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State Aid and Environmental Protection and Energy

European Commission publishes its 2022 State aid Guidelines on Climate, Environmental Protection and Energy

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The Development

"Europe will need a considerable amount of sustainable investments to support its green transition. Although a significant share will come from the private sector, public support will play a role in ensuring that the green transition happens fast. The new Guidelines endorsed today will increase everything we do to decarbonise our society. Among others, they will facilitate investments by Member States, including in renewables, to accelerate the achievement of our Green Deal, in a cost-effective way. This is a major step to ensuring that our State aid rules play their full role in supporting the European Green Deal." (EVP Margrethe Vestager, 21 December 2021)

- On 21 December 2021, the European Commission (EC) published a Communication on the "Guidelines on State aid for climate, environmental protection and energy 2022" (CEEAG) that will replace the 2014 "Guidelines on State aid for Energy and Environmental Protection" (EEAG). "Climate" was added to the title of EEAG to underscore the increased focus on climate protection.

- The CEEAG reflects the new climate, environmental, and energy priorities of the Green Deal and the "Fit for 55" policy package to make EU's economy sustainable.

- The CEEAG sets out the conditions for EC approval of State aid granted by EU Member States.

Opportunity for Business

- Under the Green Deal, the EU has set the ambitious target of becoming carbon neutral by 2050, with a 50%-55% cut in emissions by 2030. The Green Deal will directly affect costs for many businesses that will need to invest in carbon-free production processes and prepare for more expensive sources of energy (e.g., renewables, hydrogen).

- The CEEAG will enter into force in January 2022 and will be the central State aid framework for environmental protection and energy projects for many years. It enlarges substantially the opportunities for business to receive subsidies linked to decarbonisation activities as well as other environmental goals.

The CEEAG and the GBER

- The CEEAG sets out the framework under which the EC assesses the compatibility of State aid granted by Member States to support projects for climate and environmental protection and energy generation adequacy in a way that is as cost-effective for taxpayers and as non-distortive of competition as possible.

- The General Block Exemption Regulation (GBER) complements these provisions by allowing Member States to grant aid for smaller and simpler projects without notifying the measure to the EC in advance, provided the aid meets certain criteria. The targeted revision of the GBER adopted by the EC on 23 July 2021, together with a further review expected in the first half of 2022, will complement the CEEAG by facilitating further the granting of State aid for the green transition without prior approval by the EC.

- The current EEAG and the GBER have been important tools for dealing with the sharp increase in EU governments' spending for environmental protection since 2014. The CEEAG and revised GBER will undoubtedbly be the same for the Green Deal's ambitious objectives.

Objectives and Scope of the Revision

- The CEEAG has a broader scope to include new areas and aid instruments, as well as to simplify and increase the rules' flexibility.
  - New or updated areas covered include aid for the prevention or reduction of pollution other than due to greenhouse gases (GHGs), aid for resource efficiency and circular economy, and aid for biodiversity and the remediation of environmental damage. A new single "decarbonisation" section covers the reduction or avoidance of GHG emissions and facilitating the assessment of measures supporting the decarbonisation of different sectors of the economy, including through investments in renewable energy, energy efficiency in production processes, and industrial decarbonisation.
  - Member States can support the Green Deal via a broad toolbox and many technologies.
    - Various aid instruments, including tax/levy reductions and carbon contracts for difference may be eligible — these contracts fix a "strike price": If the market price is below the strike price, the State pays the difference. If the market price is above the strike price, the company may have to pay the difference to the State.
    - In many areas, aid amounts can reach up to 100% of the funding gap to cover the full additional cost of a green investment over a less green alternative.
  - The rules on aid in the form of reductions for energy-intensive users from electricity levies, which finance many energy and environment policies, are updated; more types of levies but fewer eligible sectors are covered, and maximum reductions are changed.
  - Large green projects within already approved schemes no longer require individual notifications. Conversely, safeguards are introduced to ensure that the aid is effectively directed where it is necessary to improve climate and environmental protection is proportionate, and does not distort competition. These safeguards include, for example:
    - Prior public consultations on the main features of national support schemes.
    - Competitive bidding is used as the default mechanism for awarding contracts and setting the level of the aid amount. By exception, Member States may demonstrate that a higher aid amount is needed based on a detailed analysis of the funding gap, which is the highest aid limit.
    - A mandatory calculation of the environmental protection cost (i.e., the subsidy per tonne of emissions avoided, as compared to the counterfactual) is required for most categories of aid, to ensure that aid is targeted at projects that bring genuine decarbonisation benefits in a cost effective and pro-competitive manner.
- To ensure coherence with the relevant EU legislation, the CEEAG aims to phase out subsidies for new investments into the most polluting fossil fuels, and to a lesser extent natural gas. These are deemed unlikely to have positive environmental effects. The CEEAG now covers aid for the early closure of coal, peat, and oil shale power plants and mines to accelerate decarbonisation.
- The CEEAG also applies to sectors that are subject to specific rules on State aid (e.g., transport, coal), unless those specific rules provide otherwise. While the CEEAG applies to a broad range of activities, it does not apply to aid: (a) for the design and manufacture of environmentally-friendly products, (b) for research, development and innovation, (c) for the agriculture, forestry fishery and aquaculture sectors, and (d) for nuclear energy.

