>5.</sup> The aid amount shall not exceed the difference between the eligible costs and the operating profit of the investment.

The operating profit shall be deducted from the eligible costs ex ante or through a claw-back mechanism.

<sup>6.</sup> Aid for investments in electricity and gas storage projects and oil infrastructure shall not be exempt from the notification requirement under this Article

control, direct and influence the administration of the funds. The potential presence of State aid elements as part of infrastructure tariffs design should be considered in the revised EEAG.

## Recommendations - The following questions will need to be addressed in the revised EEAG:

- It is essential to ensure sufficient grid investment, particularly in a context where infrastructure costs are more difficult to recover. This relies on an assessment of the investments needed.
- GBER: Article 48 contains provisions, and the criteria will need to be reviewed.
- Reference should be made to the fact that the GBER already provides non-limited aid to
  assisted areas for various sectors, including 'Aid for investments aimed at promoting the
  production of energy from renewable sources (art. 41 GBER)' in which it should be possible
  to include aid on infrastructures aimed at allowing the increase of Hosting Capacity (smart
  grids, upgrades, digitalisation).
- Infrastructure can also be considered as public goods: infrastructures that deliver common benefits / common goods. This raises cost-recovery issues.
- The case of charging stations will be taken as practical example of the treatment under current EEAG and the need for improvement.
- Tariffs can also raise State aid issues, as stressed below.
- Certain definitions must be clarified, e.g.: hydrogen, CCS infrastructures, etc.
- Re-use and re-purposing of oil and gas infrastructures should be included (not least for the purpose of CO2 or hydrogen transport, but should avoid creating new stranded assets.
- Support to digitalisation can be included as part of the necessary investments (link to point on eligible costs).

#### 5.2.4. Electromobility and re-charging infrastructure

#### Coverage under the 2014 EEAG

Electromobility is covered by the 2014 EEAG only in a very indirect and limited manner. Electromobility can be associated with 'aid for the acquisition of new transport vehicles', as part of the aid measures 'for going beyond Union standards or increasing the level of environmental protection in the absence of Union standards'.<sup>194</sup> The 2014 EEAG provide further details on the compatibility conditions to aid measures for that purpose. The Commission considers that aid granted to adapt to future Union standards has 'in principle' an incentive effect if the standard has not yet entered into force (at least one year before). This includes the acquisition of new transport vehicles for road, railway and waterway and maritime transport for which the acquisition occurs before applicable Union standards enter into force and that, once mandatory, they do not apply to vehicles already purchased.<sup>195</sup> Finally, and under the same framework conditions, Annex 1 to the 2014 EEAG defines the aid intensities applied for environmental investment aid (as part of the eligible costs) in relation to the acquisition of new transport vehicles by undertakings (ranged by size: small, medium and large).

<sup>&</sup>lt;sup>194</sup> EEAG (2014-2020), para. (18)(a).

<sup>&</sup>lt;sup>195</sup> EEAG (2014-2020), para. (53) and (54), reflecting Art. 36.4 GBER.

The current coverage of aid to electromobility in the 2014 EEAG is therefore very narrow and lacks precision. As a consequence, national aid measures in favour of e-mobility have been assessed directly under Article 107(3)(c) of the Treaty.

In terms of scope of application, the EEAG will only apply to the transport sector (in general) if specific Union rules on State aid do not provide for specific rules. <sup>196</sup> The type of electromobility transport means may trigger different guidelines. For example, and excluding sectors already electrified like railways, the aviation and maritime sectors are governed by dedicated guidelines. For other sectors, such as ports, motorways, inland waterways and combined transport, the Commission applies Article 107(3)(c) TFEU directly.

An important theoretical point of departure for the European Commission in the 2014 EEAG is that aids for the design and manufacture of environmentally friendly products, machines or means of transport is not included in the scope of the EEAG. The reason for excluding this is that - according to the European Commission - 'environmental aid is generally less distortive and more effective if it is granted to the consumer/user of environmentally friendly products instead of the producer/manufacturer of the environmentally friendly product'. In addition, environmental labels and claims on products can be used to provide necessary information to consumers who can make informed purchasing decisions. Therefore, only aid measures for the purchase of new vehicles are covered, under the conditions referred to above. It is recommended to repeat this approach in the revised EEAG.

#### Review of case practice under the 2014 EEAG

A short review of some key State aid decisions on electromobility reached by the European Commission shows that indeed, Article 107(3)(c) TFEU is applied directly most of the time for electromobility measures during the past decade.

- SA.34719 (2013/N) The Netherlands Electric transportation scheme in Amsterdam;
- SA.38769 the Netherlands Green Deal for Electric Vehicle Charging Infrastructure
  - o Direct grant. Scheme. Primary objective was environmental protection. Legal basis Art. 107(3)(c). Duration from 09.06.2015 to 01.07.2018
  - o In its decision, the European Commission approved, under EU State aid rules, the Dutch plans to provide almost €33 million of public funding for the installation and operation of charging stations for electric vehicles. This scheme aimed to contribute to the roll-out of electric cars infrastructures in the country. It contributes to promoting sustainable transport and improving air quality, without unduly distorting competition in the Single Market.
  - The Commission notes that the measure primarily aims to facilitate the roll out of publicly accessible charging posts for electric vehicles that faces a financing gap, since it is unlikely, in the near and medium term, to be financed by the market under regular commercial conditions through tariffs, The Commission also notes that the measure does not fall under one of the existing frameworks and guidelines. Even if the Netherlands claimed that the environmental protection benefits of the scheme should be considered as an objective of the aid, the Commission takes the view that aid measures for such infrastructure do not fall within the scope of the 2014 EEAG

<sup>&</sup>lt;sup>196</sup> EEAG (2014-2020), para.(13).

- as this type of infrastructure does not meet the definition of eligible energy infrastructures set out in point (31)a of the EEAG. $^{197}$
- As a consequence, the Commission considers that the assessment of the compatibility of the scheme with the internal market requires an assessment of the contribution of the measure to the development of 'low-emitting electric mobility' and, on this ground, needs to be based directly on the basis of Article 107(3)(c) TFEU (certain economic activities or of certain economic areas).
- This assessment is in line with Decision SA.34719 (2013/N) The Netherlands Electric transportation scheme in Amsterdam.
- SA.49276 –Romania Development of a charging infrastructure for plug-in hybrid and purely electric vehicles;
- SA.46574 Charging infrastructure for electromobility in Germany;
- Electric buses in Germany
  - o The notified measure concerns an increase in state funding by €300 million (US\$332 million) for the purchase of electric buses in Germany under EU State aid rules. The German aid scheme applies until the end of 2021 and is intended to cover the additional costs for the purchase of electrically operated or rechargeable hybrid buses instead of conventional diesel buses and the establishment of the charging infrastructure required to operate these buses.
- SA.55495 Ireland Electric Vehicle Public Charge Point Grant (awaiting decision by the European Commission)
  - The scheme concerns the development of a charging network which will support the growth of electric vehicles to at least 800,000 by 2030.

#### EFTA Surveillance authority practice:

• ESA decision, Norway: support scheme for e-vehicles. VAT exemption.

#### **Need for review**

Europe is working hard to guide the transition towards a decarbonised economy in which all sectors have an important role to play. In contrast to other sectors, transport emissions (including international aviation) in the European Union increased by 23% in the period 1990-2015 (road transport by 19%). Road transport alone is responsible for 20% of all EU emissions and 82% of all transport emissions. Cars and vans accounted for 73% of greenhouse gas emissions in 2015 (14% of all greenhouse gas emissions in the EU). The electrification of the transport sector can lead to a significant reduction in greenhouse gas emissions, better urban air quality and greater security of supply.

According to the 'Europe on Move' communication of May 2017, the EU has set a target of building a backbone infrastructure for the core network by 2025. However, the European Commission recognised the shortcomings, in particular for charging points for electric vehicles. Therefore, public investment is to overcome market failures that hold back their development.

<sup>&</sup>lt;sup>197</sup> SA.38769 – the Netherlands - Green Deal for Electric Vehicle Charging Infrastructure, para (37).

