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# Who Should Pay for Pollution?

The Relationship between the European Green Deal, State Aid for Environmental Protection,  
and the Polluter Pays Principle

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# Summary

The European Commission's guidelines on environmental protection and energy provide guidance for Member States to develop State aid schemes for certain environmental and energy measures. The Commission has proposed to broaden these guidelines in order to conform with the European Green Deal's goal of achieving climate neutrality by 2050. The European Green Deal Investment Plan also plans to mobilise at least one trillion EUR the next decade. State aid for environmental protection contradicts the polluter pays principle found in Article 191(2) TFEU. Adding further to this there is an obligation to integrate environmental protection requirements into the definition and implementation of the Union's policies and activities. This integration obligation includes the polluter pays principle which raises the question of how to justify the granting of State aid for environmental protection in light of the principle.

This thesis evaluates the current guidelines based on their effectiveness and their relevance based on current EU environmental objectives. As a result of this discussion, it is established that there is a need for State aid to contribute further, which raises the question of how the environmental considerations can be integrated into State aid policy. This is the second point of discussion that this thesis covers. This part of the thesis discusses the past relationship between the polluter pays principle and State aid for environmental protection and the apparent shift away from the focus on the principle. Finally, the thesis discusses how the current guidelines have room to be broadened to promote coherency with the European Green Deal objectives. This discussion also covers how the increase in scope can not only be consistent with the polluter pays principle but even support its integration.

The thesis concludes that there is room for State aid to further promote the objectives of the European Green Deal. This could be accomplished by granting aid consistent with the sustainable investment policies established in the Sustainable EU Investment Plan. There are two main methods for implementing the polluter pays principle found in the thesis. These are by levelling the playing-field in the internal market between undertakings with varying levels of pollution. The playing field can be levelled by either increasing the cost for technology or processes with negative externalities or by making environmentally friendlier alternatives more competitive. The thesis concludes that the most reasonable approach is to focus resources on promoting production or technology with fewer negative externalities in order to keep European industry competitive and preventing carbon leakage. As long as the State aid is granted on a limited basis with the goal of phasing out subsidies once negative externalities have been internalized, then the distortion of competition would be kept to a minimum and the market failure linked to negative externalities rectified.

# Sammanfattning

Europeiska Kommissionens riktlinjer för statligt stöd till miljöskydd och energi fungerar som rådgivande dokument till medlemsstater när de utvecklar statliga stödåtgärder för miljöskydd och energi. Kommissionen har lagt till förslag att utvidga riktlinjernas räckvidd för att implementera den europeiska gröna given som fastställer målet för Europa att bli klimatneutralt 2050. Investeringsplanen inom den gröna given planerar även att mobilisera en biljon euro det kommande årtiondet. Statliga stödåtgärder för miljöskydd står i strid med förorenaren betalar principen funnen i artikel 191(2) FEUF. Artikel 11 FEUF innebär även att där finns ett krav att i alla av Unionens aktiviteter och riktlinjer integrera miljöskydds krav. Principen om att förorenaren ska betala är en utav dessa principer som ska integreras i riktlinjer vilket väcker frågan om hur statligt stöd för miljöskydd kan rättfärdigas.

Uppsatsen utreder nuvarande riktlinjer baserat på deras effektivitet och relevans i ljuset av nuvarande miljömål för EU. Denna diskussion fastställer att de nuvarande instrumenten inte är tillräckliga baserade på nyligen ökade ambitioner för miljöskydd. Av detta följer en diskussion om hur statliga stödåtgärder kan bidra till miljöskydd. Denna diskussion behandlar hur förhållandet mellan principen om att förorenaren ska betala och statliga stödåtgärder för miljöskydd har hanterats förr och hur det verkar som att fokus skiftar i väg från principen. Slutligen diskuteras i vilket mån de nuvarande riktlinjerna har utrymme för att vidgas i enlighet med den gröna given. Denna diskussion avslutas genom att behandla frågan om hur detta stämmer överens med principen om att förorenaren ska betala.

Uppsatsen kommer fram till att det finns utrymme för förbättring och bidrar med förslag. Förbättring skulle kunna ske genom att statligt stöd enhetligt med den gröna givens investeringsplan ses som förenligt med den inre marknaden. Uppsatsen genom tolkningen av principen om att förorenaren ska betala finner två sätt att implementera den. Genom att främja en jämn spelplan för produktionssätt och teknologi med varierande mängder utsläpp på den inre marknaden implementeras principen. Spelplanen kan jämnas antingen genom att göra utsläppen dyrare eller göra teknologi och produktion med mindre eller utan utsläpp billigare. Uppsatsen kommer till slutsatsen att det bättre alternativet är att främja utvecklingen av miljövänligare alternativ. Detta för att förhindra att utsläppen flyttar utanför EU och att EU:s industri förblir konkurrenskraftig. Eventuellt när klimatneutralitet nås kommer marknadsmisslyckanden åtgärdas och statligt stöd kommer inte behövas. På dettas sätt kommer principen att förorenaren ska betala implementeras till fullo utan stora samhälleliga konsekvenser.

