The effect of state aid governance on EU climate and energy policy

1 Introduction

This paper builds on ClientEarth’s EU Climate & Energy Governance Health Check1, which assessed the EU’s 2020 climate and energy governance and considered the prospects for 2030. As identified in that paper, State aid is a key area of EU law which can drive the low carbon transition, or if used ineffectively, hinder the EU’s ability to meet its decarbonisation goals. This paper will dive deeper into the Commission’s governance of State aid policy from the perspective of whether that jurisdiction conforms with the principles of good governance, namely: effectiveness, transparency, accountability, legitimacy, flexibility, policy coherence and certainty.

State aid law stems from the grant by the EU Treaties to the European Commission of extensive powers to intervene where Member States propose initiatives that threaten to distort competition in the internal market by bestowing advantages on certain market participants. The extensive powers to direct State aid policy can essentially shape the relevant markets e.g. the market in renewable energy, having huge implications for climate and energy governance.

While this paper only gives a brief overview of State aid governance in relation to EU climate and energy goals, it does illustrate severe gaps in good governance. State aid is a highly tractable tool and could therefore prove highly effective in directing the low carbon transition. However, gaps in transparency mean that civil society is highly restricted from aiding the effectiveness of the Commission’s use of State aid jurisdiction. The restriction of civil society from assisting the Commission in policing State aid use, is all the more glaring because of large policy inconsistencies between the Commission’s State aid policy on climate and energy matters and more general climate and energy goals. The rest of this briefing will explain and analyse such gaps in good governance.

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2 What is State aid law?

Competition law aims to protect markets from being distorted by the practices of companies or by Member State policy which results in harm to consumers or the processes of rivalry and innovation. State aid law, as part of competition law, contributes to the proper functioning of the internal market by preventing some companies from gaining an unfair competitive advantage through government assistance. For a measure to amount to State aid, it must:

1. Involve a transfer of aid through State resources;

2. Entail an economic advantage for undertakings (companies);

3. Distort competition by selectively favouring certain beneficiaries; and

4. Have an effect on intra-Community trade.

Generally State aid is incompatible with the common market. However, certain forms of aid are allowed on the basis that they address certain social goods such as environmental protection. Envisably tensions arise between Member States and the Commission in the use of these powers and also between the 'traditional' single market aims of EU competition policy and other EU aims. These tensions can be compounded by the fact that the Commission has the sole authority to make decisions on State aid cases (though the Court of Justice of the EU has review authority). Even taking the sole purpose of State aid policy to be the completion of the internal energy market the following aims can conflict with each other:

1. Permitting Member States flexibility in domestic energy markets (especially to allow Member States to respond quickly and effectively to real pressures on generation adequacy);

2. Protecting the liberalisation of the EU energy market;

3. Preventing increased market fragmentation;

4. Encouraging new technologies essential to the energy transition (renewables, energy efficiency) but ensuring simultaneously that subsidisation of these technologies is limited;

It can immediately be seen that the exercise of State aid policy must be line with the aims of the EU’s climate policy or one or the other would be undermined. The exercise of State aid jurisdiction by the Commission - setting State aid guidelines and exercising the Commission's discretion in this area - is as essential to Europe's climate transition as the setting of the level of ambition of climate and energy targets. The importance of the Commission's exercise of State aid jurisdiction will only become more important given that the 2030 renewable energy target is to be binding at EU level but not national level. Therefore the jurisdiction must be exercised in accordance with the principles of good governance. This briefing will assess whether this is the case.
3 Effectiveness

State aid policy is an area of EU law which provides high traction on Member State activity. As an area that is essential to the internal market, the EU has extensive experience in utilising its jurisdiction. State aid law regulates in detail how and what environmental and energy subsidies Member States can provide, as well as to what projects and technologies, and on what conditions. In addition, State aid jurisdiction can also be used to limit discriminatory tax policies of Member States. Thereby allowing State aid jurisdiction to be used to indirectly promote harmonisation of energy taxation across the EU. In practice therefore, State aid policy can be hugely effective in influencing national energy and environmental policies.