The electrification of transport (road, trucks, ships, etc.) **needs** <u>new</u> <u>infrastructures</u> and support for them. Electricity, within a decarbonised mix, is one of the alternative fuels for obtaining a long-term replacement of fossil fuels in the transport sector. Unlike other alternative fuels, however, electricity brings positive externalities such as electrification of the transport sector:

- Increases the long-term demand for electricity by creating incentives for a broad strengthening of the electricity infrastructure, necessary to facilitate the transition from a centralised model to a decentralised model for generating energy;
- Facilitates the development of electricity from renewable sources by reducing the need to store electricity during off-peak hours, since it is possible to schedule the recharging of electric vehicles during the night and in other periods of low demand during the day;
- Allows the design of future innovative demand-side response solutions based on the combined storage capacity of batteries while electric vehicles are connected to the grid, thus increasing the security of electricity supply.

As already recognised by the Commission in the SA case 46574 notified by Germany, in the absence of public funding, investors have no incentive to invest in sustainable mobility, given the current limited number of electric vehicles in circulation, the high investment costs and the minimal amount of electricity available at the charging station.

The approach developed in this specific case should be applied in the future as a general rule, extending the scope of the Regulation on exemptions from notification (GBER) and the compatibility assessment in the context of the revision of the EEAG in order to encourage measures for the development of the charging infrastructure. This would also be in line with the objectives of the DAFI Directive and consistent with the approach already adopted in relation to other infrastructures used for the development of alternative fuels.

It is also believed that the Commission's policy on the development of sustainable mobility and the necessary electricity infrastructures could be more effective if the Member States, alongside the granting of investment aid to the charging infrastructure, supported a regulatory framework aimed at stimulating the electrification of the transport sector.

On 20 May 2020, the European Commission unveiled a green economic recovery plan, which contains several measures on EVs. To be followed up, these measures may involve State aid.

As illustrated in the table in Section 3.1 above, several provisions of newly adopted or revised secondary legislation need to be reflected in the revised EEAG. When minimum standards and minimum technical requirements are defined, only measures going beyond them can be eligible for support. Such is the case for the deployment of EV- infrastructures and recharging points, as provided in Article 8 of Directive (EU) 2018/844 of the European Parliament and of the Council of 30 May 2018 amending Directive 2010/31/EU on the energy performance of buildings.

#### Recommendations for the revision of the EEAG:

- To align with EU policy objectives, follow up on secondary legislation and provide a common level field between Member States developing their electromobility and recharging infrastructures, the EEAG will need to be expanded to cover those topics.
- The revised EEAG must address the question of aid measures for the development of charging infrastructures (see objectives in the DAFI Directive, alternative fuels regulation, including for ports).

#### 5.2.5. Energy storage, batteries

The scope of application of the EEAG should be revised to better address the growing need for energy storage and batteries.

The question of energy storage and batteries needs to be addressed separately, as batteries will deliver flexibility services.

Following technology neutrality principle, storage should be left to market forces, not to a regulated area. As already experienced for CRM, appropriate long-term market instruments are essential to allow sufficient storage investments. Given the possible risks envisaged by private investors and the challenges posed by decarbonisation and energy transition, it is of utmost importance to allow Member States to introduce instruments based on long-term market signals aimed to storage development, in order to cope with decarbonisation targets.

The case practice from the European Commission reveals that there is also a need to ensure consistency across the different State aid guidelines as the support to storage or batteries production could also fall under – for example – Regional State Aid Guidelines.<sup>198</sup>

Cross-subsidisation is another matter that has retained the attention of the European Commission in relation to energy storage. The Commission has launched an in-depth investigation to determine whether cross-subsidies between natural gas storage and transmission in France comply with EU rules on State aid.¹99 Storage was previously an unregulated, commercial service, based on the idea that it was a competitive activity (not a natural monopoly, not an essential facility, and in competition with other flexibility mechanisms). France opted for regulating (i.e. guaranteeing minimum revenues) the activity after summer-winter spreads collapsed, when the activity ceased being profitable, alleging Security of Supply reasons. The compensation is financed through transmission tariffs approved by the regulator. The compensation paid to storage operators is more than €500 million/year. While this is by far the highest cross-subsidy between gas infrastructures in Europe, it is not the only one. It is a widespread practice to include in transmission tariffs, or in tariff elements billed together with transmission tariffs, LNG costs. This is explicitly the case in Lithuania, Poland, Greece, Italy, Portugal and Croatia. Some of these cases have been cleared by the European Commission.

#### **5.2.6.** Other energy storage: hydropower, stationary batteries

Based on the same issue of technology neutrality principle, the question should be raised of the need for distinction of the coverage of hydropower and stationary batteries under the revised EEAG, based on the implementation of the current EEAG which barely address hydropower<sup>200</sup> and do not cover directly energy storage. In addition, there may be a need to distinguish between the different hydropower technologies (pumped storage and storage in general).

#### **5.2.7.** Energy efficiency

The 2008 EAG already contained rules on energy efficiency, and the 2014 EEAG only resulted in a simplification of the assessment criteria of several state aid measures previously covered.

<sup>&</sup>lt;sup>198</sup> SA.47662 LIP - Aid to LG Chem Wrocław Energy Sp. z o.o. (Batteries plant).

<sup>&</sup>lt;sup>199</sup> 'State aid: the Commission launches an in-depth investigation into the regulation mechanism for natural gas storage in France' European Commission, Press release IP/20/351, 28.2.2020.

<sup>&</sup>lt;sup>200</sup> Paragraph (117) refers to the need to take into account the possible negative impact on water systems and biodiversity when considering aid for the production of hydropower. In such case, the EEAG recalls that Member States are bound by Directive 2000/60/EC, and in particular Article 4(7), which lays down criteria in relation to allowing new modifications of bodies of water.

In terms of need for review, 'Energy Efficiency First' has been defined as a common objective by the European Commission in its different initiatives. This policy priority needs to be reflected in the revised EEAG.

As part of the European Green Deal, the European Commission has introduced a renovation wave in public and private buildings. This initiative represents one of the main pillars of the EU's fight against climate change. The choice of energy supply and the application of energy savings measures in the building sector will be instrumental in reducing emissions from a 'difficult to abate' sector. The building sector lags behind in the decarbonisation process, despite its significant potential contribution to Europe's efforts. The process of designing, constructing and using buildings offers opportunities to significantly reduce the EU's GHG emissions through the use of lower carbon materials, the deployment of distributed RES generation, increased energy efficiency building performance and, last, having buildings catalysts for system-wide efficiencies.

Switching from fossil fuels to electricity offers significant abatement potential and the electrification through mature electric technologies such as solar panels and heat pumps offers important opportunities for decarbonising the building sector.

Buildings need to be designed and constructed to dynamically interact with the electricity sector through ever-smarter grids. They would do so by adjusting energy demand depending on its availability, but also by releasing when needed energy stored in batteries mounted either as standalone or connected through V2G technologies.

In order to achieve this, there is the need to rely on digitalisation of the building sector and that Europe's digital strategy can deliver the framework to increasingly drive connectivity through hout daily lives and across economic sectors. The need for support and the eligible costs should be made updated to that respect.

#### 5.2.8. Low-carbon and renewable gases, including hydrogen

#### Coverage under the 2014 EEAG

For production of gases from renewable energy sources, the most relevant provisions in the 2014 EEAG are in para. (131) on Aid for energy from renewable sources other than electricity.

Paragraph 131 of the 2014 EEAG set the cumulative conditions under which operating aid for energy production from renewable sources will be considered compatible with the internal market:

- (a) the aid per unit of energy does not exceed the different between the total levelised costs of producing energy (LCOE) from the particular technology in question and the market price of the form of energy concerned;
- (b) the LCOE may include a normal return on capital. Investment aid is deducted from the total investment amount in calculating the LCOE;
- (c) the production costs are updated regularly, at least every year; and
- (d) aid is only granted until the plant has been fully depreciated according to normal accounting rules in order to avoid that operating aid based on LCOE exceeds the depreciation of the investment.

Support to low carbon or renewable gases will relate to a precise application, which could be energy generation, but could also be energy infrastructures or utilisations. This entails that the aid measures could fall under other parts of the EEAG, like support to alternative fuel infrastructures.