# Abbreviations

CJEU	Court of Justice of the European Union
EAG	Guidelines on State aid for environmental protection
EEAG	Guidelines on State aid for environmental protection and energy
ETS	Emissions Trading Scheme
GBER	General Block Exemption Regulation
REDII	2018 Renewable Energy Directive
TFEU	Treaty on the Functioning of the European Union

# Introduction

## 1.1 State aid

Article 107(1) of the Treaty on the Functioning of the European Union (TFEU) sets out a general prohibition that 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 deemed incompatible with the internal market. This general prohibition in 107(1) is accompanied by exceptions of aid that is deemed compatible in 107(2) and 107(3). Article 107(2) contains exceptions that shall be deemed compatible if the aid falls under one of those categories, meaning the exemptions are mandatory.<sup>1</sup> Article 107(3) is however where the majority of cases are assessed, and it contains aid measures that may be deemed compatible by the Commission if it fits certain categories.<sup>2</sup> The aid measures set out in 107(3) include aid to promote economic development of areas where the standard of living is abnormally low or where there is serious underemployment. Aid to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of a Member State. 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. Aid to promote culture and heritage conservation where such aid does not affect trading conditions and competition in the Union to an extent that is contrary to the common interest and such other categories of aid as may be specified by decision of the Council on a proposal from the Commission.

Through interpretation of the Court's case law on what measures qualify as State aid a few conditions have been identified.<sup>3</sup> There must be aid in the sense of an economic advantage, this advantage is granted directly or indirectly through State resources and is imputable to the State, the measure must be selective, meaning it favours certain undertakings or production of certain goods, and the measure must be liable to distort competition and affect trade between Member States.<sup>4</sup>

Undertakings have been defined by the Court of Justice of the European Union (CJEU) as entities engaged in an economic activity, regardless of their legal status and the way in which they are financed.<sup>5</sup> Any economic

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<sup>1</sup> European Union Law of State Aid Kelyn Bacon at 1.27

<sup>2</sup> Ibid

<sup>3</sup> Ibid at 2.02

<sup>4</sup> Ibid

<sup>5</sup> Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union (2016/C 262/01) recital 7

benefit the undertaking would not have obtained under normal market conditions is an advantage within the meaning of Article 107(1) TFEU.<sup>6</sup> Furthermore, only the effect of the measure is relevant meaning the cause or objective of the State intervention is irrelevant, if the financial situation is improved as a result of a State intervention on terms differing from normal market conditions, an advantage is present.<sup>7</sup>

The advantage further has to be granted directly or indirectly through State resources and it must be imputable to the State. State resources include all resources of the public sector.<sup>8</sup>

The selectivity criterion means that the advantage is only available to some undertakings and not to others in comparable situations.<sup>9</sup> Through case law the CJEU has found that even if a measure grants an advantage onto a recipient, it does not fulfil the condition of selectivity if it is justified by the nature or general scheme of the system of which it is part.<sup>10</sup> The case *British Aggregates* give some guidance as to how the selectivity criterion is applied in practice.<sup>11</sup> In this case the CJEU stated that, selectivity was dependent on whether operators in comparable situations in the light of the objective being pursued might receive a selective advantage.<sup>12</sup>

The final criterion for a measure to be qualified as State aid is that the measure distorts or threatens to distort competition, and only insofar as it affects trade between Member States.<sup>13</sup> A measure is considered to be liable to distort competition if it improves the competitive position of the aid beneficiary. The existence of competitors is irrelevant as long as there is potential for competition.<sup>14</sup> Competition is liable to be distorted even if the aid simply allows the aid beneficiary to maintain a stronger competitive position than it would without the aid.<sup>15</sup> Aid has the potential to affect trade between Member States even in cases where the aid beneficiary is not engaged in intra-EU trade by simply reducing the chances of other Member States exporting their products to that Member State.<sup>16</sup>

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<sup>6</sup> Ibid (66)

<sup>7</sup> Ibid (67)

<sup>8</sup> Ibid (48)

<sup>9</sup> Nowag, Julian. *Environmental Integration in Competition and Free-Movement Laws*. Oxford University Press, 2017, at p. 100

<sup>10</sup> Ibid at p. 101 and Case C.143/99 *Adria-Wien* [2001] ECR I-8365, para 42

<sup>11</sup> Case-487/06 P *British Aggregates v Commission* [2008] ECR I-10515

<sup>12</sup> Ibid, para 87 and Supra note 9, at p. 102

<sup>13</sup> Supra note 5, para 185

<sup>14</sup> Ibid para 187

<sup>15</sup> Ibid para 189

<sup>16</sup> Supra note 1, at p. 86



### 1.1.1 Commission guidelines

As mentioned above the Commission may consider certain types of aid compatible on the basis of Article 107(3) of the TFEU. Article 107(3)(c) specifically mentions that the Commission may consider aid that facilitates the development of certain economic activities or of certain economic areas, where such aid does not affect trading conditions to an extent contrary to the common interest. The Commission identified a number of environmental and energy measures that could be considered compatible according to Article 107(3)(c) in the Guidelines on State Aid for environmental protection and energy (EEAG).<sup>17</sup> The guidelines were drafted in the light of the goal of reducing greenhouse gas emissions by 20 %, raising the share of renewable energy consumption to 20 %, and a goal of improving energy efficiency by 20 %, all this compared to the 1990 levels and was a part of the Europe 2020 Strategy.<sup>18</sup> With the Europe 2020 strategy as a backdrop and the proposed 40 % reduction in greenhouse gas emissions, 27 % share of renewable energy and other ambitious climate goals by 2030.<sup>19</sup> The purpose of the guidelines were to assist Member States design aid measures that would help reach these targets and provide sustainable and secure energy, while ensuring that the measures were cost-effective for society by limiting distortion of competition and maintaining the integrity of the Single Market.<sup>20</sup>

