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BRX Update: State aid

Dear reader,
with our "BRX update: State aid" we like to inform you on current topics and principal issues in State aid law.

EU Commission: Exemption from grid fees is illegal state aid

Almost seven years after Sec. 19 para. 2 s. 2 of the Ordinance on Access Fees to Electricity Supply Networks (Stromnetzentgeltverordnung – StromNEV 2011) entered into force and about five years after the opening of the relevant state aid proceedings, the EU Commission decided on 28 May 2018 that the grid fee exemptions for the electricity-intensive industry in 2012 and 2013 violated European state aid law. The Federal Republic of Germany is now required to recover this illegal state aid. In this respect, the relieved companies should be obliged to pay the grid fees saved in the past.

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In August 2011, the fundamentally revised Sec. 19 para. 2 s. 2 StromNEV 2011 came into force. Accordingly, final consumers who achieved a number of so called usage hours (Benutzungsstunden) of at least 7,000 hours and an electricity consumption of more than ten gigawatt hours per year at a consumption point (Abnahmestelle) could apply to the responsible regulatory authority for a complete exemption from the grid fees. As of 1 January 2012, the grid operators' losses of revenue resulting from the exemption were allocated to all grid users via an allocation mechanism (so-called Sec. 19 levy). With regard to these provisions, the Commission opened a formal investigation procedure in March 2013.

Grid fee exemptions in accordance with Sec. 19 para. 2 s. 2 StromNEV 2011 for the years 2011 to 2013

In a so-called mixed decision, the Commission now finds that the exemption from grid fees in 2012 and 2013 violated EU state aid rules. The text of the Commission decision has not yet been published. However, the Commission argues that the exemptions qualify as state aid because the Federal Republic of Germany used the income from the Sec. 19 levy – and thus funds under its control – to compensate the network operators for their losses of revenue. A justification for such aid was not found. The positive effects associated with uniform consumption behaviour justified at best a corresponding reduction in grid fees.

Exemptions in 2012 and 2013 are inadmissible state aid

Exemptions in 2011 do not constitute state aid

However, grid fee exemptions from the year 2011 do not constitute state aid because the associated revenue losses were compensated via the so-called regulatory account (Regulierungskonto) and were thus not financed by the state but by the network operators (cf. EU Commission press release of 28 May 2018). In this respect, therefore, no reclaims are to be expected.

Reclaiming money from relieved companies

The German State is now obliged to reverse the illegal state aid granted in the years 2012 and 2013. Total amount of recoveries has not yet been determined. The EUR 300 million in question for 2012 appears to be the value set by the Federal Network Agency (BNetzA) for saved grid fees, to which the Commission already refers in its opening decision of 2013. However, as it is now reported that the reductions in grid fees introduced retroactively as of 1 January 2012 have also been approved, this amount is unlikely to be demanded in full according to our current understanding. The specific recovery amount applicable to the individual company will have to be determined individually.

What happens next?

The Commission's decision has direct legal effect on the Federal Republic of Germany, which is obliged to implement the decision. The Federal Republic of Germany may bring an action for annulment before the ECJ within two months. However, such a scenario currently seems unlikely. The Federal Ministry of Economics comments on the Commission's decision as follows:

"The Federal Government welcomes the fact that it has been possible to achieve the highest possible limit on the amount of recovery in favour of the companies concerned. Here, restrictions could be reached both in terms of time and the determination of the amount of the claim for repayment".

Legal remedies available to the undertakings concerned

It is questionable whether the companies concerned can also bring an action for annulment before the ECJ. In any event, potential applicants would have to prove that they are directly and individually affected by the Commission's decision.

Apart from that, every person concerned can defend himself against the individual recovery measures to be expected and

in particular against the respective amount of recovery. The appropriateness and prospects of success of such an approach should be examined on a case-by-case basis.

As soon as we have the text of the Commission's decision, we will analyse it in detail and inform you further.

State aid law as a „super competence“ – how the EU forms German energy law

German energy law has changed considerably in recent years. Numerous new regulations are based on the requirements of European state aid law. In this way, the EU has a considerable influence on the German energy policy. The question is to what extent this is compatible with the distribution of competences in the EU.

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Allocation of competences between EU and Member States

EU action in a policy area presupposes that it is given the appropriate powers in the European Treaties (principle of conferral). This applies in particular to the creation of binding legislation. Without such conferral, responsibility for the matter in question lies with the Member States. The competence of the Member States is therefore the rule and that of the EU the exception.