The 2022 CEEAG: Compatibility Assessment Criteria

Part 1: Assessment criteria applicable to all types of climate, energy, and environmental aid

- The CEEAG develops positive and negative criteria to determine the compatibility of aid measures with EU State aid law.

- The positive criteria relate to facilitating the development of the relevant economic activities and the positive effects for society.
  - Does the aid have positive effects for the society at large and, if applicable, does the aid contribute to specific EU climate, environmental, or energy policies? The Member State granting the aid needs to identify the positive contribution.
  - Does the aid have an incentive effect? The aid needs to bring about either a change in behaviour or an engagement in additional economic activities by the beneficiary that would not have occurred without the aid.
  - Is there a breach of any relevant provision of EU law? If so, the aid or its financing method breaches relevant EU law and will not be approved.

- The negative criteria concern the effect on competition and trade.
  - Is there a need for State intervention? The aid must address market failures that cannot be remedied by the market itself.
  - Is the aid appropriate? There must not be another policy or aid instrument that is less distortive of competition and trade that could achieve the same results.
  - Is the aid proportional, i.e., limited to the minimum necessary? The aid must not go beyond or above the net extra cost necessary to meet its objective. This detailed verification is not necessary for a competitive bidding processes or if maximum aid intensities are respected.
  - Is the aid transparent? The Member State must publish the full text of the approved aid measure and information on each individual aid award granted above €100,000.
  - Does the aid unduly affect competition and trade? The broader the range of the aid's potential beneficiaries, the more limited its distortive effect will be. In addition, the aid should not strengthen substantial market power, undermine market rewards to the most efficient producers, or merely affect trade or location choice without providing a net EU-wide benefit.

- As a final step, the EC will carry out a balancing test to verify that the positive effects outweigh the negative ones, e.g., that the "do no significant harm principle" is complied with.

- For certain aid schemes, the EC may limit the duration or require an *ex post* evaluation or individual notification of certain projects, e.g., those with large budgets (over €150 million per year or €750 million in total); those that contain novel characteristics; or those that may cause significant market, technology, or regulatory changes.

Part 2: Assessment criteria for specific types of climate, energy, and environmental aid

The CEEAG sets out assessment criteria (often very technical) for 13 specific types of aid in dedicated sections. A few highlights can be summarised as follows:

- **Decarbonisation aid**, i.e., aid for the reduction and removal of GHG emissions including through support for renewable energy and energy efficiency. The broad scope of this category now covers industrial decarbonisation, carbon capture use and storage (CCUS), renewables, combined heat and power (CHP), and biofuels.

  - All technologies and approaches are eligible to ensure the CEEAG is future proof. Aid can cover not only investment costs but also operating costs including for low/zero carbon industrial processes. Maximum aid ceilings are largely abolished, and aid can reach the full net additional costs of more eco-friendly investments and activities and take a variety of forms (e.g., contracts for difference or tax/levy reductions instead of grants). From July 2023, the aid per tonne of emissions avoided should be estimated and quantified.

  - Competitive bidding is the default mechanism for awarding aid and setting the level of aid. Bidding should be open to all competing activities, subject to justified exceptions (e.g., sector-specific emission targets, the particular situation of a technology or sector, or insufficient number of potential bidders). Bidding should be designed in such a way to ensure effective competition for the aid. This mechanism is introduced with the aim to drive down costs of decarbonisation technologies, as has been the case with renewables.

  - For transparency, flexibility, and stakeholder participation, a prior public consultation on the main aid features will be generally required from July 2023, subject to certain exceptions. Additional evidence will be required for the aid with limited beneficiaries.