The Commission has extensive State aid decision making and enforcement powers. The strong powers stem from the Treaties but more fundamentally from an acknowledgement on the part of the Member States that such Commission power is necessary to safeguard against the tendencies of the Member States towards nationalist, protectionist economic policy. If used appropriately, State aid law can be highly effective in directing the energy transition.

4 Transparency

Transparency is considered to be a hallmark of good governance that applies universally and climate governance is no exception. However, much of the Commission’s exercise of State aid power occurs behind closed doors. This section will look at two particular aspects of that lack of transparency: the pre-notification phase and the investigation phase.

All State aid and potential uses of State aid by a Member State must be notified to the Commission (subject to certain exceptions). Often, when Member States are considering large or strategic grants of State aid to a company or sector, the Member State will enter into informal talks with the Commission. These informal talks are called the ‘pre-notification’ stage. Where the Member State then decides to proceed with the aid, the formal notification will follow. Once a Member State notifies the Commission of its intention to issue State aid, the Commission decides whether to approve the aid or open a full investigation to consider the potential aid in more detail before making a final decision.

Where State aid is not notified by the Member State, it is regarded as illegal State aid (even where it would have been allowed if it had been notified). The Commission can require the Member State to reclaim illegal aid from the recipient. This power to order aid payback gives the Commission a powerful tool to ensure it can keep track of the use of State aid across the EU.

4.1 Pre-notification and notification stage:

The pre-notification phase is generally carried out in strict confidence, unless the Member State decides to waive the confidentiality of this phase. The notification phase should not be kept confidential but many are. In addition, Member States have the right to request that certain information (confidential, commercially sensitive information etc.) is not disclosed to third parties.
It is possible to send a request to access documents and/or ask Directorate General (DG) Competition case handlers directly whether the aid at hand has been notified. EU access to documents legislation guarantees in theory the greatest possible access to internal Commission documents (any citizen can ask for any internal document). However, in Commission v Technische Glaswerke Ilmenau (Case C-139/07) the Court of Justice of the EU (CJEU) confirmed that the Commission can apply a presumption of confidentiality to all documents in an administrative file related to reviewing State aid. Nevertheless, the Court did state specifically that the:

‘general presumption does not exclude the right of those interested parties to demonstrate that a given document disclosure of which has been requested is not covered by that presumption, or that there is a higher public interest justifying the disclosure of the document.’

This ruling means it is for the person or organisation submitting the request to demonstrate that the documents are not confidential or that there is a higher public interest justifying disclosure, even though the applicant may not even know which documents exist. Further, it is to be noted that on a number of occasions it has been submitted to the Court that protection of the environment is a higher public interest justifying disclosure in relation to various types of requested documents but the Court is often not sympathetic to this argument.²

Therefore it can be very difficult to even find out whether a Member State has notified a new aid, as notification and approval procedures take place strictly between Member States and the Commission. The lack of transparency on the part of the Commission - that NGOs may not even know certain State aid is being investigated - could hinder the Commission in doing its job effectively. Civil society and competitors could be effective allies of the Commission in many cases. But the opaqueness of the pre-notification and notification stages mean that neither civil society nor potential competitors can prepare for the coming investigation or set up an advocacy strategy.

4.2 Investigation Stage

During the notification stage the Commission can decide to open a formal investigation into the aid where the Commission has doubts over the legality or compatibility of the aid. If the Commission decides to open a formal investigation, the decision is published in the official journal. The publication of the official notice means is often the first time it becomes public that the Member State is considering the grant of State aid.

This second step in the procedure is more transparent and open to interested parties. Nevertheless, there are still certain concerns with the transparency and fairness of this stage of the proceedings: the procedure is still not open to NGOs (even though they can provide useful information) and the length of the investigation does not have a limit resulting in a lack of investor certainty (see section on certainty for more). However, it is to be noted that once the final decision on State aid has been made the Commission does publish the decision in full on the DG Competition website.