Competencies in the energy sector

As a "cross-sectional matter", energy policy is part of numerous EU policy areas (e.g. environment, research, industry, trade, etc.). Furthermore, Article 194 of the TFEU gives the EU explicit competence in the energy sector to pursue certain objectives. This is a shared competence, i.e. both the EU and the Member States can act in this area, but the latter only if and to the extent that the EU does not exercise its competence. The so-called principle of subsidiarity applies, according to which the EU may only take action if the Treaty objective pursued cannot be sufficiently achieved by the Member States and can be better promoted at EU level. This is the case, for example, with measures to create a functioning internal energy market (see the 3rd internal market package). On the other hand, the individual Member State can choose its own energy mix and, thus, may determine the extent to which renewable energies are promoted. In this respect, the EU's competence in the energy sector is limited.

EU energy policy through the back door?

In recent years, however, the EU has exerted considerable influence on German energy policy through the Commission.

Among other things, the focus was on the promotion of renewable energy or cogeneration plants as well as the various reliefs for the energy-intensive industry from energy taxes and levies (e.g. from the so-called EEG- and CHP-surcharge, with which the aforementioned subsidies are financed). In doing so, the EU Commission has not relied on the energy competence of Article 194 TFEU, but on European state aid law.

For example, the Commission considers that support payments to operators of renewable energy or cogeneration plants constitute state aid and, therefore, are to be treated in accordance with the rules of Articles 107 et seq. of the TFEU (although all payment flows take place between private market participants, so that the quality as "state resources" may be questioned). The same applies to all types of reliefs with regard to regulated and legally determined energy costs (e.g. grid fees, EEG- and CHP-surcharge, electricity and energy taxes). In particular, in its Environmental and Energy Aid Guidelines ("EEAG"), the Commission describes in detail how national rules should be designed to allow approval by the Commission under state aid rules.

Significant impact on German energy law

The ECJ has not yet finally decided on the classification of subsidies and reliefs under the German Renewable Energies Act (“EEG”) as state aid. However, in order to achieve greater legal certainty, the Federal Republic of Germany has comprehensively revised numerous legal regulations, adapted them to the abovementioned requirements of the EEAG and notified them to the Commission:

- The amount of support for renewable energy or cogeneration plants is now generally no longer determined by law, but by participation in so-called tendering procedures (*Ausschreibungsverfahren*).
- The German EEG support system has been opened to a limited extent for foreign plants.
- The conditions for the privileged so-called own generation (*Eigenversorgung*) were considerably tightened and the extent of the reliefs for own producers was significantly reduced (40 percent of the regular EEG-surcharge instead of a complete exemption).
- The conditions for limiting the EEG-surcharge for electrici-

ty- and trade-intensive industry under the so-called special equalisation scheme (*Besondere Ausgleichsregelung*) have been considerably tightened.
- The previously complete exemption from grid fees for network users with particularly extensive and uniform purchase behaviour was changed to a limit with a staggered maximum reduction. (Only recently, on 28 May 2018, the EU Commission finally decided that the complete exemption was contrary to state aid law and has to be reversed by Germany.)
- The relevant tax laws were amended recently and prohibit now explicitly, that electricity and energy tax privileges are granted to so-called companies in difficulties (in the view of the EU Commission, the same should probably also apply to all other payments and exemptions mentioned above).

As a result of these changes, some of the companies affected are exposed to considerable burdens, which in individual cases can jeopardize their existence. Against this background, the Commission's approach must be viewed critically. In particular, not every unequal treatment with regard to charges and levies can be qualified as state aid and, even more so, reliefs do not per se lead to distortions of competition in the European internal market. Moreover, the in parts very formalistic approach to so-called companies in difficulties, which are – in contrast to their competitors – no longer entitled to take advantage of reliefs and are thus driven further (or for the first time) into the crisis, also seems more than questionable.

Conclusion

Without a strong EU competence in state aid law, the single market would probably not work. It is therefore important and appropriate to give the EU this tool. However, state aid law also gives the EU great influence in policy areas where the Member States are actually responsible and can take sovereign decisions. The EU Commission should therefore use its sharp sword wisely and not unnecessarily restrict the Member States' right to shape its own energy policy. The limit of the "super-competence state aid law" is reached in the principle of proportionality at the latest.

Subsidising the UK Industry post Brexit

Following Brexit and the eventual transition period that is supposed to last until 31 December 2020, UK will not be bound by EU State aid rules anymore. The UK Government might consider appropriate to subsidise its industry in order to alleviate any negative effects deriving from Brexit. But what will be the applicable legal regime in such situation?