Finally, natural gas production, including low carbon, is not directly covered by the 2014 EEAG, but could possibly be benefit from aid for generation adequacy under Section 3.9 of the 2014 EEAG.<sup>201</sup>

New ambition level for low carbon and renewable gases and need for support under the revised EEAG – The case of hydrogen.

The role of hydrogen and low carbon and renewable gases as a potential solution to decarbonise hard-to-abate sectors has been announced by the European Commission as part of its Hydrogen and Energy System Integration Strategies published in July 2020, but also in relation to the Farm-to-Fork Strategy with the production of bioenergy by farmers. The following paragraphs focus primarily on hydrogen due to the scope delimitation of the Report.

**Setting objectives** – Currently, the EU legislation does not define any mandatory targets for hydrogen production or consumption, either in general or for specific hydrogen production processes. The only existing link between support to hydrogen and EU targets compliance that can be made is in relation to reduction of GHG emissions and renewable energy sources. However, this situation could rapidly change. **As confirmed by the European Commission in its Hydrogen strategy published in July 2020, the role of hydrogen, in particular renewable hydrogen produced using mainly wind and solar energy, will become a strategic solution to decarbonize hard-to-abate sectors in line with the net zero goals of the European Union**. A policy and legal question that could be discussed as part of the forthcoming legislative initiatives for implementing the EU Hydrogen Strategy would be whether the EU needs mandatory hydrogen specific targets, and if so, what would those be.<sup>202</sup> If such targets are defined, the revised EEAG – and GBER – could contribute to achieve target compliance.

The question of objective setting for hydrogen raises a series of **sub-questions**: first, what types of hydrogen production should the EU support; second, should the EU support specific types of hydrogen applications; third, which support mechanism will be the most appropriate, efficient and cost-effective? The revised EEAG will need to consider – if not answer – those different questions. Developing a clean hydrogen supply chain will require action – and support - at the demand, supply, storage and infrastructures levels.

Enabling transitional pathways through a step-wise approach – In its Hydrogen Strategy, the European Commission expressed a preference in favour of renewable hydrogen on the long term. When revising the EEAG, it is therefore expected that the Commission takes a similar approach. Further guidance and binding objective setting could follow in legislator form. This means that, to be consistent with the Commission's policy and based on the competence it has in competition policy, the revised EEAG should aim at providing the right enabling framework to ensure Commission's renewable hydrogen strategic production objectives in the long term.

At the same time, the Commission recognises that renewable hydrogen alone will not be able to cover the needs, and that other forms of low-carbon hydrogen will be instrumental in a transition phase. The Commission identified several phases in hydrogen development and deployment: a first phase (2020-2024) focusing on scaling-up hydrogen production and consumption; a second phase (2025-2030) where hydrogen is expected to become cost-competitive and become part to the integrated energy system and expand its usages; and a third phase (from 2030 onwards and towards 2050) where renewable hydrogen technologies should have reached maturity. To reach the milestones identified in the Commission's Strategy, the revised EEAG should reiterate a similar **step**-

87/114

<sup>&</sup>lt;sup>201</sup> For a review of the rules applicable to generation adequacy and capacity mechanisms, see Section 5.2.2 of this Report.
<sup>202</sup> In its Hydrogen Strategy, the European Commission proposes to achieve a target of at least 6 GW of renewable hydrogen electrolysers installed in the EU by 2024 and of 40 GW of renewable hydrogen electrolysers by 2030. 'A hydrogen strategy for a climate-neutral Europe', Communication from the Commission, COM(2020) 301 final, 8.7.2020, p. 3.
<sup>203</sup> Ibid, p. 5.

**wise approach**, based on the same timeline, with a progressive evolution of the support measures. As similar step-wise approach has been applied to renewable energy in previous guidelines.

**Need for support** - The production of both low carbon or renewable hydrogen is still a costly and energy-intensive process. As recognised by the Commission, a 'critical mass in investment' will be needed to drive hydrogen development, in addition to other measures such as regulatory reforms. <sup>204</sup> Taking into account the many benefits that clean and renewable hydrogen can deliver, including in terms of renewable energy and reduction of GHG emissions targets in ETS and non-ETS sectors, the contribution to a well-defined objective of common interest should be easily demonstrated. To consider the State aid measure in favour of hydrogen compatible with the internal market, the other compatibility criteria will need to be met. Supporting hydrogen processes must also pass the test of cost-efficiency and energy efficiency first principles (see Section 4 above).

**Foreseeable national support strategies in favour of hydrogen** – Several countries have adopted ambitious national hydrogen strategies (e.g. Germany, the Netherlands, Portugal) or have announced it (e.g. France). A short review of some of them enables to identify which support policy the Member States are envisaging and which measures could be subject to State aid notification.

- Germany <sup>205</sup> The German government's hydrogen strategy focuses on both production and utilisations. Hydrogen production from renewable energy is prioritised, with: possible tenders for further expansion of offshore wind and power-to-X installations for the purpose of producing hydrogen; and the production of hydrogen could be exempted from taxes, levies, and surcharges. The government plans to exempt the production of green hydrogen from the EEG surcharge. The German government also aims to support investments in hydrogen applications in the industrial sector (e.g. in the steel and the chemical industries). To do so, it plans to introduce tendering schemes for renewable energy hydrogen and launch a pilot programme entitled 'Carbon Contracts for Difference (CfD)'. Targeted hydrogen uses will be supported, as well as the development of hydrogen infrastructures, with the announced funding of the construction of refuelling infrastructure for vehicles.
- The Netherlands<sup>206</sup> The Dutch government aims at scaling up renewable hydrogen and achieve cost reduction. It recognises the importance of support schemes aimed at research and demonstration projects as well as at the scaling-up and roll-out process. The support measures extend from: (i) R&D&I programmes, (ii)scaling up through new, temporary operating cost support, and (iii) roll-out, through dedicated funding programmes. In relation to the second phase, the Dutch government plans a new temporary support scheme for operating costs related to the scaling up and cost reduction process for renewable energy hydrogen. Low carbon hydrogen projects based on natural gas with CCS are expected to receive sufficient support from CCS support programme (SDE++). Other support measures concern the industrial uses of hydrogen as well as consumption in transport and agriculture.
- France <sup>207</sup> The French government is to adopt a revised and extended hydrogen strategy in late 2020, after a first hydrogen roadmap adopted in 2018. Suggested measures aim to develop a support policy at four levels: demand to start the market; support to hydrogen production, based on the use of tenders; hydrogen infrastructure; development of French

<sup>&</sup>lt;sup>204</sup> Ibid, p.2.

<sup>&</sup>lt;sup>205</sup> German Government, 'The National Hydrogen Strategy', June 2020, available at <

https://www.bmbf.de/files/bmwi\_Nationale%20Wasserstoffstrategie\_Eng\_s01.pdf >

<sup>&</sup>lt;sup>206</sup> Government of the Netherlands, 'Government Strategy on Hydrogen,' April 2020, available at < https://www.government.nl/documents/publications/2020/04/06/government-strategy-on-hydrogen >.

<sup>&</sup>lt;sup>207</sup> French Ministry of Ecological Transition and Solidarity, 'Plan de déploiement de l'hydrogène pour la transition énergétique', available at < <a href="https://www.ecologique-solidaire.gouv.fr/sites/default/files/Plan\_deploiement\_hydrogene.pdf">https://www.ecologique-solidaire.gouv.fr/sites/default/files/Plan\_deploiement\_hydrogene.pdf</a> >, background report at < <a href="https://www.ecologique-solidaire.gouv.fr/sites/default/files/Rapport%20H2%20MTES%20CEA%200106.pdf">https://www.ecologique-solidaire.gouv.fr/sites/default/files/Rapport%20H2%20MTES%20CEA%200106.pdf</a> >. See as well the input from AFHYPAC, 'Pour un plan national hydrogène ambitieux et cohérent', 21 July 2020.

technological offer; support to hydrogen utilisations, both in the industry and in the transport sector. Both renewable and low carbon forms of hydrogen are envisaged.

This short overview already reveals that Member States envisage deploying a large variety of support measures in favour of clean hydrogen production, infrastructure development and utilisations. Support measures will address both supply and demand of hydrogen. The revised EEAG should anticipate the notification of the announced measures, and already provide for some common design requirements and help clarify assessment criteria. At the same time, many of the support measures envisaged have been used in the context of support to electricity production from renewable energy or electrification of specific sectors. Some lessons from the latter cases can be drawn and best practice in terms of compatibility criteria applied to clean hydrogen under the revised EEAG.

