

## International Trade - United Kingdom

### Is the wind changing for state aid to the energy sector?

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Two legal challenges were recently brought before the EU General Court in relation to EDF Energy's Hinkley Point C project to build two new nuclear reactors on the north Somerset coast in the United Kingdom. These challenges – respectively, by Austria<sup>(1)</sup> and a group of utilities companies in Austria and Germany collectively known as Action Alliance<sup>(2)</sup> – contest the landmark £16 billion state subsidy granted to Hinkley Point by the UK government and, as such, may have wider implications for state support for the energy sector in the European Union.

#### Hinkley Point subsidy

The UK government will subsidise the Hinkley Point project under a so-called 'contract for difference' – a key part of the government's programme for the reform of the UK electricity market. Under a contract for difference, low-carbon electricity generators are paid the difference between a fixed strike price (a price for electricity reflecting the cost of investing in a particular low-carbon technology) and a market reference price (a measure of the average market price for electricity in the UK market) for the electricity that they produce for a fixed term (typically 15 years). Conversely, at times when the market reference price exceeds the strike price, the generator will be required to pay back the difference. Contracts for difference are intended to encourage investment in low-carbon energy projects by providing greater certainty and stability of revenues for electricity generators by reducing their exposure to volatile wholesale prices, while protecting consumers from paying for higher support costs when electricity prices are high. Under the contract for difference entered into by EDF and the UK government, EDF and its partners are guaranteed a price of £92.50 for each megawatt of power generated over 35 years – twice the current market price. In addition, the UK government has agreed to underwrite up to £10 billion of debt on the project.

EDF and the UK government hailed the Hinkley Point agreement as ushering in a new era of nuclear power in the United Kingdom, arguing that a generation of new nuclear power stations will follow Hinkley Point's example. In contrast, opponents of the project argued that the agreement amounted to illegal state aid in breach of EU law and characterised it as a bad deal for consumers, with all UK energy bill payers bound to pay levies when the market price is lower than the guaranteed strike price.

The proposed aid measures for Hinkley Point were the subject of an in-depth investigation by the European Commission under the EU state aid rules, which considered "whether the construction of a nuclear power station could not be achieved by market forces alone, without state intervention".<sup>(3)</sup> After many months of deliberation, the European Commission approved<sup>(4)</sup> the arrangements in modified form. In reaching its decision, the European Commission considered that the parties to the project had demonstrated that the subsidy would address a genuine market failure, and that the project could not have obtained alternative financing due to its nature and scale. Further, the UK government had made a number of modifications to the original proposals, including a £1 billion-plus reduction in the total subsidy from £17.6 billion to £16 billion, which – in the European Commission's view – minimised any distortive effects of the support measure.

However, the government now finds the European Commission's approval of its support package for Hinkley Point contested by two legal challenges.

#### Austrian challenge

On July 6 2015 Austria filed a challenge before the European courts arguing – in the words of Austrian Federal Chancellor Werner Faymann – that subsidies are intended to support "new and modern technologies that are in the general interest of all EU countries. In no way is this true of nuclear power!" More specifically, Faymann argued:

*"The state-guaranteed purchase price for a period of 35 years, Britain's state credit guarantee of up to £17 billion and the compensation in case of early closure of the plant all, in our view, contradict the requirements for a state aid approval."*<sup>(5)</sup>

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This challenge has been seen by some in the industry as a political assault on the use of nuclear power, since Austria pursues a strong anti-nuclear agenda and has no nuclear power stations of its own. Faymann stated that even if nuclear energy contributed to the United Kingdom's decarbonisation, the overall environmental impact of nuclear power plants is negative, because "the generation of nuclear power in preference to renewable energy sources is outside the terms of the Commission's environmental and energy aid guidelines".

The European Commission, however, insists that EU member states are free to choose their mix of energy sources. The UK Department of Energy and Climate Change has said that it is confident that the European Commission's state aid decision on Hinkley Point C is legally robust and it has no reason to believe that Austria will submit a challenge of any merit.<sup>(6)</sup>

### **Action Alliance challenge**

One week later, on July 15 2015, a second challenge followed by Greenpeace Energy and nine German and Austrian green energy suppliers. The group, known collectively as Action Alliance, alleges that there were "legal and procedural errors" in the European Commission's decision.

