

For some time, two dominant concepts have driven the energy policy in South Eastern Europe (SEE). From an international perspective, the region is often viewed as a convenient gas corridor, considered as part of several more or less developed projects with different and changing suppliers, capacities, strategic aims and transit countries involved. On the other hand, dreams of national energy independence and/or regional supremacy prompted the introduction of many large-scale and overly ambitious infrastructure projects, with short-term vision, dubious cost-effectiveness and lacklustre realisation. In contrast, renewable energy, which has been somewhat neglected in international and local considerations, offers different insight into the energy potential of the region.

As carbon resources dwindle, Southeastern Europe boasts plentiful sunshine, favourable wind conditions and abundant hydro potential. This makes a diversified and robust policy on renewables a tempting development choice, backed by many regional success stories. Albania, next to Iceland and Norway, is the third European country to rely almost exclusively on electricity produced from renewable sources. Romania hosts the largest onshore wind power plant in Europe. In 2012, Bulgaria led the world in new solar power capacity per capita, with Slovenia following closely behind in fifth place. Bridging the Danube at Derdap, Serbia and Romania jointly operate Europe's largest hydroelectric power station, and a wealth of mini-hydro plants are popping up across the region, most notably in FYROM. Generally, around the region, hydro-power has been recognised as an important asset that is steadily growing; wind is increasingly becoming more popular, geothermal energy represents an untapped resource, while the situation with biomass and solar energy varies from country to country. What is unquestionably clear is that the region offers significant capacity for a robust and sustainable renewable energy policy.

For almost a decade, the region has been integrated into the Energy Community, and harmonisation of national laws with the *acquis communautaire* on promoting renewable energy has been underway for some time now. This includes local implementation of legally binding targets for the consumption of energy from renewable sources. However, organised electricity marketplaces are still undeveloped throughout the region and governmental support for renewable energy represents a common feature. Support schemes are primarily implemented by awarding long-term power purchase contracts to renewable energy producers with regulated feed-in tariffs or feed-in premiums (typically adapted to cover the cost of generation, with a reasonable rate of return). Generation of electricity from renewables is in this way subsidised by public authorities across the region. Other support mechanisms used may include priority of dispatch (guaranteed off-take of a suppliers' entire production), exemptions from balancing obligations and, more rarely, preferential terms for

the lease of land or upgrade bonuses for facility retro fittings or major overhauls. Renewable energy producers are often categorised legally as privileged generators, shielded from the general marketplace for a certain term following start-up by enabling them to sell electricity to the designated market operator at the feed-in tariff. Usually, the cost of this scheme is, at least to an extent, borne by final consumers, by adding a special fee for the promotion of RES, based on consumption, to their electricity bill.

Other Rules into Play

Good intentions are not always sufficient and governments must take into account the greater picture when promoting renewables. In the case at hand, a sound energy policy has to take into account the rules on fair market competition and restrictions to state aid grants. Since renewables are still, to a large degree, dependant on support mechanisms, any schemes or individual aid disbursed must conform with the applicable legal framework on state aid. National state aid rules in the region are more or less a blueprint of the EU *acquis communautaire*. In the EU, member states are highly regulated in providing state aid to certain businesses. Certain types of state aid may lead to market fragmentation, distortions in free trade and cross-border competition (including inter-state “trade wars” or protectionism), and can result in cronyism and prevalence of special interests. Accordingly, the closer the country is to joining the EU, the more important strict and transparent rules on granting aid become.¹

Generally, state aid is defined as an advantage in any form conferred on a selective basis to companies by the national public authorities. Such advantages presuppose real or potential public expenditure or a reduction in public income used to afford the beneficiary with a more favourable market position, which distorts or threatens to distort competition. For a measure to qualify as state aid, it has to be: (i) granted from public resources (e.g. grants, guarantees, subsidies, beneficial loans, tax reliefs, providing goods and services on preferential terms etc.); (ii) offer a selective economic advantage (favouring specific companies, regions or industry sectors²); and (iii) distort or threaten to distort market competition³. As a rule, granting state aid is prohibited, with only a limited number of policy exceptions permitted. Within the EU, the European Commission is in charge of reviewing the compliance of such mechanisms. For countries on the path to accession, individual measures and schemes are relayed to national state aid control authorities, in line with strictly predefined rules. Fortunately, compatible measures may concern the broader interests of energy and environmental policy, and especially may include the promotion of renewable energy. Indeed, the European Commission has, as recently as 2014, adopted specific Guidelines on State Aid for Environmental Protection and Energy, covering the

2014-2020 period
(the “Guidelines”).