#### Supporting hydrogen production

In a similar way than under the two previous sets of Guidelines, the Commission's objective in its hydrogen strategy is to stimulate a higher share of renewable sources in electricity production. As for renewable energy sources, the environmental benefits of hydrogen will depend on its production methods. The main question for the revision of the EEAG will be to set criteria for stimulating the desired hydrogen production, preferably renewable. The use of market-friendly support mechanisms such as competitive bidding processes and green certificates schemes / quota obligations, should be envisaged as a first option, including in combination with other technologies. In certain circumstances, more direct support might be needed.

# Supporting hydrogen demand and enabling energy efficient hydrogen applications – support to applications and infrastructures.

As hydrogen technology deployment will happen progressively, investments for the decarbonisation should focus on **selected applications** and there may be a need to prioritise renewable hydrogen, in which hydrogen proves to be the most cost-effective and sustainable solution (because direct electrification is either not technically viable or too expensive, such as certain industries or heavyduty transport sectors). The goal should be to reduce CO2 abatement costs for low-carbon and renewable hydrogen applications to be used in the medium-to-long term in harder to abate sectors.

For example, there is a need to consider the rising operating costed related to the use of hydrogen in industrial processes such as steel and chemicals.

Supporting the development of **hydrogen infrastructures** is also in line with the principle defined in the 2014 EEAG to support the consumption/use of environmentally friendly products instead of supporting the producer/manufacturer of the environmental friendly product through aid for the design and manufacture of the latter.

Policy support should focus on **accelerating the business models** that are most valuable for Europe, primarily based on renewable hydrogen – ideally domestically produced - in co-location with grid connected RES or low-carbon electricity, and destined to take off in 'hard-to-abate' sectors. This would contribute to upscaling the hydrogen European industry and to re-launching the EU economy, while using scarce financial resources efficiently.

In this context, the revised EEAG should carefully balance the needs for investments by supporting the development of hydrogen infrastructures enabling renewable hydrogen projection the long run, and avoiding the creation of stranded assets in the short run.

Supporting hydrogen technologies should contribute to the reinforcement of European leadership on hydrogen, such as electrolysis technologies. To this aim, we need to put in place instruments targeted

at supporting EU industrial uptake of most promising innovations. Sector coupling technologies, such hydrogen production and P2X, are still in an incipient phase and are a costly and inefficient process far from be commercially viable at large scale.

Efforts should first be orientated to address this lack of maturity. Europe has to tackle the industrial deployment and support research and innovation activities of P2X technologies in these most promising sectors where the use of synthetic fuel can be an efficient and effective decarbonisation option in order to reduce costs through economies of scale and to improve their performance through targets.

#### Recommendations:

- Due to the need to ensure a level playing field between energy production technologies and
  in the view of further integration of the energy system, the scope of application of the EEAG
  should be extended to hydrogen production and utilisations. The inclusion of hydrogen and,
  particularly renewable hydrogen, must be made more explicit in the EEAG as this type of
  hydrogen will be instrumental to reach the current and future EU climate goals in 2030. It
  would also support greater energy system integration.
- The revised EEAG should contribute to the goal of developing a full hydrogen supply chain and the most relevant application. They should therefore facilitate measures both at supply and demand level.
- For the support to hydrogen production, the use of market-friendly support mechanisms such as competitive bidding processes and green certificates schemes / quota obligations, should be envisaged as a first option, including in combination with other technologies (e.g. under the same tender). In certain circumstances, more direct support might be needed.
- Compatibility criteria for assessing support to hydrogen production should refer to the common assessing objectives referred to in Section 4.1.3 above, notably in terms of carbon footprint of hydrogen production.
- Because they can greatly contribute to the decarbonisation of hard-to-abate sectors, low carbon gases should be better covered by the EEAG. This has not been the case before, or to a limited extent

#### 5.2.9. Cogeneration – Heating and cooling

Cogeneration should, to a greater extent, be exposed to market signals. It should face competition from other energy forms since they can compete on the same markets. In many ways, CHP technologies have become mature enough to be put into competition with notably renewable-based solutions based on the technology neutrality principle. Like bioenergy, CHP does have consequences in terms of its environmental impact which must be taken into account through for example life cycle assessment (LCA) requirements.

Future CHP must be both efficient and consistent with the energy transition goals. Therefore, support schemes that isolate CHP from market signals must be avoided. Gas-fired CHP support as any other fossil fuel support must be phased out.

#### 5.2.10. Energy system integration: prospects and need for support

Decarbonisation should take place in all sectors: transport, energy generation, industry, heating and cooling. This is subject to a parallel process of both sector coupling and sector integration. This process is addressed in the Commission's Communication on EU Energy System Integration.

Aid for environmental protection and energy measures will be covered by the EEAG, but the delimitation of the **scope of application** of the EEAG towards other guidelines need to be set clearly. Indeed, other State aid **guidelines may apply** to measures in favour of system integration, e.g.: transport, agriculture, forestry, R&D.

Sector integration has a cost and will require financial adaptation. There are also some emission costs for transforming energy from processes such as power-to-gas, which need to be accounted for. If we apply any environmental criteria (e.g. environmental impact assessment, environmental objectives, energy performance), those solutions may not be prioritised on the short-term.

Sector integration also raises new issues relating to support in favour or:

- Re-use of existing oil and gas infrastructures for the purpose of production, transport
  or storage. There should here be a clear delimitation against stranded assets and support in
  their favour.
- **Re-purposing of batteries**. There are some links to be made to the circular economy package (changes to come, waste directive), and the waste hierarchy principles.
- **Re-powering**: with the end of lifetime of some installations, repowering can be an affordable solution to efficiently use RES resources in the best sites. Re-powering is defined in Art. 2, Directive (EU) 2018/2001.

The revised EEAG should both support the development of system integration solutions, and also ensure that **the most cost-efficient solutions are supported**. The latter will be revealed through the application of compatibility criteria, and notably the incentive effect of the aid.

#### **5.2.11.** Carbon Capture and Storage

#### Coverage under the 2014 EEAG

The process of Carbon Capture and Storage (CCS) is already covered by the 2014 EEAG in the following way.

- The design criteria for CCS support measures:
  - o Aid to CCS contributes to the common objective of environmental protection
    - CCS as a climate mitigation measure.
    - "In some industrial sectors, CCS may currently represent the only technology option able to reduce process-related emissions at the scale needed in the long term." (160)
  - Both investment and operating aid permitted
  - Aid can support: fossil fuel and/or biomass power plants or other industrial installations equipped with CO2 capture, transport and storage facilities, or individual elements of CCS chain.
  - Excluded: aid for the CO2 emitting installation as such (industrial installations or power plants); however, it can cover aid for the costs resulting from the CCS project.
  - Scope: aid limited to the additional costs for capture, transport and storage of the CO2 emitted.
    - Counterfactual scenario, i.e. the project is not carried out. CCS, similar to additional infrastructure, is not needed to operate any installation.

- Additional costs, i.e. the funding gap.
- The assessment criteria in para. (166). The Commission assesses the distortive effects of the aid based on the basis of the criteria laid down in Section 3.2.6, taking into account:
  - o whether any knowledge sharing agreements are in place;
  - o the infrastructure is open to third parties; and
  - the support to individual elements of the CCS chain has a positive impact on other fossil fuel installations owned by the beneficiary.

# Review of the practice from the European Commission and EFTA Surveillance Authority (ESA):

European Commission decisions:

- United Kingdom: CCS Demonstration Competition-Feed (Case N74/2009)
- The Netherlands: CCS Project in the Rotterdam Harbour Area (Case N 381/2010)
- The Netherlands: CO2 Catch-up pilot project at Nuon Buggenum plant (Case N 190/2009)
- Italy: Individual aid to the integrated CCS Sulcis project: Decision to initiate the formal investigation procedure (2011), followed by Withdrawal of notification (2012) (SA.33424).