  - Aid should not lead to lock-in or displace the cleaner technologies. The CEEAG aims to phase out aid to projects involving the most polluting fossil fuels (e.g., coal, lignite, oil, and diesel). Furthermore, the CEEAG allows for subsidies to gas provided they don’t produce lock-in effects. Therefore, there should be appropriate evidence or binding commitments demonstrating that the investments facilitate the transition from more polluting fuels andare compatible with the EU’s 2030 and 2050 climate targets,.

- **Other environmental aid**

  - Aid to undertakings to improve energy and environmental performance of buildings (renovated or newly built) that leads to reduced energy demand by at least a certain percentage. Unless there is a competitive process or exceptionally a funding gap analysis, aid intensity is capped at a certain percentage of the eligible costs, varying by type and timing of the aid, the size of reduction, and bonuses for SMEs and assisted regions.

  - Aid for investments into resource efficiency, and for transitioning to a circular economy including for reduction, replacement, reuse, or recycling of waste and raw materials; as well as aid for the prevention or the reduction of pollution other than from GHGs, e.g., to improve water and air quality beyond mandatory EU standards. Unless there is a competitive process or exceptionally a funding gap analysis, aid of these two types can reach 40% of eligible costs (plus bonuses for SMEs, assisted regions, or eco-innovation).

  - Aid for remediation of environmental damage, rehabilitation, and biodiversity that can reach up to 100% of eligible costs.

- Aid for clean mobility supporting (i) the acquisition, leasing, or retrofitting of clean vehicles and mobile service equipement for land, air, and maritime transport; and (ii) the creation, upgrade, or extension of recharging or refueling infrastructure and connected on-site electricity or hydrogen production or storage. Aid must generally be granted through competitive bidding, subject to certain exceptions.

  Diesel, petrol, and gas-fueled vehicles and refueling infrastructure are generally not covered, with certain exceptions such as:

  - LNG infrastructure exclusively for heavy-duty road vehicles until 2025
  - Carbon intensive hydrogen infrastructure, unless as part of a credible plan to achieve phasing out by 2035
  - CNG and LNG vehicles, equipment, or refueling infrastructure for waterborne transport if supported by relevant evidence
  - More environmentally friendly aircraft, since in contrast to other vehicles electric or hydrogen-powered aircraft will not be widely marketable in the short term

  - Reduction of taxes/levies in lieu of grants to enable environmentally friendly projects or activities for the above types of other environmental aid. The same limitations of aid amount apply, but without a requirement for a competitive bidding.
  - Reductions of harmonised and non-harmonised environmental taxes/levies to the most affected undertakings to enable the acceptance of a higher overall rate and thus a higher general level of enviromental protection by the tax/levy.
  - Aid for studies or consultancy service on matters relating to projects or activities covered by the CEEAG, to the extent this is not a continuous activity or part of the usual operating costs. Aid can reach up to 60% of cost plus SME bonuses.

- **Aid to the energy sector**

  - Aid for the security of electricity supply (e.g., capacity mechanisms, strategic reserves, demand-response, interconnection, or tackling network congestion). Rules are updated to reflect the amended sectoral legislation of the Electricity Regulation and the Electricity Directive and to codify the EC's decision-making practice of the past years. Aid is generally granted via competitive bidding. From July 2023 a public consultation is required on the measure's design, which may also combine an environmental objective, e.g., by promoting environmentally friendly technologies and/or excluding others.
  - Aid for construction, upgrade, or operation of energy infrastructure accessible to third parties now covers new and emerging categories (e.g., for digitalisation, "smartenting", and climate resilience). Aid can reach up to the full funding gap. To receive aid, natural gas infrastructure (e.g., LNG) should be ready to use hydrogen and increase the use of renewable gases. Alternatively, it must be demonstrated why that is not possible, that there is no lock-in effect, and that the project complies with the long-term 2030 and 2050 climate targets. Aid for fossil fuel infrastructure is not included in the scope of the CEEAG.
  - Aid for construction, upgrade, or operation of district heating and cooling generation, storage, or distribution introduces simplifications and now allows aid to cover the funding gap and to reach efficiency standards. Similar limitations and safeguards are introduced against lock-in or increased use of fossil fuel and gas in the aided heating networks.