When it comes to the practical application of these guidelines, the Commission will not only take into account primary and secondary EU State aid law, but also their guidelines which are binding upon the Commission.<sup>21</sup> The purpose of the guidelines is to inform the criteria that the Commission will apply when assessing compatibility.<sup>22</sup> These guidelines are not legislative documents and cannot be regarded as rule of law, they are however seen as ‘rules of conduct’ for the European Commission.<sup>23</sup> If the Commission were to stray from the guidelines in their assessment of aid compatibility they would risk breaching general principles of law such as legal certainty, equal treatment or the protection of legitimate expectations.<sup>24</sup> Furthermore, these guidelines may never contradict Treaty rules or secondary legislation as this would be beyond the competence of

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<sup>17</sup> EEAG para 18

<sup>18</sup> European Commission, 2010. Europe 2020: A Strategy for smart, sustainable, and inclusive growth. COM(2010) 2020 Final of 3.3.2020

<sup>19</sup> Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions – A policy framework for climate and energy in the period from 2020 to 2030 (COM(2014) 15 Final) of 22.1.2014

<sup>20</sup> Commission, ‘Environmental and Energy State aid Guidelines – Frequently asked questions’ (MEMO/08/31) at p. 1

<sup>21</sup> Catherine Banet, ‘Legal Status and Legal Effects of the Commission’s State Aid Guidelines: The Case of the Guidelines on State Aid for Environmental Protection and Energy (EEAG) (2014-2020)’ (2020) 2020 Eur St Aid LQ 172 at p. 4

<sup>22</sup> Ibid

<sup>23</sup> Ibid at p. 5

<sup>24</sup> Ibid

the Commission.<sup>25</sup> The guidelines do however have quite a substantial indirect legal effect on the Member States, due to the fact that the Commissions decisions have direct legal effects on Member States and undertakings and the Commission is bound by the guidelines.<sup>26</sup> As a consequence of this Member States must take these guidelines into account when designing aid schemes in order to avoid a negative decision as well as avoiding recovery of illegal State aid.<sup>27</sup>

In order to ensure that an aid measure leads to an increase in environmental protection or energy objectives without adversely affecting trading conditions to an extent contrary to the common interest the Commission established Common Assessment Principles.<sup>28</sup> In order for a State aid measure to be compatible it had to contribute to a well-defined objective of common interest. There had to be a need for State intervention, for example the existence a well-defined market failure. Furthermore, the proposed aid measure would have to be an appropriate policy instrument to address the objective of common interest. In order to ensure that the aid measure is necessary there had to be an incentive effect, meaning that the aid would change the behaviour of the undertaking in a way that would lead to said objective getting accomplished. The aid had to be proportional, meaning that the aid is limited to the minimum needed to achieve the objective. The negative effect on competition had to be outweighed by the positive effect for achieving the objective. Finally, the aid would have to be transparent, meaning Member States, the Commission, economic operators, and the public should have easy access to all relevant acts about the aid.<sup>29</sup>

## 1.1.2 Why State aid control is needed

Competition policy rests upon the idea that a market-based economy provides the best guarantees for raising living conditions in the EU to the benefit of citizens. A functioning market is one of the primary objectives of the EU Treaty and is essential to enhance the competitiveness of the European economy.<sup>30</sup> State aid control is needed to maintain a level playing field for all of the undertakings active in the Single European Market, regardless of which Member State they are established in.<sup>31</sup> Unwarranted selective advantages preventing market forces from rewarding competitive firms decrease the competitiveness of the European market, create market barriers, and eventually lead to higher prices for consumers, lower quality goods and less innovation.<sup>32</sup> Another function of State aid control was to avoid subsidy races between Member States, meaning when a country

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<sup>25</sup> Ibid at p. 6

<sup>26</sup> Ibid at p. 9

<sup>27</sup> Ibid at p 3

<sup>28</sup> EEAG para 26

<sup>29</sup> EEAG para 27

<sup>30</sup> Commission, 'State Aid Action Plan Less and better targeted state aid: a roadmap for state aid reform 2005-2009' (Consultation document) COM(2005) 107 final para 6