ESA most recent decisions in relation to Norwegian CCS projects:

- 30 July 2020: ESA approved a prolongation of Norway's financing for the carbon capture testing facility in Mongstad (TCM). TCM will receive financing for a further three years and four months.
- 17 July 2020: ESA approved Norwegian public financing of **the Full-Scale CCS Project**, covering 80 percent of the estimated project costs. It should be noted that this is the largest single state aid award ever approved by ESA.
- 8 August 2017: ESA decision on continued financing of **CO2 Technology Centre Mongstad**.
- 16 March 2017: ESA has approved Norwegian public financing of "Concept and FEED Studies" for full-scale CCS demonstration projects that aim to reduce CO2 emissions.
- 25 November 2015: ESA raises no objections to the prolongation of the **CLIMIT Demo aid** scheme.

Previous decisions by ESA in relation to Norwegian CCS projects:

- Decision No 302/05/COL of 30 November 2005 on Gassnova funding; later amendments to Gassnova scheme, Decisions No 768/08/COL of 17 Dec 2008 and Decision 348/10/COL of 15 Sept. 2010.
- **Test Centre Mongstad**: Decision No 503/08/COL of 16 July 2008 (TCM Step 1); Decision 91/12/COL of 15 March 2012 (Step 2).
- CCS facility Kårstø: Decision No 27/09/COL of 29 January 2008.
- Brevik Norcem: Decision No 74/13/COL of 20 February 2013.

#### Recommendations for the review of the EEAG:

The State aid decisions taken by the European Commission and the EFTA Surveillance
Authority indicate that the EEAG rules are appropriate and enable the development of a
diversity of projects. Several countries envisage to rely on CCS technologies to further
decarbonise their energy system and industrial processes. For these reasons, the report
suggests to keep the current rules in the revised EEAG.

# **5.2.12.** Exemptions or reductions from energy taxation, including for energy intensive industries

Among the changes introduced compared to the previous Guidelines, the EEAG allow Member States to relieve energy intensive undertakings particularly exposed to international competition from charges levied for the support of renewables.

Following the judgment in the EEG-2 German case of March 2019, the revised EEAG should clarify conditions under which exemptions for energy-intensive companies are not State aid.

#### 5.2.13. Nuclear energy as part of the EEAG, or not

#### Coverage under State aid rules

Nuclear energy has so far been excluded from the scope of application of the EEAG. This section reviews the relationship with the Treaty provisions and the difference in assessment criteria between the TFEU and the EEAG for support measures in favour of nuclear energy. Reference is made to the Hinckley Point C decision by the Commission and the General Court judgment. This discussion must be put into perspective with the application of the technology neutrality principle.

In the judgment of 12 July 2018, Austria v Commission (T-356/15, EU:T:2018:439, thereafter the 'Hinkley Point C case'), the General Court confirmed the decision of the European Commission (the Commission) to declare aid to the 'giant' nuclear project compatible with the internal market on the basis of Article 107(3)(c) of the TFEU.

This case was an opportunity to clarify to some extent the interface between the Euratom and TFEU treaties. The General Court stated that, even though the Euratom Treaty constitutes a *lex specialis*, the TFEU rules on State aid still apply as the Euratom Treaty does not contain specific rules in this regard. Since the case covers aid in the nuclear sector, the provisions and objectives of the Euratom Treaty must nevertheless be considered when applying the TFEU provisions on State aid.<sup>208</sup>

One of the interesting parts of the judgment is arguably when the General Court addresses the definition of an 'objective of common interest' within the meaning of Article 107(3)(c) TFEU. In this regard, the General Court rejected the applicant's argument that one must consider the legitimate interests of all Member States. The Court found that it is sufficient for State aid to pursue an objective common interest that is appropriate, necessary, and proportionate for *one* Member State.<sup>209</sup> The Court also rejected the applicant's arguments that the Commission disregarded the fact that the impact on trade must be assessed from the point of view of the EU, and that the Commission wrongfully concluded that a Member State is entitled to pursue the promotion of nuclear energy. As such, a Member State is permitted to realise an objective of common interest related to the Euratom

<sup>&</sup>lt;sup>208</sup> T-356/15, paras 72-28.

<sup>&</sup>lt;sup>209</sup> T-356/15, para 85 and judgment of 15 June 2010, *Mediaset v Commission* (T-177/07, EU:T:2010:233).

Community's goal of facilitating investment in the nuclear field, thereby raising the standard of living of Member States. <sup>210</sup>

Another key point of the judgment is the assessment of the existence of a 'market failure.' The Court concluded that a finding of market failure is a relevant, but not essential, factor for declaring State aid compatible with the internal market on the grounds of Article 107(3)(c) TFEU. In short, to pass the necessity test, the relevant question is to demonstrate whether the objective of common interest pursued would have been reached without public intervention. State intervention can be considered necessary when market forces alone are unlikely to allow for the said common interest to be reached, even although the market is not failing altogether.

The judgment contains valuable conclusions when the Court discusses the type of aid which is deemed compatible with the internal market. The Court states that operating aid intended to maintain the status quo or lower the usual ongoing operating expenditure is not considered compatible with the internal market. Other sorts of aid, including operating aid, may however be declared compatible with the internal market if the conditions laid out in Article 107(3)(c) TFEU are met.<sup>211</sup>

To sum up, the General Court allows for Member States to intervene in nuclear energy capacities. The Court confirms that it is not essential to consider the legitimate interests of *all* Member States. Nor is it essential for there to be *new* nuclear technology, seeing as the State aid should also be assessed in the context of the Euratom Treaty. Additionally, the Commission's discretion under Article 107(3)(c)TFEU should be assessed in light of the Commission's State Aid Modernisation.<sup>212</sup> Furthermore, the literature suggests that instead of referring to a balancing exercise, the Commission should dictate that State aid is rendered incompatible when it creates unnecessary distortions to the internal market.<sup>213</sup> Such a hypothesis can be illustrated in this nuclear case, where not only competition but also the energy mix of a Member State and the Euratom Treaty are taken into account.

#### 5.2.14. Coal phase out (hard coal and lignite)

The section addresses whether there is a need to cover compensation for coal (hard coal and lignite) phase out in the revised EEAG, and if so, under which conditions. For so doing, this section reviews the scope of phase-out activities, the new provisions in the Electricity Directive on coal phase-out, the effects of the Just Transition package, the Commission's practice in terms of State aid approval and the relevant case law.

#### Definition and scope of phasing out activities

The concept of 'phase out', although not legally defined, has a broad understanding and refers to both mining and burning activities from fossil fuels such as hard coal and lignite.

The 2019 Electricity Regulation refers to 'generation and mining capacity', when referring to Member States and regions affected by the energy transition from fossil fuels to clean energy transition.

The mining and the power generation processes often take place at the same site.

#### The qualification of compensation for closure as State aid

Law Review, (2019) issue 276.

<sup>&</sup>lt;sup>210</sup> T-356/15, paras 93-99.

<sup>&</sup>lt;sup>211</sup> T-356/15, paras 579-580.

<sup>&</sup>lt;sup>212</sup> COM/2012/0209, "Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, EU State Aid Modernisation (SAM)", Brussels, 8 May 2012.

<sup>213</sup> P. Nicolaides, 'What should state aid control protect? A proposal for the next generation of state aid rules' European Competition

As a reminder, only if it determines that the compensation is (or could be) State aid and is above the notification thresholds does the Commission need to consider whether the aid is compatible with EU law. In the lignite decision (SA.42536), the Commission concluded that it was a State aid: imputability and involvement of state resources plus existence of a competitive advantage.

#### **Coverage under current framework**

The 2014 EEAG barely mention coal when referring to the scope of application of the Guidelines, 214 and does not include it in the list of measures identified by the Commission and covered by the Guidelines.<sup>215</sup> If the aid measure is included on the list, the EEAG will apply to it, even if the sector is subject to specific Union rules on State aid, but at the condition that those specific rules do not provide otherwise. If so, the sector-specific rules will prevail over the EEAG. Coal is mentioned as one of those specific sectors, but is not included on the list of measures of the EEAG.

The second reference made to coal in the EEAG is in relation to compensation for the financing of support to energy from renewable sources. 'Mining of hard coal' is include in the list of sectors eligible to compensation pursuant to the conditions set in Section 3.7.2 of the Guidelines. Among those conditions, 'the aid should be limited to sectors that are exposed to a risk to their competitive position due to the costs resulting from the funding of support to energy from renewable sources as a function of their electro-intensity and their exposure to international trade.'216

Based on those criteria, the phase-out of coal activities is not covered by the EEAG as such.