Anyone may submit a well-documented complaint at any time during an investigation of State aid. NGOs (unlike competitors of the beneficiary) do not have the formal party status to qualify as legitimate complainants. However, the Commission may register information from an NGO as general market information. In effect, the Commission has an obligation to take into account all information regarding unlawful State aid regardless of the source. This can be used by NGOs as an opportunity to provide the Commission with information, economic analysis, legal expertise etc. and thereby to influence the Commission's decision.

Nevertheless, the right to be an 'interested party' for the purpose of State aid is very restricted (only those who are affected in monetary terms have full rights of intervention). In contrast, NGOs are often well placed to gather information that the Commission may not have access to and/or that the Member State may not wish to give to the Commission. This is particularly true for unlawful State aid - aid that has not been notified to the Commission. Organised NGOs across the EU can be aware of State aid rules and Member State breaches of the same.

The lack of transparency in the pre-notification, notification and investigation stages mean that it is extraordinarily difficult for civil society to even track what State aid Member States hand out. An example of this can be seen in the work of Transport & Environment on State aid to the aviation sector. It was only possible for the NGO to gain access to the cases which had already been published and though the Commission acknowledged that there was a large backlog of cases in the notification stage, the Commission would not even release the names of those cases. Meanwhile the Commission launched a consultation on a new version of guidelines for aviation State aid that civil society had to respond to, without access to even the number of cases that could be affected by the new guidelines. Considering that State aid is taxpayer money given directly to particular companies or industries, this huge lack in transparency must be rectified immediately.

5 Accountability

State aid is not only highly tractionable by the Commission, but also by national actors. Any participant in the market who feels they are at a disadvantage because another market participant is a beneficiary of unlawful State aid, can go directly before a national court and the national court is obliged to do all it can to remedy the situation. The Commission encourages cases by national actors as an additional tool to assist them in policing aid across the EU as the Commission recognises that it does not have the capacity to monitor all State aid given.3

In addition, challenges to the Commission's State aid decisions can be brought directly to the CJEU by Member States, the intended beneficiaries, and competitors (but not by NGOs). During the proceedings, the Court has allowed interveners to submit comments to the Court. It is important to note that the intervener must have already submitted comments on the aid to the Commission and be likely to suffer harm if the aid were allowed.

While this high level of national accountability could be a fundamental good governance tool, the effect is severely limited by the very restrictive rules around who can access the courts and/or make complaints to the Commission. It is only those companies or persons who are affected in monetary terms that can complain. This leaves NGOs and other stakeholders outside the

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process and unable to take action against uses of State aid that can be considered bad for the environment or that are likely to impede the EU’s decarbonisation goals. This not only severely hampers accountability of Member State actions but also illustrates a lack of legitimacy in the exercise of State aid jurisdiction. The restrictive rules on access to national courts and the Commission for State aid cases essentially excludes citizens from being able to challenge the way taxpayer money is spent by Member States, even where it contravenes EU law.

6 Legitimacy

In addition to the lack of legitimacy inherent in the exercise of State aid accountability outlined above, the division of jurisdiction over State aid matters within the Commission itself raises serious concerns on climate and energy grounds.

The Commission is becoming increasingly centralised, especially in the current Juncker college. The Secretariat General (the central administration of the Commission) is increasing its power over Commission files relative to the dedicated DGs concerned with those files, for example, the Secretariat General now often drives climate and energy policy decisions.

Competition matters are even more centralised, including State aid decisions. DG Competition is in charge of the Commission’s State aid jurisdiction (except on agriculture and fisheries) and has historically closely guarded that competence. This is becoming even more acute as centralisation spreads across the Commission.

However, there are some opportunities for other DGs to influence DG Competition. One of the most important ways to influence the development of State aid documents produced by DG Competition is through the interservice consultation (a procedure where all interested DGs can comment on documents produced by other DGs). However this can be a time consuming process and appropriate notice is not necessarily always given that important documents are being produced, requiring a quick turnaround of detailed comments. In addition, every DG has its own internal and competing priorities and it may not be able to give the development of State aid policy the necessary time and capacity, even when highly relevant to that DG’s main policy area.

