

ECJ Case on Cross-border Participation in Renewable Energy Support Schemes - Free at Last?

On 28 January 2014, the European Court of Justice's Advocate General (AG) Yves Bot delivered a strong opinion in favour of cross-border participation in support schemes for renewable energy generation. If followed by the Court, it would result in a fundamental paradigm shift in European renewable energy support, with great opportunities but also challenges. In this note, we explain the facts, the issues, the ruling and the implications for renewable energy trade and support in Europe.

The Facts

In C-573/12, a Swedish court referred legislative restrictions on foreign participation in the Swedish renewable energy support scheme. Because of the restrictions, a wind generator on the Finish Åland islands, Ålands Vindkraft, was not allowed to obtain Elcertifikates, the Swedish renewable energy certificate. The Åland islands' electricity network has only a connection with the Swedish electricity network. The electricity of the generator was sold into the Swedish electricity market, and consumed there.

The administrator of the Swedish Elcertifikat Scheme, Energimyndigheten, argued that the Renewable Energy Directive 2009/28/EC allowed such restrictions for support schemes and that the Elcertifikat Scheme was a support scheme. It also argued that because of the Directive, the restriction cannot be assessed against the free movement of goods of Art. 34 of the Treaty on the Functioning of the European Union (TFEU). Even if it did, such restriction would be justified on grounds of environmental protection.

The Issue, from a Different Perspective

The facts of the case go to the very heart of the logic, or not, of keeping support schemes confined to national generation. Is it justified, with an internal energy market and with free movement of goods, that the importing country restricts extra-territorial electricity generation from participating in a renewable energy support scheme? And is it justified even in a case where that electricity is solely sold to and consumed in the importing country's electricity market?

The central issue in all of it is the entitlement to benefits of renewable electricity generation. The quandary of what the economic benefits of renewable energy generation really are, who pays for them, and to whom they accrue. The intangible nature of electricity and the physicality of flow path against its contractual path often complicate the issue. The following, different perspective may help to demonstrate it.

Imagine your country, convinced of the health benefits of organic apples (an apple a day...), passes a law that obliges you to buy a quota of organic apples each month. To comply with the law, you must meet your quota with organic apples from growers in your own country. The quota is set in a way that there is always more demand for organic apples than supply, and organic apples trade at a constant premium.

Fruit logistics cause conventional and organic apples to be transported in the same box. They mix. In the end, a number of apples from this box get classified as organic. You pay for these apples the organic premium. But you can't say for certain that you eat organic apples. And whilst you are munching on them, you ask yourself: What is the benefit I am paying for? And why only national organic apples?

Because the apples get mixed, you are certainly not paying for the benefit of eating only organic apples. Rather, you seem to be paying for the benefit of apples being grown and consumed by the community (maybe by you, maybe by someone else). The quota obligation also helps the economy. It is great for apple

growers and producers of wooden boxes and ladders. The fruit logistics business flourishes. People invent nifty apple picking equipment which gets exported all over the world. And the environment benefits from all the new apple trees that get planted because of the quota.

The proponents of the scheme argue that restricting the scheme to national organic apples is required for environmental protection. They say that letting foreign organic apple growers participate in the scheme does not guarantee that you pay for and receive organic apples only. They claim it will lead to greater financial burden for national consumers. They also argue it does not allow them to control the types of organic apples grown nationally and that it will be misused by foreign growers with lower production costs.

But you are sceptical. Most reasons seem to be of commercial rather than environmental nature. Isn't environmental protection a trans-boundary issue? How is a tree located one kilometre this side of the border better for the environment than a tree located one kilometre on the other? And why does it increase financial burden on customers? If there is a set consumption quota (whatever its percentage), wouldn't a larger number of growers help to get to that quota faster and probably reduce prices for organic apples? And whilst you like local sourcing for its benefits to local economy, shouldn't that be a matter of choice?

The Ruling

The above cheek in tongue example characterises surprisingly well the issues addressed in AG Bot's opinion. The limited possibilities to justify trade restrictions in the internal market have led to remarkable legal acrobatics to cloak a wide array of concerns against cross-border support scheme participation under the environmental protection banner. This is how the AG opines on them:

Does the Renewable Energy Directive allow support scheme restrictions for foreign generation?

The AG finds the Elcertifikat Scheme to constitute a support scheme in the meaning of the Directive. In addition, the AG finds that the Directive does allow support scheme restrictions. Recital 25 refers to the Member States right to only provide support to national generation. He notes that flexible mechanisms (statistical transfers, joint projects and support schemes) are formulated as voluntary agreements. And that Guarantees of Origin (Goo) do not on their own create entitlement to participate in another support scheme.

Does the national restriction breach the principle of free movement of goods?

The AG concluded that to the extent the Directive allows national restrictions, it is to be declared invalid.

