UNLOCKING EC GREEN STATE AID INVESTMENT

COMPARED WITH THE PREVIOUS ENVIRONMENTAL PROTECTION AND ENERGY AID GUIDELINES (EEAG) OF THE EUROPEAN COMMISSION, THERE ARE NOW MORE OPPORTUNITIES TO RECEIVE STATE AID FOR PROJECTS THAT ARE SEEN TO BE ADVANCING THE EU-WIDE GREEN DEAL OBJECTIVE BY GRAHAM VINTER, CHAIR OF THE COVINGTON GLOBAL PROJECT FINANCE TEAM AND CAROLE MACZKOVICS, OF COUNSEL IN THE FIRM'S EU STATE AID PRACTICE.

The new Climate, Environmental Protection & Energy Aid Guidelines (CEEAG), adopted by the European Commission on January 27 2022, open the list of projects eligible for state aid to new areas such as clean mobility and biodiversity, and to new technologies and market developments capable of delivering on the EU Green Deal objectives. The guidelines also allow higher aid amounts, which could cover the full funding gap of a project, and novel forms of aid, such as carbon contracts for difference.

Under European law, to prevent potential distortion of competition and trade within the EU, Member States are in principle prohibited from supporting companies financially, unless they demonstrate that their proposed support is compatible with the internal market. The CEEAG set out the criteria under which the commission will assess whether state support for climate, environmental protection and energy is compatible with the internal market and may be authorised.

The CEEAG replace the EEAG that were in force from 2014 to take account of the new EU Green Deal objectives. Although the previous EEAG generally delivered on supporting environmental and sustainable energy policy objectives, they were not suitable to address the new EU challenges of achieving its goals of a 55% reduction of net greenhouse gas emissions compared with 1990 levels by 2030, and carbon neutrality by 2050. Estimates to attain the new 2030 target point to the need for additional annual investment of €390bn compared with levels in 2011–2020, which would require both public and private investment.

Categories of aid

To address climate change, state aid measures may include support for the reduction and removal of greenhouse gas emissions, eg through carbon capture storage or use. State aid may support renewable energy, including the production of low carbon hydrogen, and energy efficiency, and support can also be granted for the improvement of the energy and environmental performance of buildings and for district heating and cooling, including highly-efficient cogeneration. Clean mobility could also benefit from state support, which would encourage the acquisition or leasing of clean vehicles used for air, road, rail, inland waterway and maritime transport, clean mobile service equipment, the retrofitting of vehicles, as well as the deployment of recharging or refueling infrastructure for clean vehicles.

State aid can also be given for environmental protection at large with support for resource efficiency and for the transition towards a circular economy. Support for the prevention or the reduction of pollution other than from greenhouse gases is also envisaged in the CEEAG. Furthermore, the CEEAG cover aid for the remediation of environmental damage, eg soil pollution, the rehabilitation of natural habitats and ecosystems, the protection or restoration of biodiversity and the implementation of nature-based solutions for climate change adaptation and mitigation. Also, reductions in taxes or para-fiscal levies may be approved to encourage companies to change or adapt their behaviour by engaging in more environmentally friendly activities.

Aid to the energy sector may cover support for the security of electricity supply, meaning not only the adequacy of generating capacity in a Member State, but also storage or demand response, interconnections and network congestion measures. Energy infrastructure may also receive state aid. The CEEAG furthermore cover potential reductions in electricity levies for energy-intensive users. Finally, support for the closure of power plants using coal, peat or oil shale and of mining operations relating to coal, peat or oil shale extraction may also be approved under the CEEAG.

Assessment criteria

When a Member State intends to grant state aid to an activity or a project relating to the climate or environmental protection or in the energy sector, it must in principle seek prior approval by the Commission. To have its intended state aid validated, the Member State must demonstrate that the state aid will facilitate the development of certain economic activities within the European Union without adversely affecting trading conditions to an extent contrary to what is termed "the common interest".

Substantively, the Member State will need to identify how the economic activity that would be facilitated by the intended state aid will support the green economy or how the proposed state aid will increase the sustainability of that activity.

The company that will benefit from the proposed state aid must be induced by the aid to change its behaviour and engage in more environmentally-friendly economic activity.

In addition, as a matter of law, the prospective aid must not be in breach of any relevant provision of EU law. Such a breach would exist for example, if it was proposed only to give the aid to persons buying domestically produced products.