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Applicable legal regime during the implementation period

Apparently during the implementation period (most likely to last as of March 2019 until the end of 2020) the status-quo will not change much since "the UK will continue to apply the EU State aid rules and that the Commission would be responsible, as now, for approving and monitoring aid". Thus the status-quo and the enforcer do not change within this period.

Applicable legal regime and defence tools for EU Industry players in case of "hard" Brexit

If the "hard Brexit" scenario (i.e. UK leaving the EU without having agreed a free trade deal with the EU) occurs, UK will be bound by WTO rules on subsidies. At the same time, since the UK will not be part of the EU Club anymore, it will represent a third country and therefore its exports to the EU might undergo anti-subsidy probes and be subject to countervailing measures in case the investigation reveals that undue advantages were granted to the UK Industry undermining the EU Industry. Of course, any anti-subsidy probe will have to be carried out bearing in mind the fact that it could eventually be scrutinised under WTO anti-subsidy rules. Another aspect one should bear in mind is the fact that any subsidies that the UK Government might grant to its industry will only be scrutinised by the EU trade defence watchdog if such goods reach the EU market. The EU Industry could also make use in such scenarios of the WTO dispute settlement mechanism. However, one should bear in mind the fact that any EU company that sees itself affected as a result of the subsidies granted by the UK Government

will have to convince the EU to commence the dispute settlement proceedings. However, the EU is not very prone on initiating dispute settlement cases and usually seeks other ways to find a solution like informal negotiations which can be very lengthy.

Applicable legal regime and defence tools for EU Industry players in case the of "soft" Brexit

Recently, the UK Government has made public its intention of setting up a domestic State aid regime to be handled by the Competition and Markets Authority (CMA). In what concerns the substance, the envisaged UK State aid rules will mirror the provisions of those of the EU since according to Government sources "the EU State aid rules will be transposed under the European Union (Withdrawal) Bill". However, it is a long way to go since the functioning principles of the UK domestic State aid regime will have to be inserted in the leaving terms of the EU. The negotiations will yield probably a two-pronged hurdle: the fight for supremacy and/or competence between the EU and the UK and an internal competence issue. Therefore, it will be difficult for the UK to accept to make the newly created UK State aid system dependent on EU rules and their future interpretation post-implementation period. Furthermore, there will be a problem of competence and hierarchy between the UK Government and the CMA since the latter is meant to be an independent body ordering the former not to spend public money or not to give tax concessions.

State aid for the UK car-manufacturers post-Brexit?

The above topic is of the utmost importance since there were rumours that post-Brexit the UK car-manufacturers will receive subsidies to offset any tariffs they might have to pay as a result of the fact that UK will have left the bloc without securing a free-trade deal.

State aid: effect on inter-state trade

Not all subsidies that governments grant to enterprises fall under the prohibition of the Treaty (TFEU), as illegal aid. To be considered as State aid, which is incompatible with the common market, aid must fulfil five criteria: it must be finance from the State, which is selective, meaning it is not generally available; confer an advantage on the recipient; distort or threaten to distort competition and affect trade between Member States.

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Aid capable of affecting trade between Member States

The last criterion is often difficult to assess. To qualify as State aid, there is no requirement that trade is in fact affected. The possibility that a subsidy may affect trade is sufficient to meet this criterion. Aid, which is intended to support local services, may be caught because it strengthens the position of an enterprise, which competes with other entities in inter EU trade or creates barriers to entry for competitors to enter a local market. Where a market is open to competition from other Member States, the inter-state trade effect may be triggered.

Commission's assessment

The assessment that the Commission carries out in making this determination is unlike the analysis that it makes of the effect on trade criterion in antitrust law, where it must define a market and make an economic assessment. There is no minimum threshold or presumption of compatibility based on the amounts involved, the size of the recipient or whether an effect is appreciable or substantive in State aid law. The question is important not least because since the State aid modernisation reforms the Commission has shifted its focus to dealing *ex ante* with aid, which has a major impact on the common market and left it to Member States to deal with other less important aid.

Commission's guidance on the notion of aid

So what guidance do we have? Following the modernisation process, which involved a complete overhaul of most of the

State aid instruments, in 2016, the Commission adopted a notice on the notion of aid, which includes guidance on the issue of effect on trade. This provides that there must be some analysis of the foreseeable effects of a measure, which goes beyond the hypothetical. However the guidance falls short of defining what may be considered the effect on trade in any concrete way but provides examples of its recent practice in some sectors such as sport, cultural events, health care, ports and ski-lifts. In these cases it found that public support was unlikely to affect trade between Member States because the activities, which were supported, were unlikely to attract customers or investment from other Member States and that it could not be foreseen that a measure would have more than a marginal effect on the conditions of cross-border investments or establishment.