The rules on the granting of state aid seek to implement a policy that considers the promotion of renewable energy generation to be desirable, provided that state aid measures are designed so as not to threaten market competition. Likewise, local state aid control authorities are unlikely to take an overtly harsh stance against measures seeking to foster renewable energy generation, taking into account the importance of renewables for a modern energy and environmental policy. However, establishing national champions is as frowned upon in the renewables sector as in any other sector. In particular, state aid is considered compatible only if it is strictly necessary, proportionate, transparent, without undue negative effects on competition and trade, appropriate for the public interest objective (i.e. generation of energy from renewable sources) and with a well-defined incentive effect⁴. Any support mechanisms have to be well-considered and structured as objective, transparent and economically justifiable. Ad hoc, discriminatory or discretionary measures, even if nominally implemented for a good cause, can only bring problems in the future.

State Aid Aspects

According to the Guidelines, state aid granted for renewable energy generation can be handed out in two ways: as investment or operating aid. Investment aid relates to a state’s involvement in the construction of new facilities and operating aid relates to individual measures or schemes supporting the generation of electricity for a set term. Different support mechanisms for renewables previously noted across the region imply specific state aid aspects. By definition, feed-in tariffs or feed-in premiums represent governmentally-subsidised prices of a specific good; guaranteed prices are generally above the market price, and feed-in mechanisms therefore relieve the beneficiaries from competitive pressure and commercial risk. This naturally puts them in a better position compared to competitors. Priority of dispatch ensures guaranteed sales to the renewable energy generator, with a similar basic effect. Although there is an objective reason as to why balancing obligations are generally not suitable for renewable producers (production is much more dependent on weather conditions than for carbon or nuclear plants, making prediction of future generation difficult), relief from this obligation may represent another advantage granted to renewable producers. Most grid users are required to pay for such services, and the public authorities forego this revenue for a specific category of users.

Preferential terms for lease of land and upgrade bonuses may also favour renewable energy producers over other producers (or industries) as a form of investment aid.

The Guidelines foresee that by 2030, established renewable energy generators will become grid-competitive, implying that subsidies and exemptions from balancing responsibilities should be phased out in a digressive way. Therefore, transition to a cost-effective delivery is supposed to happen through market-based mechanisms, enabling market integration of renewable sources and direct sales of beneficiaries to the market. The European Commission expects that, as technology advances and facilities spread, with regional networks becoming more interconnected and energy markets more developed, governments should slowly withdraw from propping up renewable electricity generation.

Under the Guidelines, from 2016, operating aid can be granted: (i) as a premium in addition to the market price, where generators sell their electricity directly in the market; (ii) if the beneficiaries are subject to standard balancing obligations, unless no liquid intra-day markets exist; and (iii) if measures are put into place to ensure that generators have no incentive to generate electricity under negative prices. As of 2017, the European Commission further requires that aid is granted in a competitive bidding process, based on clear, transparent and non-discriminatory criteria (with certain exceptions allowed⁵). State aid schemes can only be granted for 10 years, with the possibility of subsequent re-evaluation. In addition, state aid can only be granted until a plant has fully depreciated and any investment aid must be deducted from operating aid. Finally, in assessing whether the aid is compatible, the European Commission generally looks at the relationship between the total levelised costs of producing electricity (including capital expenditure, operational expenditure and financing costs) and current market prices (with a reasonable rate of return⁶).

It is easy to spot certain difficulties in applying these standards of review to specific jurisdictions in the Balkans: undeveloped energy markets make it hard to estimate current market prices and terms, which affect the calculation of compatible aid. Additionally, since no intra-day markets exist, requiring renewable energy generators to be subject to balancing obligations would not make sense, so applying this precondition will likely require prior development of institutional capacity. As certain kinds of RES are brought online for the first time, greater flexibility could reasonably be expected from local state aid control authorities in countries which are not yet member states. However, taking into account the broader framework, the Energy Community and the necessity for harmonisation, the outlined principles and standards should generally be followed consistently in aid review across the region.