<sup>31</sup> Ibid para 7

<sup>32</sup> Ibid

subsidises a national producer active in the internal market, other Member States could respond by subsidising their own producers. These subsidy races have the potential of undermining the functioning of the internal market.<sup>33</sup> State aid can however, as mentioned above, have an overall positive impact despite distortions of competition. By correcting market failures and contributing to achieving objectives of common interest the overall balance of the aid measure could be positive. This can also be the case when the aid measures promote social and regional cohesion, sustainable development, and cultural diversity, without the presence of a market failure.<sup>34</sup> It is however crucial to recognize that State aid does not come for free and is not a miracle solution that can instantly cure all problems.<sup>35</sup> The costs for State aid are covered by tax payers and State resources are limited and should be used for essential purposes. Adding onto this, State aid for combating pollution can be seen as compatible under the EEAG. Providing State aid for a measure to combat or mitigate pollution means that tax payers end up financing the measure, that should according to Article 191(2) TFEU be covered by the polluter. The situation is, however, complicated, and regardless of method the costs of pollution would most likely end up being financed by tax payers in either case.<sup>36</sup> While State aid can be a useful effective tool in contributing to common interest objectives it is essential to control it in a way that keeps the internal market competitive. State aid without control has the possibility of doing more harm than good by preventing the market from rewarding the most efficient and innovative producers. This could lead to a situation where, in the case of environmental and energy aid, cleaner technologies and more efficient or innovative competitors are unable to enter the market.<sup>37</sup>

### 1.1.3 Revision of the EEAG

The EEAG that entered into force in 2014 together with the relevant provisions of the General Block Exemption Regulation (GBER) have been extended until 31 December 2021 and are currently under revision.<sup>38</sup> The reason for the revision is based on the result of the “fitness check” to ensure that the framework was fit for purpose. In regard to the EEAG and relevant

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<sup>33</sup> Supra note 1, at p. 5

<sup>34</sup> Supra note 30 para 10

<sup>35</sup> Ibid para 8

<sup>36</sup> See chapter 4.3 below

<sup>37</sup> EEAG para 91

<sup>38</sup> Communication from the Commission concerning the prolongation and the amendments of the Guidelines on Regional State Aid for 2014-2020, Guidelines on State Aid to Promote Risk Finance Investments, Guidelines on State Aid for Environmental Protection and Energy 2014-2020, Guidelines on State aid for rescuing and restructuring non-financial undertakings in difficulty, Communication on the Criteria for the Analysis of the Compatibility with the Internal Market of State Aid to Promote the Execution of Important Projects of Common European Interest, Communication from the Commission – Framework for State aid for research and development and innovation and Communication from the Commission to the Member States on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to short-term export-credit insurance 2020/C 224/02

GBER provisions the fitness check showed that the framework had thus far facilitated a more effective and less distortive employment of State resources to improve environmental protection.<sup>39</sup> The rules did need to be further adjusted in light of new technologies and novel support types, as well as recent environmental and energy legislation. The Commission also stated that State aid can, and should, contribute further to the European Green Deal and that the revision of the EEAG would have to facilitate appropriate measures to promote accomplishing the set goals, while ensuring limited distortions of competition and adequate safeguards to the integrity of the single market.<sup>40</sup>

The revisions main focus will be on the compatibility criteria for environmental protection as well as an assessment of State aid to energy intensive users.<sup>41</sup> The Commission has proposed that the scope of the EEAG should be widened to better reflect the developments in environmental ambitions since the EEAG were developed. This widened scope would still have to be effectively directed where it is needed and limited to what is needed to achieve the environmental goals.<sup>42</sup>

The Commission published a preliminary assessment of expected economic, social, environmental, fundamental rights, simplification impacts. The Commission stated that the correct calibration of the EEAG between important environmental objectives and potential distortion of competition would contribute to the future competitiveness of the EU economy.

## 1.1.4 The European Green Deal

The European Green Deal communication was published by the Commission in December 2019, highlighting the need to achieve climate-neutrality in Europe by 2050.<sup>43</sup> In order to deliver the European Green Deal there is a need to rethink policies for clean energy.<sup>44</sup> As part of delivering the European Green Deal, evaluations of relevant State aid guidelines would be done, including the EEAG.<sup>45</sup> The revision will reflect the policy objectives of the European Green Deal, supporting a cost-effective transition to climate neutrality by 2050.<sup>46</sup> This would be accomplished by phasing out fossil fuels and ensuring a level-playing field in the internal market. One of the main elements of the Green Deal is the Green Deal Investment Plan which aims to mobilise at least 1 trillion EUR of private and public

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<sup>39</sup> Commission, ‘Commission publishes results of evaluation of EU State aid rules’ (Press release)

<sup>40</sup> Ibid

<sup>41</sup> Commission, ‘Revision of the Guidelines on State aid for environmental protection and energy 2014-2020 (2014/C 200/01)’ (Inception Impact Assessment) at p. 2

<sup>42</sup> Ibid

<sup>43</sup> Commission, ‘The European Green Deal’ (Communication) COM(2019) 640 Final

<sup>44</sup> Ibid at 2.1

<sup>45</sup> Ibid at 2.2.2

<sup>46</sup> Ibid

sustainable investments over the upcoming decade.<sup>47</sup> State aid will play a part in this investment plan and the revision of the guidelines should provide a clear, fully updated, and fit-for-purpose enabling framework for public authorities to reach the objectives of the Green Deal.<sup>48</sup> Pending the revision the Commission has stated that the application of the current State aid guidelines should be more flexible in order to reach the objective of climate neutrality.<sup>49</sup> The cost of remedying pollution should in principle be covered by the polluter according to Article 191(2) TFEU, furthermore, this principle needs to be implemented in State aid policy according to Article 11 TFEU. The Green Deal places an emphasis on the fact that State aid will play an important role in achieving climate neutrality, which in turns begs the question if this is consistent with the polluter pays principle.