In addition, it can be very difficult for civil society to actively engage with the development of State aid policy. For instance, the Commission did not receive very many replies to the consultation on the draft energy and environment guidelines. This could be ascribed to a lack of knowledge or awareness on the part of civil society as State aid is a highly technical area. The result can be seen directly in the State aid guidelines on energy and environment - while the EU as a whole is attempting to promote renewables, the guidelines make subsidisation of renewables much more difficult, leading to a severe lack of policy coherence across EU policy.
7 Flexibility

Competition policy (and State aid policy as a subset of that) is an exclusive competence of the EU. This means only the EU can act in this area. However, the Commission can (and does) limit its jurisdiction and discretion by adopting guidelines and frameworks on State aid in certain sectors. The guidelines and frameworks set out when the Commission will consider aid to be incompatible with the internal market and what exemptions may apply. The guidelines and frameworks are necessary to provide Member States with legal certainty and assist them in drafting compatible aid schemes. In addition, the guidelines and frameworks ease the work of the Commission in assessing aid as the rules are already set out.

How the Commission intends to use these powers in the context of environment and energy has recently been clarified via the publication of the guidelines on State aid for environmental protection and energy 2014-2020. The issuing of guidelines on environment and energy is in line with usual policy on specific sectors as the Commission closely guards its jurisdiction over State aid policy with the heavy reliance on soft instruments, usually guidelines. Guidelines are non-binding expressions of policy by the Commission, often termed a 'soft-law' instrument. However, they have great normative force and the guidelines are binding on the Commission itself.

In addition to guidelines, the Treaties grant the Commission power to propose (binding) regulations on State aid, however, the Commission rarely uses this power. The Commission prefers guidelines as it can then be the sole author and so, director of policy. In adopting regulations, the Council would have the final say - the adoption of regulations on State aid is by use of the special legislative procedure so that the European Parliament is only consulted and does not have a full co-legislative role. This in itself illustrates the very sensitive nature of the exercise of jurisdiction over State aid - only new areas of competence or politically sensitive topics are still subject to the special legislative procedure.

For climate and energy purposes the adoption of guidelines, under the Commission’s jurisdiction rather than regulations under the Council’s jurisdiction is on the whole useful. One of the reasons why the Member States have given the Commission such extensive powers over State aid is because the Member States themselves recognise it is necessary to safeguard against the tendencies of the Member States towards nationalist, protectionist economic policy. In the energy sector the possibility of protectionist Member State energy policies is particularly high.

However, a regulation would also result in more national traction - national courts can take account of the guidelines but they are not binding on the Member States, whereas regulations would be binding in Member State courts. Similarly, the CJEU will use the guidelines a tool to assist them in making any decisions on State aid cases but will not look at the guidelines as definitive on the topic. Indeed the CJEU often goes back to the wording of the Treaty in deciding State aid cases. Referring to the Treaty wording is an acknowledgement that State aid is an objective legal concept which only the CJEU and the national courts can interpret. The recognition of State aid as an objective concept where the Commission can only provide guidance does give the Commission flexibility to provide such guidance as necessary. The flexibility could be usefully used to ensure that maximum policy coherence is maintained between the general State aid goals (minimum State intervention) and the goals of the climate and energy transition. Unfortunately, however, as outlined below, the Commission has not taken the opportunity to do so.

However, the exercise of flexibility by using soft law instruments also allows Member States to retain flexibility in applying the guidelines to their own national context. Though this may simply add to the fragmentation of climate policy across the EU, with the more progressive Member States doing more to support low-carbon technologies in contrast to other Member States interpreting the guidelines to allow for support for coal or other fossil fuels.