#### **Current legal framework besides the EEAG**

The European Coal and Steel Community (ECSC) Treaty expired on 23 July 2002. After that date, the general State aid rules of the EC Treaty (now TFEU) have applied to the coal sector, except certain transitional provisions.

The ECSC Treaty defined an absolute prohibition on all subsidies or aid granted by the State, or special charges in any form whatsoever, without possible exemption.<sup>217</sup> As this absolute prohibition proved to be difficult to apply, the European Commission availed itself of Article 95 ECSC to enact a series of decision within the coal sector, in line with the competence recognised to it by the case law from the Court of Justice. 218

In the past, the Commission has assessed the compatibility of the coal phase out directly under Article 107(3)(c) TFEU, because no Guidelines cover this type of measure. Compatibility of aid in the energy sector is ordinarily assessed on the basis of the EEAG. However, the EEAG do not cover the situation for aid to compensate closure of electricity generation plants, so it must be assessed based directly on the TFEU. Article 107(3)(c) TFEU article states that the Commission may find aid to be compatible if it "facilitate[s] 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". Under Article 107(3)(c) TFEU, the Commission approves aid on this basis only where a number of criteria are met: a. Contribution to a well-defined objective of common interest; b. Need for State intervention; c. Appropriateness of the aid measure; d. Incentive effect; e. Proportionality of the aid; f. Avoidance of undue negative effects on competition and trade between

 $<sup>^{214}</sup>$  EEAG, para (13) (Scope of application).  $^{215}$  EEAG, Section 1.2.

<sup>&</sup>lt;sup>216</sup> EEAG, para. (185).

<sup>&</sup>lt;sup>217</sup> For a review of the historical development, see L. Hancher and F. Salerno, 'State aid', in C. Jones (ed.), EU Energy Law, Vol II – EU Compeition Law and Energy Markets (Claeys & Casteels, 2019, p.665.

<sup>&</sup>lt;sup>218</sup> Case 238/85 Deutsche Babcock v Commission ECR [1987] 5131.

Member States. This was the basis on which the Commission assessed the State aid in the Lignite Reserve Decision.

Current legal framework for such measures is composed of:

- The Council Decision 2010/787/EU of 10 December 2010 on State aid to facilitate the closure of uncompetitive coal mines
  - The 2010 Decision is currently the only measure specifically applicable within the EU covering coal industry activities. They exclusively regulate State aid compatible with the Treaty limited to the closure of non-competitive mines. The Council Decision on State aid, facilitating the closure of uncompetitive coal mines (OJ 2010 L 336/24), is valid from 1 January 2011 to 31 December 2027 and replaces the previous provisions in Council Regulation No 1407/2002. The aid covered only costs connected with coal for electricity production, combined production of heat and electricity, production of coke, and fuelling blast furnaces in the steel industry, where such use takes place in the EU.
  - o This decision provided for two types of aid. The first is for closure (Art. 3) and mines that incurred losses could benefit from such aid provided they present a liquidation plan with a maximum deadline of 31 December 2018. The second type of aid covers exceptional costs, such as from closing coal production units, not related to current production (Art. 4). Such aid may be used to cover costs or provisions by enterprises that are closing or have closed coal production units, including enterprises benefiting from closure aid. Such aid may also be used to cover costs incurred by several enterprises. An exhaustive list of cost categories that can be covered by State aid was included in the annex to the Council's decision.
  - Responsibility for decisions on whether or not to close public coal mines rests with Member States. EU State aid rules, in particular Council Decision 2010/787/EU, allow Member States to support the closure of uncompetitive coal mines in order to alleviate the social and environmental impact.
- Commission Regulation (EU) No 651/2014 (GBER)
  - o Art. 13 and 14 of the GBER exclude regional aid to support the coal sector.
- Commission Regulation (EU) No 1407/2013 (de minimis)
  - o In principle, the de minimis Regulation could cover the support in favour of people or companies affected by phasing-out coal.

#### **Review of Commission's practice**

- (i) State aid decisions based on Art. 107.3(c) and Council Decision 2010/787/EU of 10 December 2010 on State aid to facilitate the closure of uncompetitive coal mines:
- SA.52832 Amendments to the closure plan for the Polish coal mining sector in the period 2015-2023
  - Primary legal basis: Art. 107(3)(c) TFEU Certain econ. activities/areas
  - Secondary legal basis: Coal Council Decision 2010/787/EU of 10 December 2010 on State aid to facilitate the closure of uncompetitive coal mines
  - Scheme. Direct grant.
  - o Related cases: SA.41161 and SA.46891:

- By decision of 18 November 2016 in SA.41161 (2015/N) State aid to Polish coal mining in the period 2015-2018 (the initial Decision), the Commission approved State aid to Spółka Restrukturyzacji Kopalń S.A. (SRK") on the basis of a closure plan (i) to assist the closure by 31 December 2018 of the coal mining companies remaining in operation in the Polish coal sector by covering current production losses arising from the operation of mining units in the period 2015 2018; and (ii) to grant aid to cover exceptional costs arising from the definitive closure of mining units in the period 2015 2018 in accordance with Council Decision 2010/787/EU of 10 December 2010 on State aid to facilitate the closure of uncompetitive coal mines.
- By decision of 8 February 2018 in SA.46891 (2017/N) Restructuring of the Polish mining companies (the amending Decision), the Commission approved amendments to the initial Decision.
- On 4 January 2019, the Polish authorities notified additional amendments to the closure plan in accordance with Article 7(3) of the Council Decision.
- SA.41161 State aid to Polish coal mining in the period 2015-2018
  - Legal basis: Council Decision 2010/787/EU of 10 December 2010 on State aid to facilitate the closure of uncompetitive coal mines
  - The European Commission has found Poland's plans to provide PLN 7.95 billion of support to alleviate the social and environmental impact of closing uncompetitive coal mines by 2018 to be in line with EU State aid rules. The Commission concluded the support would not unduly distort competition.
- Other relevant cases are:
  - SA.34332 Aid to facilitate the closure of coal mines in Spain
  - State Aid SA. 41939 (2015/N) UK –Aid to UK Coal
  - o SA.40773 Closure aid to Hatfield coal mine
- (ii) Decisions taken under Article 107.3(c) TFEU only:
- German Lignite decision (SA.42536) State Aid SA.42536 Germany, Closure of German lignite-fired power plants. 27.5.2016
  - Assessment directly under Article 107.3(c) TFEU. To be noted that the compensation granted was grounded on a CO2 price scenario extremely low that changed dramatically in the following year so that the plants received an overcompensation.
- SA.54537 Prohibition of coal for the production of electricity in the Netherlands<sup>219</sup>
  - o On 12 May 2020, the European Commission announced it had approved the financial compensation envisaged by the government of the Netherlands in favour of the early closure of the Hemweg coal fired power plant. The compensation of €52.5 million has been deemed to be in line with the EU State aid rules, as the closure will contribute to reducing CO2 emissions and there will not be undue distortion of competition in the EU single market, according to the Commission.

<sup>&</sup>lt;sup>219</sup> "State aid: Commission approves compensation for early closure of coal fired power plant in the Netherlands", <u>IP/20/863</u>, 12 May 2020 <a href="https://ec.europa.eu/commission/presscorner/detail/en/ip\_20\_863">https://ec.europa.eu/commission/presscorner/detail/en/ip\_20\_863</a>

- $\circ$   $\,$  Some interesting elements of the reasoning of the Commission are commented below.
- o First, the decision to proceed to the early closure of the Hemweg plant was a consequence of the adoption of the Dutch law of 11 December 2019 prohibiting the use of coal for electricity production as of 1 January 2030 at the latest. Four coal fired power plants have been granted a transition period of five to ten years, while the Hemweg plant had to close before 1 January 2020. This very rapid closure resulted in a direct commercial loss for the operator of the plant, which is, according to the Dutch law, eligible for financial compensation due to its early closure. Negotiations between the Dutch government and the company resulted in an agreement on the amount. This case should be related to previous experience for early phase out of plants, as experienced in Germany, as already covered in a previous post on this blog. In December 2016, the German Constitutional Court ruled that energy companies affected negatively by the accelerated phase-out of nuclear plants were entitled to 'appropriate' compensation.
- Second, in its decision on the Hemweg plant, and according to the Commission still, the latter has not taken 'a final position' on whether the measure provides the operator with an advantage over its competitors, and whether it thus constitutes State aid. This is quite unusual for a State aid decision, and the choice of legal basis for approving the aid is not either indicated in the press release
- Last, much emphasis is put on the objective of the measure and its contribution to EU environmental and climate goals, which 'outweighs any potential distortion of competition and trade brought by the support.' A close link is made to the European Green Deal, although still a strategy document, and the need to proceed to a rapid phasing out of coal and of the decarbonisation of gas.