## 1.2 Purpose of the essay and related research questions

The purpose of this thesis is to discuss how environmental and energy objectives can be achieved using State aid and how this is justified in light of the polluter pays principle. In order to accomplish this, the revision of the EEAG is used as an example. In order to play its part in delivering the Green Deal the Commission has proposed to broaden the scope of the EEAG, providing a better framework for allowing Member States to design aid measures contributing to climate neutrality. The example of the EEAG is interesting due to the seemingly contradicting objectives of environmental protection and energy production. The EEAG are tasked with the objective of ensuring not only a stable energy supply but also increased environmental protection, two interests that at first glance appear to be in conflict. This thesis discusses how the revision of the EEAG could be broadened in order to achieve coherence with the Green Deal Objectives. Furthermore, this thesis also discusses the question of how State aid for environmental protection can not only be justified in the light of the polluter pays principle, but also support the integration of it.

The relevant research questions for this discussion are as presented:

- What is the role of State aid in environmental protection and how has State aid pursued environmental objectives?
- What does the integration of environmental protection in Article 11 TFEU imply for State aid?
- What is the relationship between the polluter pays principle and State aid for environmental protection?
- What impact does the Green Deal have on State aid for environmental protection?

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<sup>47</sup> Commission, 'Sustainable Europe Investment Plan European Green Deal Investment Plan' (Communication) COM(2020) 21 final at p. 1

<sup>48</sup> Ibid at p. 12

<sup>49</sup> Ibid at p. 13

- How can State aid promote environmental protection in light of the polluter pays principle?

## 1.3 Method and materials

The presented research questions are answered by evaluating the framework against their purpose. The purpose of the material that is being interpreted is discussed and investigated through traditional legal sources. These traditional legal sources being regulation, jurisprudence, preparatory work, and doctrine. The purpose of the essay is as stated to not only determine what the current law is, meaning a ‘de lege lata’-argumentation, the essay also makes the argument for how it should be, meaning a ‘de lege ferenda’-argumentation.<sup>50</sup> The varying nature in research questions prompts the need for applying different methodologies. In order to determine what the law is, the legal dogmatic method is applied. This method analyses traditional legal sources in order to establish what the law is in the case at hand.<sup>51</sup>

As for the research questions suggesting improvements or the rethinking of the law established in the first portion of the essay a critical legal dogmatic method can be used. This method is used to not only describe what the law is but rather from the analysis performed, suggest through a teleological interpretation that the current situation is unsatisfactory.<sup>52</sup> The materials used are in accordance with the legal dogmatic method, traditional legal sources.

The sources, according to the legal dogmatic method, can be divided into three tiers namely sources that *must* be considered, sources that *should* be considered and finally sources that *can* be considered. This thesis is analysing EU law which can be divided into two categories, primary and secondary law. Primary law is said to be the treaties which are the starting point for EU law. Secondary law include regulations, directives, decisions, recommendations, and opinions which must be interpreted and established in accordance with the treaties and the general principles established there in.<sup>53</sup>

Sources that *must* be considered according to the legal dogmatic method would be primary EU law, most relevant for this thesis being TFEU. EU secondary law, most relevant for this thesis being decisions and directives, are sources that either *must* or *should* be considered depending on the case. As for the third tier of sources from an EU perspective are for example Union soft law. Examples of this, with particular importance to this thesis, are non-binding documents in the form of guidelines, as an example, from

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<sup>50</sup> Jan Kleineman and Mauro Zamboni, *Juridisk metodlära*, (2:1 edition, Lund, Studentlitteratur AB, 2018) at p. 36

<sup>51</sup> *Ibid* at p. 21

<sup>52</sup> *Ibid* at p. 40

<sup>53</sup> *Ibid* at p. 119–120

the European Commission.<sup>54</sup> These soft law documents, while non-binding, usually have considerable legal effect as opposed to legal force. Another source used in this thesis that falls under this third tier is legal doctrine, which is used in a way that provides perspective for the legal analysis.

## 1.4 Disposition

This thesis has in the introduction provided the necessary context for the discussion. In order to answer the presented research questions, the first point of discussion is how the current guidelines have performed. The current guidelines are evaluated in the light of their purpose and objectives. The purpose of this first discussion is to establish whether there is a need for change and also if the current framework has been effective. This chapter relates to the first two research questions of what role State aid can play in pursuing environmental and energy objectives, as well as how it has pursued them. This chapter, while mostly focusing on what has been achieved, also carries forth the argument that it is not enough, given the current ambitions of the Green Deal. As mentioned, the Green Deal proposes to broaden the current guidelines and in order to discuss how this could be done this chapter acts as a foundation for the later discussion. Making arguments for what has made State aid effective and also the areas where it is lacking.