Conclusion

In conclusion, it would seem that however local the market, those giving and receiving *ad hoc* aid, which is not block exempted or *de minimis* and their advisors need to be careful to make a detailed assessment of the potential for an inter-state trade effect in every case.

The Commission Notice on the notion of State aid – an overview

As the final act of the "state aid modernisation" initiative launched in 2012, the European Commission published a *Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union (2016/C 262/01)* (hereinafter: Notice).

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The notice is intended to give guidance on what can be considered as illegal State aid under the Treaty rules. It reflects the case law of the European courts and the decision-making practice of the EU Commission. It helps national courts, granting authorities and entities, which are operating in the market to decide whether subsidies potentially amount to State aid, which may therefore need to be exempted for a pre-defined policy objective (e.g. protection of the environment). Illegal State aid exists and is prohibited if all of the five the criteria of Article 107 para. 1 TFEU are fulfilled. These criteria are:

Criteria of State aid

- Granting an advantage to undertakings engaged in an economic activity
- Financing by the State
- Limiting the aid to certain sectors, regions or undertakings (selectivity)
- Causing at least a potential distortion of competition and
- Affecting interstate trade

If these criteria are fulfilled, there is State aid. It may nevertheless be considered as compatible with the common market if it falls under an exception or can be exempted following notification or because it is in line with the General Block exemption regulation.

The approach, which involves first deciding whether all the constituent criteria for State aid are present, allows the lawyer to conclude that the granting of aid is legally permissible

without further examination of possible exemptions from the general principle that State aid is prohibited.

However, while the Notice contains helpful explanations on some aspects, it remains vague on others, making it difficult in some cases to make a legally sound assessment. This depends to some extent on whether or not case law exists on the individual concepts and their interpretation and assessment.

Granting an advantage to undertakings engaged in an economic activity

The first criterion focuses on the distinction between an economic and a non-economic activity. In addition to the general demarcation characteristics defined by the European courts, the notice gives detailed guidance on non-economic activities such as "social security", "health care", "education and research activities" and "culture and conservation of cultural heritage including nature conservation". These areas, which initially appear to be an exercise of public powers, can in some cases involve economic activity and therefore be subject to the rules. The position of such activities in markets varies considerably from one Member State to another.

The so-called Market Economy Operator Test (MEOT) also plays an important role. If the public authorities act on the market like a market investor, there is no aid present because there is no advantage.

Financing by the State

The EU Commission interprets the criterion of financing through state resources broadly, considering the origin of the resources used to be irrelevant and regards state control of the resources as decisive. In the current decision by the EU Commission of 28 May 2018 on the exemption of German companies from grid charges, the EU Commission held that the state exercises control over the income (exchanged between private companies) from the levy by regulating the mechanism by a legal act pursuant to § 19 StromNEV although the European Courts are tending to put a break on this expansive approach.

Limiting the aid to certain sectors, regions or undertakings (selectivity)

As far as selectivity is concerned, the EU Commission deals in detail with tax questions, in particular the possibility of tax amnesties, advance tax rulings and tax settlements. Selectivity must always be considered in the context of the granting

of an advantage, i.e. whether one or certain beneficiaries obtain an advantage, which would not be available more generally.

Causing at least a potential distortion of competition

In principle, any granting of a financial advantage to a company can distort competition. The EU Commission excludes distortion of competition only in very limited exceptional cases. Because State aid is not subject to economic analysis like other areas of competition law this criterion is not one which should be invoked if a lawyer is trying to exclude State aid.

Affecting interstate trade

The prerequisites to assume that barriers to trade between states are present are also low. In particular, even is the amount of aid is small or a small company receives aid, these circumstances do not preclude the presence of impermissible aid. Although cases of purely local impact do usually not impact interstate trade the proof required for only local impact can only be provided on the basis of numerous indications which make it a complex task to achieve legal certainty.

Financing of infrastructure

In the Notice, the EU Commission has dedicated a few pages to the topic of infrastructure financing. The increasing market liberalisation and privatisation of formerly exclusively state-financed infrastructure (airports, broadband, energy or research infrastructure) has led to a rethinking. State financing of infrastructure is still possible, but the private operator must pay a market price for its use.

Conclusion

Overall, the Notice provides a good overview of the case law of the European Courts and, in part, of the decision-making practice of the EU Commission. However, for an assessment of some criteria, the EU Commission would like to take the situation in the specific member state into account. This considerably increases the time and effort involved in arguing that case law of the European Courts are to be transferred to cases taking place in other Member States.

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