The granting Member State must further establish the need for its intervention. It would do so if its intervention remedies market failures that prevent the achievement of a sufficient level of environmental protection or an efficient internal energy market. Examples of market failures related to environmental protection and energy would generally consist of "negative externalities" where the consequences of the behaviour of a company are not taken into account, for example, because the company does not bear the cost of the pollution it generates.

Other examples would include "positive externalities", where the benefits of a project also accrue to other companies than the investor entailing the risk of under-investment; asymmetric information, where external financial investors have a lack of information on the risks of a project; and coordination failures between various market participants.

The aid must not only be needed, it must also be appropriate in that the objective pursued could not be sufficiently achieved by alternative measures, eg the EU's emission trading scheme, or by adopting less distortive forms of state aid, eg repayable loans as opposed to direct grants.

The aid must be proportionate. That means that the commission will verify that the proposed state aid is limited to the minimum necessary, which will be the net extra cost (funding gap) needed to meet the relevant environmental or sustainable energy policy objective. Being able to cover the full funding gap is an important difference between the CEEAG and the previous EEAG.

The funding gap is calculated as the difference between the economic revenues and costs including of the investment and operation of the project if the proposed state aid were approved and granted, and those of the alternative situation in which the company receiving the aid would credibly finds itself in the absence of such aid. The counterfactual scenario is not limited to instances where the beneficiary would carry out a less environmentally-friendly project. It may also consist of the beneficiary not carrying out an activity or investment at all, or continuing its business without change.

The aid amount being determined through a competitive bidding process would generally constitute a reliable estimate of the minimum aid required by potential beneficiaries. In the absence of a competitive bidding process, the funding gap can be determined by comparing the profitability of the project in a scenario where it receives the aid with the profitability of a realistic, plausible counterfactual scenario without the aid. This implies quantifying for both scenarios all main costs and revenues and the estimated weighted average cost of capital (WACC) of the beneficiaries in order to discount future cashflows and calculate the net present values (NPVs) for the factual and counterfactual scenarios, in each case over the lifetime of the project.

The Member State's proposed support must finally avoid undue negative effects on competition and trade, taking into account any distortive effects on competitors that operate on a similar environmentally friendly basis.

The European Commission will weigh up the positive and negative effects of the proposed state aid, paying attention to the sustainability of the project and in particular to the requirement that it "does no significant harm" to environmental objectives. In this exercise, the commission would generally consider that direct or indirect support for fossil fuels is unlikely to create positive environmental effects and often has important negative effects. Therefore, support for natural gas would in principle not be authorised, unless it was demonstrated that there was no "lock-in" effect, ie the gas project must be part of a transition to a more environmentally friendly project, and not a permanent structural solution, such as, for example, gas infrastructure that would be hydrogen-ready.

The CEEAG recognise that natural gas may play a role in the energy transition, though under strict conditions. Support to other fossil fuels would only be authorised to ensure their phasing out. Nuclear energy projects remain outside the scope of the CEEAG, because they are often limited but very large projects, and therefore the commission will assess them on an ad hoc basis.

Conclusions

When considering a project for the protection of the climate or environment or in the energy sector, companies could seek support from public authorities to cover any funding gap. That might be feasible if such support results in the companies investing in cleaner technologies, thereby assisting in the achievement of the EU Green Deal objectives that could not be (sufficiently) achieved by alternative measures such as, for example, carbon pricing.

By allowing public authorities to bridge the full funding gap, the CEEAG enable projects that may be required to address climate change but that would not otherwise be carried out because of their higher costs compared with less environmentally friendly alternatives. The CEEAG therefore provide a potential solution for green projects that are faced with a shortfall of funds they can raise in the markets. As such, the CEEAG hold out the prospect of public support encouraging traditional project finance lenders themselves taking more risk with those types of projects. The CEEAG therefore appear to offer the potential for unlocking both public and private investment for the greening of the economy. To make the most out of the CEEAG, it would be advisable to examine the possibility of state aid being approved under the guidelines early on in the development of a project to ensure it can be properly structured. If this is done, sponsors should be able to determine whether and how their projects might be eligible for public support and to engage with EU Member States and private lenders to structure the funding of their projects accordingly. Early consideration of state aid issues should also enable companies to design projects in such a way as to increase their chances to obtain the commission's approval. ■