#### **Coverage under the Clean Energy package**

As part of the Clean Energy Package, the 2019 Electricity Regulation<sup>220</sup> refers explicitly to the coalphase out situation that several Member States and regions are facing, which create 'social, industrial and economic challenges.' To address those challenges, the European Commission has set up a 'coal and carbon-intensive regions initiative', and, 'in that context', the Commission should assist Member States, including with targeted financial support to enable a 'just transition' in those regions, where available.'<sup>221</sup>

Article 4 of the 2019 Electricity Regulation (entitled 'Just Transition') provides further details as to the purpose of such support and the Commission's obligations in that connection. To start, the Commission has the obligation ('shall') to 'support Member States that put in place a national strategy for the progressive reduction of existing coal and other solid fossil fuels generation and mining capacity through all available means,' and so with the objective of enabling 'a just transition' in regions affected by structural change. The assistance provided by the European Commission shall be in relation to 'the social and economic impacts of the clean energy transition.' Then, the Electricity Regulation does not include any reference to State aid rules, contrary to other legislative provisions where there is an obvious possibility of State aid measures (e.g. in favour of renewable energy), although such rules will apply when such cases occur. The type of measures are referred to in the Electricity Regulation, and that the Commission 'shall facilitate the access to and use of is 'available funding and programme'. In practice, a series of funding opportunities already exist, especially

<sup>&</sup>lt;sup>220</sup> Regulation (EU) 2019/943 of the European Parliament and of the Council of 5 June 2019 on the internal market for electricity, Recital (51).
221 Ibid.

through the ESIF, and the 'Just Transition Platform' and the 'Just Transition Fund'. The European Commission has also announced, at the beginning of 2020, the creation of a 'Just Transition Fund for coal regions'.<sup>222</sup> The wording of the Electricity Regulation indicates that the active role of the Commission will focus on orienting the national and regional authorities of the concerned Member States towards available funding possibilities, including at European level. The Regulation does not require the European Commission to elaborate any State aid rules accommodating for the economic and social consequences of coal of fossil-fuel phase out.

It is therefore recommended that the revised EEAG should not defer from the approach followed by the EEAG (2012-2020) in reference to tax exemptions and compensation for support to RES in the fossil fuels sector. It should not include support to coal (or fossil fuels) phase out, since this would not aim at reaching an environmental protection or energy objective, but to address social and economic issues.

In addition, and as indicated above (Section 3.33.3), Member States should, under the control of the European Commission, avoid creating inconsistencies across finance instruments and distorting competition by supporting non-profitable plants to be phased-out.

#### Upcoming challenges and announced measures

It is expected that the European Commission will soon have to deal with a series of national measures aimed at supporting coal phase-out. In addition to the main phase-out question, there is the additional question of 'accelerated phase-out'. Accelerated or early phase out has already given rise to a series of legal issues in the nuclear energy sector, where the state had to provide for compensation to the affected companies. Within the coal sector, some national legislations have also newly adopted phase-out obligations, allowing affected operators and owners to ask for financial compensation (like in the Netherlands). This raises some fundamental question of legal consistency in the approach of European Commission for the approval of such measures under EU State aid rules.

Then, as mentioned above, in past decisions on coal support to coal phase out, the Commission has based its assessment directly on Article 107(3)(c), but not under the EEAG. In its most recent administrative practice in the Dutch compensation for early coal phase-out, the European Commission justifies the need for support in the environmental benefits of the measure ('the measure will contribute to the reduction of CO2 emissions'), with a calculation of the avoided emissions (in this case, 3.6 megatons of CO2 annually). The Commission also argued that the measure (i.e. compensation for early coal-phase out) will 'contribute to the reduction of  $CO_2$  emissions'. There is a risk of inconsistency in the application of assessment criteria between, on the one hand, assessments conducted directly under Treaty rules (as for nuclear and coal phase-out), and, on the other hand, assessments conducted under the EEAG, while the objective of the measures is said to be the same one, i.e. 'EU environmental and climate goals' and contribution to EU Green Deal (which remains a strategy at the time of writing). This divergence increases the risk of legal uncertainty in the application of the rules, and risks of contradictory decision in case of judicial review.

If state intervention is allowed and justified by environmental and climate objectives, it is important that the revised EEAG and GBER, contain clear criteria as to which aid measures to fossil fuels phase-out could be eligible.

<sup>222</sup> https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12113-Fast-track-interservice-consultation-on-the-SEIP-including-a-JTM-and-the-JTF-

<sup>223</sup> Add reference to cases.

<sup>&</sup>lt;sup>224</sup> S.A.54537, press release IP/20/863.

 $<sup>^{225}</sup>$  S.A.54537, press release IP/20/863.

14 EU Member States that have agreed on a phase-out so far. Looking at the announcements made by Member States, some plan for the compensation of closures of plants. The German Coal Exit Plan can be taken as an example. Germany's 'Coal Commission' recommended that the phase-out could be achieved through a combination of company-to-government negotiations, tender procedures and legally ordered closures. It also recommended that the phase-out might entail compensation for plants asked to close. Companies like RWE have been demanding up to €1.5bn per gigawatt (GW) closed, after the 'Coal Commission' recommended that compensation for operators should form part of the phase-out negotiations with the German government.

As well as a few isolated decisions, the European Commission has on its side expressed its willingness to approve national government aid to coal plant operators for closing early under specific conditions. For the purpose of legal certainty, those conditions should be known in advance. The Commission has notably announced that it would only approve compensation in line with the operator's expected losses from an early power plant closure, as referred to in the Sustainable Europe Investment Plan published in early 2020.<sup>226</sup> This seems to have been the approach followed in the Dutch Decision on the Hemweg plant. National governments would also have to structure the compensation to minimise any market or competitive distortions.<sup>227</sup>

The European Commission has also expressed a possible 'flexible approach' when assessing State aid measures in favour of coal and lignite phase-out, when this could contribute to reaching the climate neutrality goals. This argument of 'flexibility' has also been investigated by the European Committee of the Regions.<sup>228</sup>

#### **Recommendations:**

- The revised EEAG should not defer from the approach followed by the EEAG (2012-2020) in reference to tax exemptions and compensation for support to RES in the fossil fuels sector.
- The revised EEAG should not enable for providing support to coal-phase out, since it is not as such a measure with an environmental protection or energy objective, and therefore falls outside the scope of application of the EEAG.
- Supporting the phase-out of fossil fuels activities, like coal mining and firing, would bring undue negative effects on competition and trade between Member States.
- Member States should refrain from supporting the coal phase out under the EEAG. Support
  to coal phase-out should be addressed under the relevant instruments in relation to economic
  and social aid.
- There is a risk of inconsistency in the application of assessment criteria between:

   (i) assessments conducted directly under Treaty rules (like for nuclear and coal phase-out);
   (ii) assessments conducted under Council Decision 2010/787/EU; and (iii) assessments conducted under the EEAG. Assessments conducted under criteria
   (i) and (iii) tend to give the impression that the objective of the measures is said to be the same one, i.e. 'EU environmental and climate goals' and contribution to EU Green Deal (which remains a strategy at the time of writing). This divergence increases the risk of legal uncertainty in the application of the rules, and risks of contradictory decision in case of judicial review.

 $<sup>^{\</sup>rm 226}$  Add reference to SEIP and cross-reference in the Report.

