

# THE IMPACT OF THE EUROPEAN UNION LAW ON THE IMPLEMENTATION OF STATE AID MEASURES OR SCHEMES FOR SUPPORTING THE DEVELOPMENT OF NEW NUCLEAR POWER STATIONS IN THE EUROPEAN UNION

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## Abstract

Owing to the fact that, when compared with the construction of conventional power plants, the construction of new nuclear power stations is characterized by higher capital/sunk costs and the substantially longer time periods needed for their depreciation, the development of nuclear power plants is exposed to considerable levels of financing risks. Such financing risks could lead to a situation where the implementation of a new project would be dependent on state aid measures to ensure its successful development.

The aim of the author is to present a high-level description of the impact of certain aspects of European Union law on the feasibility of implementing such state aid measures with particular emphasis on the approach of the EU Commission and its substantiation expressed in the decisions related to the measures to be implemented in the case of the development of Paks II NPP in Hungary (two VVER units) (further referred to as the “Paks Project”) and Hinkley Point C NPP in the United Kingdom (two EPR units) (further referred to as “HPC”).

Although both investments are completely different in terms of the contractual structure of their implementation, from the point of view of EU law they have one crucial factor in common: involvement of state aid.

## Notified measures

### *The Paks Project*

Based on an inter-governmental agreement concluded on 14 January 2014 between the governments of the Russian Federation and Hungary on the implementation of the nuclear programme (hereinafter referred to in as the “IGA”) [1], the parties agreed to cooperate in the maintenance and development of the Paks NPP in Hungary, including the design, construction, commissioning and decommissioning of two new units. The new units were to replace the loss of capacity of the plant caused by the retirement of units 1-4. Each of the parties was to nominate a state-controlled organization, financially and technically capable of carrying out its obligations related to activities resulting from the cooperation provided for in the IGA.

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The detailed rules of cooperation between the parties were to be implemented in separate agreements (hereinafter referred to as the "Implementation Agreements"). The set of Implementation Agreements consists of:

- a) the engineering, procurement and construction contract for the construction of two new VVER 1200 units;
- b) the operation and maintenance contract, and
- c) the agreement on fuel supply and utilisation of spent fuel.

As regards financing, pursuant to the IGA the Russian party was to provide the Hungarian party with a State loan to finance the maintenance and development of the Paks Project under a separate agreement (hereinafter referred to as the "Financing IGA")[2], the conclusion of which was a prerequisite for the implementation of the IGA. The Financing IGA provides a revolving credit facility of EUR 10 billion (limited to the sole implementation of the Paks Project), to be used by Hungary to directly finance the investments related to the Paks Project. Apart from the revolving credit facility, Hungary was to provide an additional amount of up to EUR 2.5 billion from its own budget to finance the investment at the Paks Project.

## **HPC**

The notified measure consisted of [3]:

- a) a contract for difference;
- b) the state credit guarantee;
- c) the Secretary of State Agreement.

### *Contract for Difference*

The contract for difference (hereinafter referred to as the "CFD") aims to provide revenue support during the operation of HPC, the beneficiary of which was a company (hereinafter referred to as "NNBG"), which at the time of the European Commission issued its decision was fully controlled by EDF. The CFD is a private law agreement between NNBG and Low Carbons Contracts Company Ltd. (hereinafter referred to as "LCCC"), an entity funded through a statutory obligation imposed on all licensed electricity suppliers collectively. Under the CFD framework, NNBG is liable to the extent that the funds have been transferred to it by a licensed supplier or from the UK government. Each of the suppliers will be liable based on its share on the market, but all suppliers will be collectively liable for any obligations arising under the contract. If payment obligations are not complied with, the Secretary of State will designate a different counterparty to the CFD, collect payments from other suppliers, or pay producers directly.

Based on the CFD, NNBG is to receive an amount of revenues determined by the sum of the wholesale market price at which it sells electricity and a difference payment corresponding to the difference between a pre-determined strike price and the reference price observed in the previous reference period. The main aim of the CFD is to set out the rules based on which NNBG will earn relatively stable revenues, as when the reference price is lower than the strike price, LCCC will pay the difference between the strike price and the reference price, and when the reference price is higher than the strike price, NNBG will pay the difference to LCCC.