The second point of discussion, after having established that the current framework is lacking, is to establish a framework for integration of environmental objectives. As stated in the introduction, there are several interests that must be balanced, and this chapter discusses how to best achieve this balance. The interests presented are the environmental and energy objectives, such as climate neutrality and a secure energy supply. Another important aspect of this discussion is the polluter pays principle. This chapter looks to the past guidelines and State aid policy for environmental protection to discuss if the changes were effective and what there is to learn from the previous revisions. The relationship between State aid for environmental protection and the polluter pays principle is also discussed in this chapter. This chapter also makes the argument that while State aid for environmental protection seems to contradict the polluter pays principle, it can support its implementation. Furthermore, recent case law and legislation are discussed as they have an impact on the future of State aid policy. The research questions focused on in this chapter are the relationship between State aid and the polluter pays principle and what the integration obligation of Article 11 TFEU means for State aid for environmental protection. The main arguments presented are how State aid can be consistent with the polluter pays principle by focusing on aid that either supports its implementation by internalizing negative externalities or avoids conflict with the principle by providing aid for measures that fall outside of its scope. Another argument this chapter provides is how the negative effects of the aid can be limited. Through the interpretation of

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<sup>54</sup> Ibid at p. 128

recent case law and proposed legislation, the argument that aid measures that conflict with the objectives of the Green Deal should be deemed incompatible is also provided.

The third and final point of discussion is then to establish what should be accomplished moving forward. This chapter focuses on the remaining research questions of what impact the Green Deal has for State aid for environmental protection and how the changes can be compatible with the polluter pays principle. The first point of discussion is evaluating the assessment criteria in light of what the thesis has discussed up to this point. The arguments this chapter establish are what needs to be broadened in order to be consistent with the Green Deal and proposes an objective based approach with climate neutrality as the focus. Another argument provided is that the focus should shift away from what aid measures contribute towards the common interest, and instead focus on what aid measures conflict with the environmental objectives. Furthermore, the broadened compatibility criteria that the thesis argues for are evaluated in light of the polluter pays principle. The arguments provided are based on the interpretation of the polluter pays principle presented earlier in the thesis, and instead focus on supporting the implementation of the principle not by making pollution more expensive but rather making less polluting technologies and products more competitive. Finally, the findings are summarised in the final chapter where the research questions alongside their developed answers are presented.



## 2 Evaluation of the EEAG

### 2.1 Effective State aid

The Commission stated that State aid can, and should, contribute even further to the European Green Deal, as well as to the EU's Digital and Industrial Strategies. In particular, the revision of the energy and environmental rules will have to facilitate appropriate measures further promoting a modern, decarbonised, and circular economy, while ensuring limited distortions of competition and adequate safeguards to the integrity of the single market.<sup>55</sup> In order to properly discuss how to best revise the guidelines, certain criteria for evaluation must be established for how State aid should be used. As mentioned in Article 107(3)(c) TFEU the Commission may consider compatible with the internal market State aid to facilitate the development of certain economic activities within the European Union, where such aid does not adversely affect trading conditions to an extent contrary to the common interest. Furthermore, the Commission established common assessment principles to ensure that the aid measures positive impact would outweigh its potential negative effects on trade and competition.<sup>56</sup>

#### 2.1.1 Objective of common interest

The State aid must contribute to a well-defined objective of common interest according to The Communication on State aid modernisation of 8 May 2012.<sup>57</sup> Putting this criterion in the context of the EEAG, the general objective of environmental aid is to increase the level of environmental protection compared to the level that would be achieved in absence of the aid.<sup>58</sup> Furthermore, the primary objective of aid in the energy sector is to ensure a competitive, sustainable and secure system in a well-functioning Union energy market.<sup>59</sup> While drafting the EEAG the Europe 2020 strategy had in particular set targets for a resource-efficient, competitive low-carbon economy. The actual targets set were to reduce greenhouse gas emissions by 20%, raise the share of renewable energy consumption to 20% and increase energy efficiency by 20% compared to 1990 levels.

The environmental and energy objectives have become significantly more ambitious since the EEAG were drafted. As a part of the European Green Deal a number of new ambitious energy targets were set. The main interest

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<sup>55</sup> Supra note 43

<sup>56</sup> EEAG para 26

<sup>57</sup> Commission, 'Fitness Check of the 2012 State aid modernisation package, railways guidelines and short-term export credit insurance' (Staff working document) SWD(2020) 257 Final, at p. 4

<sup>58</sup> EEAG para 30

<sup>59</sup> Ibid

being prioritising energy efficiency, while developing a power sector that is based largely on renewable resources, complemented by rapidly phasing out coal and decarbonising gas. Additionally, EU's energy supply needs to be secure and affordable for consumers and businesses.<sup>60</sup> What the revision of the EEAG should facilitate according to the Green Deal is a cost-effective transition to climate neutrality by 2050, phasing out of fossil fuels, ensuring a level-playing field in the internal market and addressing market barriers to the deployment of clean products.<sup>61</sup>