8 Policy Coherence

The Commission has produced several iterations of guidelines for State aid on environmental policy (the latest iteration of which now also explicitly include energy policy in their title). The general consensus on the 2008 guidelines on state aid for environmental protection was that they gave Member States quite a broad and generous scope to subsidise green energy. But, the same cannot be said of the 2014 update of the guidelines. While a detailed commentary on the guidelines\textsuperscript{5} is beyond the scope of this briefing, this section will highlight some of the more glaring lapses in coherence between the guidelines and wider climate and energy policy.

The inherent aim of EU Competition policy (removal of subsidies) has lead to the Commission's attempt to erode the use of support schemes by the Member States for green technologies before those technologies are really ready to compete on an equal basis. The policies set out in the 2014 guidelines do not necessarily promote the (explicit) aim of the guidelines to support the Member States in meeting their 2020 and 2030 climate and energy targets:

1. \textbf{Lack of appropriate support for renewable energy:} The guidelines from 2008 recognised the need to provide support for developing technologies and allowed for support to be dependent upon each technology's production costs. However, the new 2014 guidelines focus almost entirely on the cost-effectiveness of the support, pushing Member States to use only auctioning for supporting renewable technologies. The use of only auctioning or competitive bidding for support means that all technologies will now receive the same level of support, regardless of their market maturity or penetration (apart from a few exceptions\textsuperscript{6}). Indeed, Keep on Track which follows the progress of Member States towards their renewables targets considered the new guidelines and stated:

\begin{quote}
'the newly adopted State aid guidelines are limiting the member states' freedom of choice of support schemes that have proven to be effective.'
\end{quote}


\textsuperscript{6} In terms of operating aid, FiT/premium are still allowed for installations with an installed capacity of less than 500 kW. Also the guidelines see a number of exceptions to the auctioning requirements due to: the longer-term potential of a given new and innovative technology; or the need to achieve diversification; or network constraints and grid stability; or system (integration) costs; or the need to avoid distortions on the raw material markets from biomass support. In addition, aid may be granted without a competitive bidding process as described to installations with an installed electricity capacity of less than 1 MW, or demonstration projects, except for electricity from wind energy, for installations with an installed electricity capacity of up to 6 MW or 6 generation units.
Further they state that, ‘since the announcement of new state aid guidelines, many potential inventors fear less stable conditions. In case the guidelines are implemented as announced, investments will drop to a much lower level.’

2. **Aid for generation adequacy (capacity markets):** The guidelines allow Member States to give aid to ensure generation adequacy i.e. aid to ensure that there will always be a reliable supply of power. This has mainly arisen in the Member States where a high penetration of renewable energy raises concerns for adequate power supply when the sun does not shine and the wind is not blowing. The guidelines suggest that generation adequacy schemes should ensure that they do not contradict the aims of phasing out harmful fossil fuel generation. There is a danger that capacity measures could be a hidden way to subsidise aging and polluting power plants. Specifically, the guidelines state that schemes should ‘facilitate’ and ‘encourage’ demand side response measures. The Commission's decision to approve the UK capacity market was one of the first decisions taken under the new guidelines. But the fact that the UK capacity market has an extremely limited role for demand side response, did not result in the scheme being declared in contravention of the guidelines. Therefore it is not clear that even where the wording of the guidelines support wider EU climate and energy goals, that the guidelines will be implemented accordingly.

3. **Support for co-firing biomass:** The definition of 'energy from renewable energy sources' in the guidelines allows energy from renewable sources to be considered as 'the share in terms of caloric value of energy produced from renewable energy sources in hybrid plants which also use conventional energy sources.' This definition allows the Commission to assess co-firing of biomass and coal as eligible for State aid. Therefore directly contradicting wider EU climate and energy aims. The practice of co-combustion of biomass with coal has very negative environmental consequences and constitutes an indirect subsidy to fossil fuels.