## *State Credit Guarantee*

In addition to the CFD, NNBG should also benefit from a state credit guarantee on the debt it issues. The state credit guarantee guarantees the timely payment of the principal and interest on qualifying debt, which could be as much as GBP 17 billion, and will be delivered by Infrastructure UK, a unit within the UK Treasury overseeing the administration of the UK Guarantees Scheme.

## *Secretary of State Agreement*

Under the CFD, NNBG's investors are entitled to compensation if the UK Government decides to shut down HPC on political grounds (i.e. not on health, safety, security, environmental, transport or safeguard concerns) – which would be funded through a supplier levy. In order to secure payment of the compensation, a separate agreement was to be concluded between the Secretary of State and the investors in NNBG, based on which, following a political shutdown, if LCCC was to default on compensatory payments to NNBG's investors, the Secretary of State would have to pay the compensation. The agreement does not provide for any other additional compensatory payments.

## **Treaty on functioning of the European Union and state aid**

Article 108 of the Treaty on Functioning of the European Union (hereinafter referred to as the “TFEU”) provides that the Commission keeps under constant review all systems of state aid existing in the Member States of the European Union. If the Commission finds that aid granted by a Member State or through state resources is not compatible with the European internal market having regard to Article 107 of the TFEU, it must decide that the Member State must abolish or alter such aid within a period of time determined by the Commission. The consequence of non-compliance with the decision of the Commission is that the Commission or any other interested Member State may refer the matter to the Court of Justice of the European Union.[4] [5]

Furthermore, any plan to grant or to alter state aid requires that the Commission be informed about it within a period of time enabling it the submission its comments. If the Commission considers that such a plan is not compatible with the internal market, it shall initiate procedures determining compatibility of the planned aid with the European Union laws. The Member State may not implement the notified measure until such a procedure has resulted in final decision of the Commission.

Pursuant to Article 107 of TFEU, “[s]ave as otherwise provided in the Treaties, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market.”.

Thus, a measure constitutes state aid if it fulfils all the four following conditions:

- a) it is funded by the State or through its resources;
- b) it distorts or threatens to distort competition in the internal market,
- c) it provides for a selective advantage for certain undertakings or economic activity, and
- d) it affects trade between Member States of the EU.

## ***Measure funded by the State***

*HPC*

In order to categorize an advantage as state aid, it must be granted through state resources directly or indirectly, i.e. the sums need not be permanently held by the State as such – it is sufficient that the entity receiving the advantage is under public control.

As regards the approach of the Commission related to the Secretary of State Agreement and the CFD and taking into consideration the fact that the former engages the liability of the public authority and the latter is due to the State, the advantages related thereto are imputable to the State. The same conclusion was drawn with respect to the state credit guarantee.

Therefore, the general conclusion of the Commission was that the package consisting of the CFD, the Secretary of State Agreement and state credit guarantee constituted state aid.

### *The Paks Project*

As regards implementation of the Paks Project, the financing was to be provided directly by the Hungarian State with State funds (20% from its own funds, 80% from the loan from the Russian Federation), therefore the Commission concluded that the measure adopted by the Hungarian State also constituted a transfer of State resources.

### **Existence of selective advantage**

#### *HPC*

The position of the UK was that as the notified measures do not entail an advantage for NNBG, they would meet the so-called “Altmark” criteria, i.e. the criteria specified by the Court of Justice as clarifying under what circumstances compensation provided by the public authority does not constitute State aid.

The „Altmark” criteria specified by the Court of Justice are as follows:

a) "(...) the recipient undertaking must actually have public service obligations to discharge, and the obligations must be clearly defined. (...);

b) (...) the parameters on the basis of which the compensation is calculated must be established in advance in an objective and transparent manner, to avoid it conferring an economic advantage which may favour the recipient undertaking over competing undertakings (...);

c) (...) the compensation cannot exceed what is necessary to cover all or part of the costs incurred in the discharge of public service obligations, taking into account the relevant receipts and a reasonable profit for discharging those obligations. Compliance with such a condition is essential to ensure that the recipient undertaking is not given any advantage which distorts or threatens to distort competition by strengthening that undertaking's competitive position;

d) (...) where the undertaking which is to discharge public service obligations, in a specific case, is not chosen pursuant to a public procurement procedure which would allow for the selection of the tenderer capable of providing those services at the least cost to the community, the level of compensation needed must be determined on the basis of an analysis of the costs which a typical undertaking, well run and adequately provided with means of transport so as to be able to meet the necessary public service requirements, would have incurred in discharging those obligations, taking into account the relevant receipts and a reasonable profit for discharging the obligations.”[6]

All the above criteria must be fulfilled; if even one of them is not fulfilled, then a measure constitutes State aid.