<sup>&</sup>lt;sup>227</sup> Add ref

<sup>&</sup>lt;sup>228</sup> European Committee of the Regions, *Assessing the need for a modification of the state aid rules for the phasing-out of coal*, 2020 https://cor.europa.eu/en/engage/studies/Documents/state-aid-rules-phasing-out-coal/Coal-regions-state-aid.pdf

- If state intervention is allowed and justified by environmental and climate objectives, it is important that the revised EEAG and GBER, contain clear criteria as to which aid measures to fossil fuels phase-out could be eligible.
- The alternative would be to continue with a two track process for SA approval in the field of environmental protection and energy.

06

# CONCLUSIONS AND RECOMMENDATIONS

#### 6. Conclusions and recommendations

#### 1. Keep alignment with the 2030 climate and energy targets

- The EEAG should continue to be **part of the compliance strategy with the EU climate and energy targets**. This role should be restated as grounds for the revised EEAG in the Guidelines themselves as they will support their interpretation. In the present phase, the revised EEAG should be part of the instruments enabling compliance with the 2030 climate and energy targets and the 2050 climate neutrality goal. Because the EEAG play an important role in supporting Member States in their target compliance, it is recommended to closely link the revised EEAG to the 2030 targets and 2050 goal. In terms of assessment methodology, a similar approach as in the 2014 EEAG should be followed: if an aid measures has the purpose of meeting the 2030 targets, the Commission should presume that, if all other conditions are met, the requirement of appropriateness of the aid is met.
- As the EEAG, like the GBER, is a crucial instrument in supporting Member States in their efforts to meet climate and energy targets, there is a need for target and objectives alignment. The revised EEAG should build on the forthcoming revised GBER.
  - In its 2012 State Aid Modernisation strategy, the European Commission called for 'a common approach' in the revision of the different Guidelines and frameworks. A similar common approach across State aid instruments should be maintained.
  - The revision of the GBER and the EEAG should be closely coordinated, where the general key principles of State aid support should be set in the GBER and then further detailed in the EEAG, as it has previously been the case. The close interaction between the GBER (legally binding on Member States) and the EEAG (legally binding on the Commission, but not on the Member States as a general rule) should be maintained.
- Because of ongoing and forthcoming legislative processes under the European Green
  Deal, including on sector integration and sector coupling, the revised EEAG should
  also enable the development of new technologies and measures aimed at
  reaching the set targets and environmental goals defined in secondary EU legislation.

### 2. Methodological approach: 'combined approach' of common objectives and specific aid measures.

Alternative structure of the EEAG based on a combined approach;

During the last EEAG revision process, an important improvement was made concerning the structure of the guidelines, with a first part of the EEAG being dedicated to common assessment objectives. Through that change, a common methodological framework for application of the EEAG was defined, with the aim of improving consistency, transparency and legal certainty. As the new approach has been proven to increase legal certainty and transparency, this should be reiterated in the revised EEAG.

Therefore, the methodological approach introduced in the EEAG (2014-2020) should be reiterated, i.e.: having first a list of common assessment principles, starting with the definition of the objectives of common interest, and then specific provisions for each type of measures.

However, there is also a need to update the methodological approach. Alternatives exist, oscillating between an objective-based approach and one focused on a list of criteria for specific measures. This report argues in favour of a combined approach. Under such a combined approach, it would be important to define clear assessment criteria to determine to which extent the measure contributes to an 'objective of common interest', as a benchmark. The objectives referred to in the first approach should serve as basis for defining those objectives of common interest.

- The need for **clear assessment criteria**:
  - Technologies and services contributing to the same objective should be subject to the same assessment criteria, in accordance with the principle of technology neutrality. The revised EEAG should contain a reinforced reference to those criteria and update them: technology neutrality principle and resilience.
  - o The application of the proportionality test should be improved.
- The definition of the **objectives of common interest** should be updated, and should foresee consistency with the GBER.
  - The definition of the objectives of common interest in the revised EEAG should be updated. A revised definition of the conditions for contributing to an objective of common interest can be an opportunity to integrate elements of the objective-based approach. If the revised EEAG put emphasis on environmental / climate / adequacy objectives, the EEAG must define a clear assessment criterion for that purpose, e.g., in terms of impact assessment/life cycle assessment.
  - The definition of the objectives of common interest should be aligned with the latest EU law and policy framework for environmental and energy policy, including the Clean Energy Package and the EU Green Deal. It should also refer to the EU legal framework on sustainable finance in order to ensure consistency in investment signals.
  - o Importantly, the definition of objectives of common interest with an environmental or energy perspective should be common to the EU State aid framework, and should not only be stated in the EEAG, but also in the GBER, which are binding on Member States. The goal is to ensure consistency in the assessment of measures which fall both under the scope of application of the EEAG and those which fall outside.
  - In the view of recent disruptive events related to extreme natural phenomenon (e.g., heatwaves, floods, loss of biodiversity) and public health (e.g. COVID-19), resilience should become one of the common objectives and should be applied in combination with the other assessment criteria in the EEAG.
- The revised EEAG should be aligned with a **European strategy for green recovery**.
- They should contribute to the **fast tracking of the decarbonisation** of the energy system and the European economy at large scale.
  - All measures and technologies will be needed, both existing and new. The EEAG should reflect this dual need, i.e. deployment of existing low carbon technologies and development of demonstration technologies.

- Because of the need for a deep and rapid decarbonisation of the European energy system and economy, the EEAG should enable the use of the technologies available today at large scale (subject to local acceptance), and also support the deployment of new technologies. This could follow a stepwise approach.
- o In order to ensure a rapid decarbonisation of the European economy, the revised EEAG should enable the definition of decarbonisation pathways for a rapid decarbonisation of the economy and the whole energy system, in respect of the principle of sovereignty over the choice of energy mix for the Member States, as defined in the TFEU.
- The EEAG could reward further the measures enabling a rapid and deep decarbonisation. Complying with the adopted and announced targets requires huge changes in investments, which often must be made in a very short timeframe.

#### 3. Revise the material scope of application of the EEAG

- The revised EEAG should reflect and build on the provisions laid down in the Clean Energy Package for All Europeans.
- They should enable the implementation of the European Green Deal, without adding rules to the legally binding provisions of secondary EU law, and with due respect of the principles set in the Treaties.
  - The revised EEAG should focus on the energy system holistically (electricity, gas, heating and cooling) (holistic approach). Such an approach is in line with both the technology neutrality principle and the process of smart sector integration.
  - The revised EEAG should enable Member States to define different decarbonisation pathways across the different energy carriers, with due respect to Member States' sovereignty over their energy mix.
  - To reflect the latest evolution in environmental technologies and in the energy market, the scope of application of the EEAG should be revised. For example, support for flexibility services or for electric mobility, must be included within the scope of application of the EEAG. Similarly, the definition of energy infrastructures covered by the EEAG and the GBER should be updated to include, notably, electric vehicles re-charging infrastructures and hydrogen infrastructures. The assessment for aid measures already covered must be updated in the view of technological developments, market developments and case practice. This includes sections relating to support in favour of renewable energy sources and capacity remuneration mechanisms.
  - Given the ongoing and forthcoming legislative processes under the EU Green Deal, including sector integration and sector coupling, the revised EEAG should also enable the development of new technologies and measures aimed at reaching the set targets and environmental goals defined in secondary EU legislation. A holistic approach for the whole energy system should be adopted. In the context of sector coupling, the revised EEAG should provide for a level-playing field, and cover notably cogeneration/CHP, and clean and renewable gases.
- The material scope of application of the EEAG should be clarified.

A practice has developed of assessing the compatibility of State aid measures directly or indirectly related to environmental protection or energy – such as nuclear energy and coal phase-out - directly under Article 107.3(c) TFEU, and not under the Guidelines, because falling outside the material scope of the latter ones. If the assessment of these measures indeed falls outside the EEAG, there remains a need for coherence in the assessment method, not least when justifying the measure as contributing to the same policy objectives.

#### 4. Enforcement and judicial review of State aid rules

- The EEAG should reflect the latest case law of the Court of Justice of the EU with relevance for the definition of State aid.
- Recent case law from the Court of Justice of the EU has shown the importance of the respect of procedural rules during the evaluation phase of notified aid, as well as the extensive role that the Guidelines can play in the Commission's control of State aid. Those are elements to be taken considered in the drafting of the revised EEAG.

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