Applying Art. 34 TFEU where a Directive exists

If a Directive harmonises national legislation exhaustively, this restricts the application of TFEU's free movement of goods to the subject matter dealt with by that Directive. The Renewable Energy Directive however does not harmonise support schemes. Rather, it leaves Member States wide discretion to choose schemes. The AG therefore opines that the national restriction must be assessed under Art. 34 TFEU.

Environmental protection and other justification

Based on previous ECJ case law, electricity is a good. The Swedish national support scheme restriction is straightforwardly identified as a measure of equivalent effect to quantitative restrictions, thus breaching Art. 34 TFEU. The AG then examines the argument of environmental protection as a justification.

As in our organic apple example above, he points at the flaw in the environmental protection argument. If support for a national renewable energy generator meets the aim of environmental protection, why would a comparable generator not equally meet this aim, when the import and consumption of its electricity would reduce the use of national, conventional and potentially less environmentally friendly generation?

The AG examines all arguments advanced in favour of a national restriction to determine their merits (in some cases irrespective of their apparent lack of relevance for environmental protection), and finds them unconvincing. He observes in particular:

- the further progress in the liberalisation of the electricity market;
- the implementation of a functioning system of guarantees of origin;
- that cross-border participation is not conditional on intergovernmental agreements; and
- that Member States have adequate regulatory measures to intervene and adjust should the cross-border participation lead to undesired effects on fuel mix or level of support.

The first two observations directly address the reasons for which a temporary justification of restrictions was found by the ECJ in *PreussenElektra* (C-379/98). The AG refers to the recitals of the Electricity Directive 2009/72/EC and conclusions of the European Council of 2011 and 2012 that the completion of the Liberalisation of the electricity market is in its final stage of completion. He further notes, that even if an adequate evidentiary means is missing, this would be insufficient to justify a restriction.

The AG's answer to international agreements as a condition to cross-border trade is a little cryptic. He seems to deny it as a form of *venire contra factum proprium*. In other words, if a Member State does not make genuine efforts to conclude these agreements, it cannot claim that they need to be in place first. The AG substantiates this with assessments by the Commission that whilst cross-border participation could help reduce costs, Member States have mostly not made visible efforts in this area. Moreover, a condition of prior international agreements in a Directive would not suffice to limit the application of the TFEU.

Lastly, the AG examines overt and covert arguments best categorised as misuse or loss of control concerns:

- effects on the ability to determine the national renewable energy mix;
- effects on the ability to adjust support levels to national generation potential;
- concerns over 'unfair cherry picking' if a generator from a country with greater production potential and thus seemingly better economics picks a support scheme with higher levels of support made for lower production potential;
- concerns over a sudden and significant increase of electricity and a consequential oversupply of renewable electricity leading to price pressure on Elcertifikates (or causing more electricity to be purchased under schemes that do not operate with a quota); and
- concerns over a sudden increase in exports due to higher support levels in another Member State.

The AG does not find these sufficiently substantiated or essentially conflicting. He notes that given physical transmission constraints and existing off-take commitment, cross-border participation through import is unlikely to have sudden material impacts. Even then, there would appear to be adequate regulatory means to address them to achieve the desired mix of generation types. For instance, if a quota or target is reached further support for the respective type of generation could be stopped or lowered.

The export concern arises in connection with the targets set by Renewable Energy Directive. Here the AG could have explored further their relevance given the Renewable Energy Directive's allocation rule that unless agreed otherwise by Member States, generation is allocated to the country in which it is sited.

Time of invalidity

In principle, the parts of Directive found to be in breach of Art. 34 TFEU would be immediately invalid and may have retrospective effect. However, Art. 264 TFEU allows the Court to deviate for imperative reasons, notably legal certainty. The AG concludes that in light of the importance of a stable investment framework for renewable energy generation. He recommends that the invalidity of the provision should only take effect 2 years after the ruling, to allow the Directive to be adjusted.

The Implications

Before bottles get cracked open or alarm bells ring (depending on which side one takes), it is worth putting the opinion into context to better understand its implications.

Potential limitations of effect

This is an opinion not a ruling. It needs to be adopted by the Court to have any bearing. Usually the Court follows the opinions of its AGs. Interestingly, in *Preussenelektra* it did not.

If adopted, the ruling casts light on the issue for green certificate schemes. This is a smaller group of support schemes. This group loses with the impending switch in the United Kingdom from the Renewable Obligation Certificates to Feed-in Tariff Contracts for Differences one of its main proponents. Moreover, the ruling relates to obtaining a certificate in the target state based on physical trades, rather than exchanging or redeeming certificates of the origin state.