The Longest Way Round is the Nearest Way Home

What are the consequences of failure to notify state aid? In a worst case scenario, after an ex post review, the grants could be withdrawn and beneficiaries could be forced to return the state aid received. This can even occur many years after the aid was originally granted, in an altered market environment and with potentially disastrous consequences for operations. The outlined rules are consistently applied by the European Commission and local state aid control authorities are likely to adopt a similar approach even in jurisdictions that are not member states. If aid is notified to the European Commission or local state aid control authorities, they may require certain concessions or amendments prior to declaring the granted aid compatible with the legal framework.

After accession, the European Commission has exclusive jurisdiction over review of state aid measures in member states. However, findings by local state aid control authorities may simultaneously be reviewed in substance by the European Commission through different mechanisms. The European Commission may naturally review such decisions post-accession, but it may even raise objections prior to accession and the local authorities generally communicate and consider state aid grants with their EU counterpart⁷. This means that it is vital to ensure that any aid granted to renewable producers is compliant not only with the local rules, but with the *acquis communautaire* (and specifically, the Guidelines), even for countries which are not yet member states.

Renewable energy represents a field of great potential for the Balkans, affording countries which have for way too long been considered the European periphery with a chance to lead the way forward to a sustainable, clean and efficient energy policy. While promoting renewable energy generation represents an admirable goal, both governments and beneficiaries should also keep in mind other policy concerns, specifically the importance of free competition and the appropriate role of state aid in a market economy. On one hand, international obligations encourage states to increase their share of renewables; on the other, the very same rules prohibit them from dishing out excessive state aid. These are not conflicting goals, but two sides of the same coin. A wise support scheme should be formulated at the earliest stage to ensure compliance with state aid rules, so as to avoid any unwelcome surprises. Ad hoc and poorly thought-out measures, even if driven by good policy intentions, could cause significant headaches down the road. A well-developed renewables policy must take the big picture and the longer term into consideration, including the broader effects of state support.

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1 As an example, state aid, in particular in relation to shipyards, was a major issue in the final stages of the Croatian accession. Since the Energy Community mimics EU rules and procedures, the applicable treaties naturally also include rules on granting state aid for energy policy.

2 Therefore, subsidies granted to individuals or general measures affecting all companies are not covered by state aid restrictions (e.g. common taxes). State aid has to afford the beneficiary with a more favourable position, which it would not enjoy under normal market conditions (absent the aid). In the case of renewables, support mechanisms favour a specific industry sector, at the expense of the more traditional electricity generation methods.

3 An additional factor often required is for the measure to affect cross-border trade. Since electricity is a good which may be traded within the Energy Community, state aid granted to producers generally affects interstate trade and may distort competition since it improves the position of beneficiaries in relation to competing international undertakings.

4 “Incentive effect” means that the state aid influences the beneficiary to engage in an activity which it wouldn’t carry out or would carry out differently, absent the aid. The aid must not subsidise costs of an activity that the beneficiary would bear anyhow, nor compensate for normal business risk. According to the Guidelines, in relation to renewables, incentive effect is supposed to induce the beneficiary to increase the level of environmental protection or improve the functioning of a secure, affordable and sustainable energy market.

5 For instance, if only a very limited number of projects or sites could be eligible, or in order to avoid strategic bidding or underbidding, or limiting bidding to specific technologies (in some instances). If an open bidding process was carried out, the European Commission shall consider that the aid is proportionate and does not cause distortions of competition.

6 While estimating a reasonable rate of return can be difficult, it should normally be at least equal to the weighted average cost of capital (e.g. for Estonia, the European Commission accepted a weighted average cost of capital of 10%). In Slovenia, the European Commission cleared a scheme with an estimated internal rate of return of 12%.

7 This is another reason why it is important to notify the measures to the local state aid control authority – if previously reviewed, state aid can be deemed “existing aid” upon accession. Existing aid get more favourable treatment than “new aid” in relation to the European Commission’s power of subsequent review. For new aid in particular, the European Commission could order the measure to be abolished and aid recovered, which

was previously the case with power purchase agreements in Hungary and Poland. The Commission could require amendment, adjustment or abolition of existing aid, under more limited circumstances, but could not require its' recovery.

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