  - Aid for closing coal, peat, or oil shale power plants and mines to compensate in full eligible costs resulting from early closure, i.e., foregone profits or exceptional social, environmental, and safety costs, so as to mitigate impacts on the electricty system and employment. A specific provision will allow the EU's poorest countries, which have no capacity mechanism in place, to replace by 2026 such activities with more eco-friendly generation including from gas as part of a credible long-term decarbonisation strategy.

- **Reductions for energy-intensive users** (EIUs) of electricity consumption levies to avoid relocation outside the EU where environmental disciplines are absent or less ambitious.

  - This section now covers not only levies funding renewables but also funding any energy or environmental policy, such as combined heat and power, social tariffs, and energy prices in isolated regions, and possibly also decarbonisation more broadly. It does not cover network charges, charges for capacity mechanisms, or levies on gas consumption.

  - Eligible sectors are included in the relevant list based on the statistical data on their openess to international trade and the "electro-intensity" of their economic activity. Sectors are classified as at "significant risk" or at "risk" of relocation outside the EU, with some conditions varying for each category. Compared to the previous guidelines, the current list reduced significantly the eligible sectors from 220 to 116, due to stricter trade-intensity and electro-intensity thresholds. However, this is more than double from the 50 sectors proposed in the EC's initial CEEAG draft, and the 10 sectors and 20 sub-sectors eligible for aid to prevent carbon-leakage under the ETS State aid guidelines.

  - In alignment to those ETS guidelines, the CEEAG introduces the same green conditionality and energy audit obligations linked to the levy reductions. In particular, beneficiaries will have to carry out energy audits, make investments in energy efficiency, invest in technologies to reduce their emissions, or decarbonise their electricity sources.

  - Beneficiaries still need to pay at least 15% of a levy or up to 0.5% of their Gross Value Added, but in any case no less than 0.5 €/MWh. To avoid a sudden increase of the levy burden, transitional plans allow for individual undertakings that were eligible for such levy reductions under the previous guidelines but are no longer eligible to gradually adjust and pay a progressively higher amount of the levies until 2028.

Key Takeaways

- The EC has considerably expanded the scope of the CEEAG to reflect the Green Deal objectives. To reach the GHG emission reduction targets, annual EU-wide investments of €350 billion will be required — such investments cannot be borne by private means alone, and so will require public support. The expanded CEEAG acknowledges this need, also in line with the green transition supported through EU funds and the COVID Recovery and Resilience Fund.

- The CEEAG takes a stricter line on fossil fuels. It aims to phase out subsidies into the most polluting fossil fuels (e.g., coal, lignite, oil) while allowing aid for an accelerated closure. Conversely, the CEEAG aims to discourage support for gas except under strict conditions and as a temporary solution compatible with the timeframe of the 2030 and 2050 climate targets. Accordingly, EU countries will have to demonstrate this compatibility, for instance through a "national decarbonisation plan" with binding targets or binding commitments by the aid beneficiary to implement technologies to capture, store, and reuse carbon emissions, or to timely close natural gas activities or replace them with cleaner alternatives such as renewable gases and hydrogen.

- To prevent competition distortions from the increased scope, new instruments, and amount of aid allowed, the CEEAG adds safeguards such as market-based instruments like competitive bidding and stakeholder participation through public consultations. This increased "proceduralization" for aid awards is supplemented with a detailed EC verification of eligible costs through an *ex ante* funding gap analysis on the basis of business plans, *ex post* claw-back mechanisms to avoid overcompensation, or *ex post monitoring* and evaluation plans. Accordingly, Member States, beneficiaries, their competitors, and other stakeholders can expect active engagement with the EC.

- Compared to the initial draft, the final CEEAG appears to have been subject to intensive input from industry and Member States and further refinement by the EC services. Changes include technical fixes, notable additions, carve-outs and major amendments, most notably on electricity levy reductions. These major amendments are of relevance for many sectors and will shape the financing base and possibilities for energy and environmental policies as well as the additional costs that EU businesses will have to bear for an ambitious green transition.

Next Steps: Timeline

January 2022: Entry into force of the CEEAG. The revised Guidelines will be formally adopted as soon as all linguistic versions are available. They will be applicable from that moment.

January 2024: Under the transitional provisions, Member States are required to align existing schemes to the CEEAG.

December 2027: Evaluation of the CEEAG by the EC (for effectiveness, efficiency, coherence, and added value).

Sources

EC press release announcing the publication of the CEEAG.

Text of the CEEAG.

Contacts

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