In the case of HPC it was crucial to determine whether the project could be qualified as a so-called Service of General Economic Interest (hereinafter referred to as an “SGEI”). According to the position of the UK, the service to be provided would constitute an SGEI as it would be aimed at ensuring that the investment in NPP was delivered within a specific time-frame.

As there is no legal definition of an SGEI, the Member States have a wide margin of discretion in defining a given service as an SGEI and in granting compensation to the relevant service provider. Such discretion is not unlimited as it is the role of the Commission to ascertain that the Member State did not commit a manifest error when applying a service as an SGEI (e.g. in the case of attaching a public service obligation to services that are already provided or can be provided by undertakings operating under normal market conditions). Consequently, after analysis the Commission decided that the first Altmark criterion was not met as ensuring the investment in NPP was to be delivered within a specified time-frame does not constitute an SGEI, and decided that the measure would provide NNBG with a selective advantage.

### *The Paks Project*

As the Hungarian authorized organization was to be the owner and operator of the NPP based on a resolution of the government, the Commission concluded that the measure was selective as it related to only one undertaking.

### ***Distortion of competition and effect on trade***

#### *HPC*

The Commission concluded that the CFD, the Secretary of State Agreement and the state credit guarantee can distort competition and influence trade between the Member States as their application may have an influence on the implementation of alternative investments and affect trade between Member States. Further concerns of the Commission related to reductions in wholesale market liquidity as well as distortion of the functioning of the downstream market.

### *The Paks Project*

In its decision regarding the Paks Project, the Commission stated that the notified measure would enable construction of a significant amount of capacity that could be the subject of private investments by other operators and with the application of other technologies, therefore the measure threatened to distort competition and had the potential to affect trade between Member States.

### **Economic advantage criterion in the case of the Paks Project**

In the case of the Paks Project, the Commission also adopted another methodology in order to assess whether State aid may be applied to implement the project.

The reasoning was as follows: under Article 345 of TFEU, the treaty in no way prejudices the rules of the Member States governing the system of ownership, so the competition rules do not discriminate against companies whether they are in public or private ownership. Consequently, as long as a measure satisfies the so-called “MEIP Test” (Market Economy Investor Test), then it is not considered State aid. As the Paks Project is financed by the Hungarian State, the Commission assessed whether the existence of an economic advantage could be excluded if the investment by the Hungarian State was a market-based investment. Although the MEIP has no direct legal basis in the TFEU, the MEIP principle and the MEIP test have been widely applied by the Commission and in the case law. The aim of the MEIP test is to determine whether the terms and conditions of an investment by a public authority in a project would also be acceptable for a private market investor operating under normal market conditions.[7]

Therefore, the Commission examined in detail whether the measure entailed an economic advantage for Paks as the NPPs were to be fully financed by the Hungarian State. The result of the assessment was positive – the Commission concluded that the measure would entail an economic advantage as the Paks Project would benefit fully from a new asset with an economic value and a private investor would not have invested in the project on the same terms and conditions.

Thus, in both cases, i.e. HPC and the Paks Project, the Commission found that the measures involved State aid.

### **Assessment of the state aid under Article 107 (3) TFEU and objective of common interest**

Pursuant to Article 107 (3) (c) TFEU, aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest, may be considered to be compatible with the internal market. According to the case-law, the Commission may declare State aid compatible with the internal market when the aid contributes to the attainment of an objective of common interest [8], is necessary for the attainment of this objective [9] and does not adversely affect trading conditions to an extent contrary to the common interest. [10]

Pursuant to Article 1 of the Euroatom Treaty [11], “it shall be the task of the Community to contribute to the standard of living in the Member States (...) by creating the conditions necessary for the speedy establishment and growth of nuclear industries”. Further, pursuant to Article 2 (c) of the Euroatom Treaty Member States must “facilitate investment and ensure, particularly venture on the part of undertakings, the establishment of the basic installation for the development of nuclear energy in the Community”, and pursuant to Article 40 “in order to stimulate action by persons and undertakings and to facilitate coordinated development of their investment in the nuclear field, the Commission shall periodically publish illustrative programmes indicating in particular nuclear energy production targets and all the types of investment required for their attainment.”