The Elcertifikat Scheme also does not constitute state aid. The implications of justifiable state aid were thus not considered. Some of the renewable energy support schemes are of state aid. The ECJ case law on the interrelation between free movement of goods and state aid is complex. Whilst in principle both seek to address trade barriers, the scope for justification in the area state aid is wider. In ECJ jurisprudence the application of the state aid rules does not rule out the application of the free movement of goods. However, in practice measures viewed as justifiable state aid are unlikely to be ruled incompatible with the free movement of goods. It is worth noting, however, that draft Guidelines on Environmental and Energy Aid for 2014-2020 at paragraph 118 provide that support schemes should be open to cross-border participation and Member States must duly substantiate the absence of cooperation mechanisms.

Nonetheless, even considering the above circumstances, AG Bot's reasoning is of such fundamental and generic nature that if adopted the ruling will be of relevance to all types of support schemes in Europe. It demonstrates with great clarity that a justification of support scheme restrictions to national generation on the grounds of environmental protection alone are without substance and logic.

Need to address the white elephants in the room

So what triggers Member States resistance to cross-border participation in support schemes? Apart of widespread pride of one's own support scheme and prejudice against another, there is a degree of fear about the unknown consequences of cross-border participation. As most fears this is not particularly rational as shown by the concurrent fear of too much export and too much import. But mostly, it stems from the commercial considerations demonstrated in our organic apple example. They have become the white elephants in the room and need to be addressed if trade is to progress.

Firstly, supporting the growing of organic apples, or the construction and operation of electricity generation from renewable sources for that matter, on own territory creates more jobs in one's own economy than importing the product. It is as simple and as important as that.

Secondly, the increasing financial burden on end consumers from support schemes is already a topic for heated debates. There is a fear that any additional support for foreign electricity is the proverbial stick that breaks the camel's back carrying the constituents support for renewable energy support schemes. The national border seems to foster a binary view of where the benefit of 'greenness of electricity' accrues irrespective of physical flow realities.

In fact, on closer inspection the prospects for cross-border participation for existing generation appear to be limited. For most of the smaller generation, the transaction costs of arranging the physical trade and meeting the legislative requirements there are simply too high. In contrast, larger generators have usually been financed and will have limited ability to change the project agreement basis of their financing.

What's next

If the Court adopts the ruling, the following amongst other things should be considered and progressed:

- Address the white elephants in the room: establish a dialogue between generators, traders and the Member States to dispel some of the myths and focus on real, demonstrable effects:
 - Establish the scope in which cross-border participation would be likely (e.g. considering long-term off-take commitments, grid access and interconnector limitations, and general transactional costs);
 - Understand justified net value differences (e.g. based on different renewable energy intensity, land costs, operating costs) in the level of support for the same type of generation in Member States;
 - Evaluate experience from present or previous cross-border schemes (e.g. the Norway-Sweden Elcertifikat Scheme, the UK Climate Change Levy and Levy Exemption Certificates, the recognition of Swiss electricity for exemption under the Italian Certificati Verdi support scheme, the abandoned cross-border support scheme in the Netherlands)
 - Reassess regulatory barriers to use Guarantees of Origin for cross-border redemption;
 - Consider the impact of priority rules on capacity allocation for renewable energy;
 - Adjust inter-TSO liability and allocation of costs in feed-in schemes to reflect that they may now also arise at interconnection points.
- Develop Art. 34 TFEU and state aid compliant safeguards that balance conflicting trade and economic interests and ensure fair and proportionate cross-border support scheme participation:
 - Apply a discount to imported electricity on the basis of justified net value differences;
 - Enable national consumers to pay for the aspirational value of regional generation
 - Limit cross-border participation to new or uncommitted existing installations and create stabilisation arrangements for existing projects that do not wish to trade;
 - Establish participation thresholds to focus on trade relevant installations whose cross-border support scheme participation makes a net contribution to lower support costs.
- Develop model intergovernmental agreements for cooperation mechanisms to regulate the issues identified above (including the allocation of the benefit of the generation and the statistical transfers, cooperation of national authorities, use of GoOs or other means as evidentiary tools in cross-border participation, application of safeguards, inter-TSO compensation mechanism);
- Incorporate the ruling in the Guidelines for Environmental and Energy (state) Aid; and
- Consider adequate changes to the Renewable Energy Directive.

As most issues are interrelated, an iterative process will be required to address and adjust obstacles and to create the basis for the cross-border support scheme participation required by the potential ruling. With a view to the on-going consultation on the Guidelines for Environmental and Energy (state) Aid and the number of issues to be addressed in the 2 year timeline, timely action is required.

After all, nobody would really accept an argument that only nationally produced organic apples benefit the environment. And this really should not be any different for other goods like electricity.

Questions or comments?

Andreas Gunst
Solicitor England and Wales
Partner, DLA Piper, Vienna & London
Mob. Vienna: 004367688881232 - Mob. London: 00447756968458 - Email: andreas.gunst@dlapiper.com