The goals were to improve the EU's energy efficiency by at least 32.5%, increase renewable energy to 32% of the EU's final energy consumption by 2030 and reduce greenhouse gas emissions by at least 40% by 2030 compared to 1990.<sup>62</sup> This target has since been changed as part of the European Green Deal to increase the EU's greenhouse gas emission reduction to at least 50% and aim towards 55% compared to 1990 levels.<sup>63</sup>

## 2.1.2 Need for State intervention

In order for State aid to be compatible there must be a need for State intervention, meaning the situation if left to the market is unlikely to produce an efficient outcome.<sup>64</sup> State aid can under certain conditions, correct market failures and thereby contribute to achieving a common objective that the market alone cannot. In order to ensure effective State aid, it is necessary to define the market failures.<sup>65</sup> The EEAG states that market failures related to environmental and energy aid could lead to an inefficient outcome based on different types of failures, negative and positive externalities being the main ones.<sup>66</sup> Negative externalities mean that the cost of production borne by the undertakings are lower than the costs borne by society, meaning that pollution is not adequately priced. Positive externalities mean that more than just the investor will benefit from the investment. However, the mere existence of market failures do not justify State intervention, State aid may only be directed at residual market failures, meaning market failures that are unaddressed by other policies and measures.<sup>67</sup> In the case for energy and environmental aid there are plenty of other policies and measures already in place such as the Emissions Trading System, carbon taxes, and pollution standards. Therefore, in order for a State aid measure to be compatible it should effectively target a residual market failure.<sup>68</sup>

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<sup>60</sup> Supra note 43 at p. 6

<sup>61</sup> Ibid

<sup>62</sup> Commission, 'A Clean Planet for all A European strategic long-term vision for a prosperous, modern, competitive, and climate neutral economy' (Communication) COM(2018) 773 Final, at p.5

<sup>63</sup> Supra note 43 p. 4

<sup>64</sup> EEAG para 34

<sup>65</sup> Ibid

<sup>66</sup> EEAG para 35

<sup>67</sup> EEAG para 36

<sup>68</sup> Ibid

### **2.1.3 Appropriate instrument**

Another compatibility assessment criterion is that the aid has to be an appropriate instrument to address the policy objective concerned, meaning the same positive outcome is not achievable through less distortive policy instruments.<sup>69</sup> As mentioned above State aid is not the only policy instrument available to achieve increased levels of environmental protection or promoting a well-functioning European energy market. Regulation and market-based instruments are the most important tools to achieve environmental and energy objectives, and different measures to remedy the same market failure may counteract each other.<sup>70</sup> If a market-based instrument is put in place a State aid measure may undermine the efficiency of that mechanism. Another important instrument to keep in mind for energy and environmental aid is the polluter pays principle. According to the EEAG respect for the polluter pays principle through legislation ensures in principle that market failures linked to negative externalities will be rectified. Because of the polluter pays principle, State aid is not an appropriate instrument and cannot be granted where the beneficiary could be held liable for the pollution under existing Union or national law.<sup>71</sup> Costs of pollution are however difficult to quantify, and full implementation of this principle remains difficult to accomplish which will be discussed further below.

### **2.1.4 Incentive effect**

Another part of the compatibility assessment is if the State aid measure has an incentive effect, meaning that the aid changes the behaviour of the undertaking in a way that would not occur without the aid. This behavioural change must also increase environmental protection or improve the functioning of a secure, affordable, and sustainable energy market. Aid granted to go beyond, or adopt EU standards early, have in principle an incentive effect.<sup>72</sup>

### **2.1.5 Proportionality of the aid**

Aid for environment and energy is considered proportionate if the aid amount is limited to the minimum needed to achieve the aimed objective.<sup>73</sup> The minimum amount is determined by establishing a counterfactual scenario where the aid is not given, meaning the difference between the

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<sup>69</sup> EEAG para 40

<sup>70</sup> EEAG para 42

<sup>71</sup> Ibid

<sup>72</sup> EEAG para 49

<sup>73</sup> EEAG para 69

more environmentally friendly behaviour with the aid and the behaviour the undertaking would carry out in the absence of aid.<sup>74</sup>

### **2.1.6 Avoidance of undue negative effects on competition and trade**

For the aid to be compatible the negative effects on competition must be outweighed by the positive effects on the environment and a well-functioning energy market.<sup>75</sup> When assessing the distortion of competition of environmental aid, the damage to more polluting products and technologies will not be viewed as an undue distortion of competition.<sup>76</sup> What damage to more polluting firms implies is for example reduced output or demand for their products or technologies due to the promotion of the environmentally friendlier alternatives. This is due to the very nature of the aid being to make the economy greener and therefore the goal of the aid is to reduce the pollution caused by more polluting undertakings. In order to reduce the pollution from these undertakings it is necessary to make it less profitable, either by making the activity more expensive or by making the less polluting undertakings more competitive. Instead, when assessing negative effects of environmental aid, the impact on market position and profit of firms that operate on an environmentally friendly basis, even without aid, will be considered. The main potentially harmful effect State aid for environmental and energy objectives could have is to prevent the market mechanism from delivering an efficient outcome by rewarding the most efficient and innovative. State aid could in the long run possibly prevent cleaner, more efficient, and innovative technology by granting aid to inefficient technologies.<sup>77</sup>