#### ***HPC***

Therefore, based on the above provision of the Euroatom Treaty, in the case of HPC, the Commission concluded that the aid measures aimed at promoting nuclear energy pursue an objective of common interest and contribute to the objectives of diversification and security of supply.

#### ***The Paks Project***

In the case of the Paks Project the Commission also concluded that the measure planned by the Hungarian authorities pursues the objective of promoting new nuclear investments as enshrined in the

Euroatom Treaty, and provided the following substantiation: “[...] the provisions of the Euratom Treaty were expressly confirmed by the Treaty of Lisbon [12] and therefore, the Euratom Treaty cannot be considered an outdated or antiquated Treaty without applicability. The parties to the Lisbon Treaty considered that it is necessary that the provisions of the Euratom Treaty continue to have full legal effect. The preamble of the Euratom Treaty recognises that the conditions necessary for the development of a powerful nuclear industry should be created.[...] the Commission concludes that the promotion of nuclear energy is a key objective of the Euratom Treaty, and therefore the Union. As set out in the preamble to the Euratom Treaty, the Commission is an institution of the Euratom Community and is obliged to ‘create the conditions necessary for the development of a powerful nuclear industry which will provide extensive energy resources’. This obligation should be taken into account in exercising its discretion to authorise State aid in accordance with Article 107(3)(c) and Article 108(2) TFEU.”

In the opinion of the author, the above substantiation is one of the most important ones with respect to the implementation of the new nuclear power plant projects in the EU as it clearly shows that development of the nuclear power industry and promotion of nuclear energy is a key legal objective of the European Union.

[1] Agreement between the Government of the Russian Federation and the Government of Hungary on cooperation on peaceful use of nuclear energy concluded on 14 January 2014 and ratified in Hungary by Act II of 2014 of the Hungarian Parliament (2014. évi II. törvény a Magyarország Kormánya és az Oroszországi Föderáció Kormánya közötti nukleáris energia békés célú felhasználása terén folytatandó együttműködésről szóló Egyezmény kihirdetéséről), <https://mkogy.jogtar.hu/jogszabaly?docid=a1400002.TV> (access on 17 August 2018, translated from Hungarian by google translator)

[2] Agreement between the Government of the Russian Federation and the Government of Hungary on the extension of a State loan to the Government of Hungary for financing the construction of a nuclear power plant in Hungary, concluded on 28 March 2014

[3] Commission Decision (EU) 2015/658 of 8 October 2014 on the aid measure SA.34947 (2013/C) (ex 2013/N) which the United Kingdom is planning to implement for support to the Hinkley Point C nuclear power station (notified under document C(2014) 7142), section 2.

[4] As regards HPC, please see the Commission decision to initiate the procedure relating to the implementation of competition policy – State aid SA.34947 (2013/C), O.J. C 69/60

[5] As regards the Paks Project, please see the Commission decision - State Aid S.A.38454 (2015/C) dated 23.11.2015 C(2015) 8227 final

[6] Case C-280/00, Altmark Trans GmbH and Regierungspräsidium Magdeburg v Nahverkehrsgesellschaft Altmark GmbH, par 87 to 93.

[7] For further reading please see: Karim, Md. Rezaul, The EU Market Economy Investor Principle: A Good Paradigm? (April 28, 2014). Available at SSRN: <https://ssrn.com/abstract=2498873> or <http://dx.doi.org/10.2139/ssrn.2498873>, (access: 15.09.2018)

[8] Case T-162/06 Kronoply v Commission [2009] ECR II-1

[9] Case T-187/99 Agrana Zucker und Stärke v Commission [2001] ECR II-1587; Case T-126/99 Graphischer Maschinenbau v Commission [2002] ECR II-2427; Case C-390/06 Nuova Agricast [2008] ECR I-2577

[10] Commission decision of 8 March 2011 on State aid measure C 24/09 (ex N 446/08) — State aid for energy-intensive businesses under the Green Electricity Act in Austria

[11] Treaty establishing the European Atomic Energy Community, Consolidated version, OJ 2012/C 327/1 <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A12012A/TXT> (access 15.09.2018)

[12] Treaty of Lisbon amending the Treaty on European Union and the Treaty establishing the European Community, signed at Lisbon, 13 December 2007, OJ 2007/C 306/01