In adopting the new State aid guidelines, the EU has tried to support policy integration and consistency between EU State aid rules and its climate and energy objectives. However, as illustrated in this (non-exhaustive) list there are serious doubts as to whether the guidelines will provide a sufficiently robust driver of policy integration and consistency. A good summation of the guidelines by one commentator is that:

’in the new state aid guidelines … the Commission departs from consistent positions taken in the past. The mechanism for awarding support would be in the procedure most favorable to large utilities, the scheme most likely to discourage small projects and small developers. … The pace of RES [renewable energy] investment has already slowed considerably. All of these twists and turns have only one thing in common, that they favor the large established utilities. Just as the European Union is calling for increased renewable energy development by 2030 and when most Members will not achieve the 2020 target, the Commission is changing the rules to create more barriers to investment.⁶

In addition to the gap between the guidelines and the more general climate and energy goals, there is a gap in policy coherence between State aid and the polluter pays principle. The polluter pays principle stems from the Treaties. It means that the polluter who causes pollution should bear the costs of dealing with the pollution. While the Commission acknowledges the polluter

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⁸ Mott, New state aid guidelines for renewable energy discourage competition, green energy and energy security, EEJ, Vol 5, Issue 2, pg 22.
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The pays principle is important for environmental State aid decisions, the Commission does not always give it full weight but rather allows many exemptions that erode the functioning of the principle. The most egregious example of this is perhaps the granting of free allowances from the Emissions Trading System to certain polluters who are said to be at risk of carbon leakage or where the power plant is said to be 'carbon capture and storage-ready'. There are questions over the compatibility of these exemptions from having to purchase allowances with State aid law. But more importantly the question of whether such granting of free allowances is compatible with the EU's efforts to fight climate change is seriously in question.

9 Certainty

As stated above, there are serious defects in policy consistency between State aid and climate and energy policy. This can lead to uncertainty for investors as where climate and energy policy of the EU is promoting renewables but the State aid guidelines restrict the ways in which Member States can support renewable energies, investors could understandably be left wondering where they stand. In addition to the policy concerns that reduce investor certainty, the procedure utilised for State aid does not promote investor certainty.

As stated above, all potential State aid (minus certain exceptions) is to be notified to the Commission. The notification stage is supposed to last only two months but this often is extended, adding to the existing lack of transparency in the notification stage, as discussed above. The extension of the notification period also adds uncertainty to the sector. An example of this uncertainty came when the UK notified potential aid to the Commission, which UK community energy groups heard about but could not get confirmation of that notification, due to the extension of the non-transparent notification period.

However, there are no absolute time limits to the period the Commission may take to investigate potential aid but it is expected to be concluded within two years. This is quite a long time period where new and innovative technologies are concerned. For example, Denmark applied for approval of a State aid scheme for photovoltaic and other renewable energy installations, including a strong community energy component. Denmark had the intention of commencing the scheme in 2013. However, the scheme was only approved in late 2014, therefore the scheme was only able to start operation in 2015, with a two year delay. The recent REFIT study of the renewables directive considered the issue of State aid approval time and noted that the average time frame of up to two years is a key concern hampering the deployment of renewable energy. Indeed, the Court of Auditors of the EU has identified the time taken for State aid decisions to be made as a severe hindrance to investment in many EU sectors.

Finally, while the 2030 climate and energy framework is already being discussed, the State aid guidelines only go to 2020 but there is no discussion yet of what will happen post-2020. This is too late for investors who have long time frames and need to know years in advance what will be

12 European Court of Auditors, Do the Commission’s Procedures Ensure Effective Management of State Aid Control?, Special Report No. 15 of 2011
allowed. Couple this with the two years it often takes for State aid to be approved, and investors are facing serious uncertainty over their ability to further the climate transition in Europe.

10 Conclusion

State aid could be a highly effective governance tool to direct the European energy transition. However, currently the exercise of jurisdiction over State aid by the Commission suffers from a number of defects in governance, the most glaring of which being a lack of transparency and policy inconsistency. Europe is at a critical time in driving forward the low-carbon economy, aligning and optimising State aid policy with wider climate and energy goals needs to be set as the Commission’s number one objective for State aid in the energy sector. This paper highlights a number of areas where that process must start.
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ClientEarth is funded by the generous support of philanthropic foundations and engaged individuals.