In addition, Action Alliance is concerned about potential increased competition from subsidised nuclear power across Europe. It alleges that the UK government's support for Hinkley Point will set a precedent for future nuclear projects, which could affect German electricity prices by up to 12% and "massively distort" competition. Action Alliance, it claims, would be "directly and individually affected" by the European Commission's decision to approve the aid measures for Hinkley Point and the consequential expansion of nuclear power in Europe, which would have a "clearly negative effect on the market value of wind and solar power in Germany".<sup>(7)</sup>

### **Interesting times**

These challenges come at an interesting time for discussions about state support to the UK and EU energy sectors.

In February 2015 27 low-carbon electricity generation projects in the wind, solar, energy from waste and advanced conversion technology sectors in the United Kingdom were selected to share £315 million's worth of contracts in the first auction of the new contract for difference subsidy regime. These included both onshore wind projects (eg, the 177-megawatt Dorenell Wind Farm in Scotland) and offshore wind farms (eg, ScottishPower's 714-megawatt offshore wind project EAOne, located in the North Sea off the coast of Suffolk).

However, the new UK Government announced in June 2015 that it intends to end new public subsidies for onshore wind farms one year earlier than originally planned by introducing primary legislation to close the Renewables Obligation scheme across the United Kingdom to new onshore wind generating stations from April 1 2016. The statement issued by the Department of Energy and Climate Change also signalled that the contract for difference scheme may be closed for all onshore renewable energy projects. The secretary of state for energy and climate change said that the move was designed to enable technologies to "stand on their own two feet" and "not encourage a reliance on public subsidies". The department is therefore "driving forward our commitment to end new onshore wind subsidies".<sup>(8)</sup>

This new approach by the UK government, together with the legal challenges to the Hinkley Point project, has caused a certain amount of uncertainty among those projects across the energy sector which are seeking to receive government support in future.

Moreover, the application of the state aid rules to the EU energy sector is kept under constant review. For instance, the European Commission is considering whether national measures taken by various EU member states to ensure that their electricity supply can match demand in the medium and long term (so-called 'capacity mechanisms') are in line with state aid rules. The European Commission launched its first-ever state aid sector inquiry in April 2015.<sup>(9)</sup> Commissioner Margrethe Vestager, in charge of competition policy, said that "[g]overnments have a legitimate interest to ensure that there is sufficient electricity supply – households and industry should not face black-outs". However, she also stated:

*"My role is to safeguard that public measures to underpin investment in electricity supplies do not unduly favour particular producers or technologies, or create obstacles to trade across national borders. For example, in some cases it might be more efficient to invest in improving electricity grid connections between EU countries than to build new power stations."*

The commissioner considered that the sector inquiry would send a clear signal to EU member states to respect EU state aid rules when implementing capacity mechanisms.

### **Comment**

The legal challenges to the European Commission's approval of the UK government's support package for Hinkley Point may – if they succeed – harden the European Commission's approach to such aid measures for energy projects by EU member states in future. It remains to be seen whether this will indeed be the case and it is likely to take some time for the outcome to become clear. However, it is hoped that the European Commission will not change its approach merely in order to avoid challenges by individual EU member states pursuing their own national, political or technological agendas. In the energy sector in particular, the European Commission should refrain from using state aid rules as a political tool.

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## Endnotes

- (1) Case T-356/15, *Austria v Commission*.
- (2) Case T-382/15, *Greenpeace Energy v Commission*.
- (3) European Commission Press Release IP/13/1277 (December 18 2013).
- (4) Case SA34947, *Support to Hinkley Point C Nuclear Power Station* (October 8 2014).
- (5) Statement by the federal chancellor of Austria (July 6 2015), available at [www.bundeskanzleramt.at/site/cob\\_\\_60017/6597/default.aspx](http://www.bundeskanzleramt.at/site/cob__60017/6597/default.aspx).
- (6) See [www.bbc.co.uk/news/uk-england-somerset-33312776](http://www.bbc.co.uk/news/uk-england-somerset-33312776).
- (7) Press release by Ökostrom AG (July 15 2015), available at <http://oekostrom.at/press/klage-eingereicht/>.
- (8) Press release by the Department of Energy and Climate Change (June 18 2015).
- (9) European Commission Press Release IP/15/4891 (April 29 2015).

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