## **2.2 Have the EEAG been effective?**

In order to evaluate if the EEAG have been effective the current situation of the energy and environmental goals must be compared to the situation when the EEAG were first implemented. As mentioned above the EEAG were adopted with the Europe 2020 strategy as a backdrop aiming to reduce greenhouse gas emissions by 20%, raise the share of renewable energy by 20% and improve energy efficiency by 20% compared to 1990 levels in 2020.<sup>78</sup> In terms of progress made on these particular objectives the EU has achieved a net emission reduction of greenhouse gas by 25% compared to

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<sup>74</sup> EEAG para 70

<sup>75</sup> EEAG para 88

<sup>76</sup> EEAG para 90

<sup>77</sup> EEAG para 91

<sup>78</sup> EEAG para 3

1990 levels.<sup>79</sup> The share of renewable energy in the final energy consumption was at 19.7% in 2019, only 0.3% short of the 2020 target.<sup>80</sup> The energy efficiency target was 2.6% above the 2020 target in 2019.<sup>81</sup> These targets were not the only reason for implementation of the EEAG, but the State aid modernisation also called three additional objectives. The objectives were to foster sustainable, and inclusive growth in a competitive internal market, focus Commission on *ex ante* scrutiny on cases with the biggest impact on the internal market while strengthening the cooperation with Member States in State aid enforcement. Furthermore, the EEAG were intended to streamline the rules and provide for faster decisions. However, the EEAG were not the only policy instrument aimed at facilitating progress towards the 2020 strategy so a better baseline for comparison would be to look at how spending evolved from the previous 2008 guidelines to the EEAG. With the introduction of the EEAG there was a +135% change in spending for State aid for environment and energy with the numbers being 15.8 billion EUR in 2013 compared to 37.3 billion EUR in 2014.<sup>82</sup> Interesting to note is that the number of notified cases for which expenditure was reported actually decreased from 123 to 121.<sup>83</sup> There was however a significant growth of measures under the general block exemptions going from 174 in 2013 to 376 active cases in 2018.<sup>84</sup> The reason for the big spike in spending for notified measures was nearly driven by one single measure for which Germany spent around 130.8 billion EUR between 2014 and 2018 which is 48% of total EU State aid expenditure for environmental and energy savings.<sup>85</sup> The changes to the GBER therefore appears to have facilitated more efficient and streamlined aid measures and the number of notified measures remains roughly the same.

## 2.2.1 Are the guidelines still relevant?

In order to evaluate if the EEAG are still relevant a few questions must be answered, with the first one being how well the objectives of the EEAG still correspond to the needs within the EU. As previously mentioned two out of three of the Europe 2020 strategy targets were met, which were the backdrop to the intervention, alongside efforts to modernise State aid. The EEAG also were supposed to respect and prepare the ground for the 2030 framework of, at the time, 40% reductions in greenhouse gas emissions, and

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<sup>79</sup> Commission, 'Kick-starting the journey towards a climate-neutral Europe by 2050' (Report) COM(2020) 777 Final

<sup>80</sup> Eurostat, 'Share of renewable energy more than doubled between 2004 and 2019' (Article)

<sup>81</sup> Commission, '2019 assessment of the progress made by Member States towards the national efficiency targets for 2020 and towards the implementation of the Energy Efficiency Directive as required by Article 24(3) of the Energy Efficiency Directive 2012/27/EU (Report) COM(2020) 326 Final

<sup>82</sup> State aid scoreboard 2019 at p. 38

<sup>83</sup> Ibid

<sup>84</sup> Ibid

<sup>85</sup> Ibid at p. 39

27% of the final energy consumption coming from renewable energy.<sup>86</sup> These 2030 targets has since become more ambitious increasing the reduction in greenhouse gas emissions from 40% to minimum 50%.<sup>87</sup> The renewable energy target has been increased to at least 32% of final energy consumption by 2030 and the target for energy efficiency is to improve it by 32.5% by 2030, all this compared to 1990 levels.<sup>88</sup> Therefore, the EEAG are still relevant in terms of there being environmental protection and energy saving goals to be achieved. The question if the market failures the EEAG were intended to target still exist needs to be answered. As mentioned above the different goals are not all connected to the same market failure, so the aid measures have to be looked at individually.

### **2.2.1.1 Aid to energy from renewable sources**

The target for the share of renewable energy was increased to be aligned with more ambitious reduction of greenhouse gas emissions as well as technological improvements, including costs reductions for investments in renewable energy.<sup>89</sup> The purpose of this target is to encourage development of technologies for the production of renewable energy as well as providing certainty for investors. A binding Union target would also leave greater flexibility for Member States to reach their greenhouse gas reduction targets. The problem with renewable energy targets as well as legislative acts to support achievement of renewable energy targets, is that they may not always result in the most efficient market outcome.<sup>90</sup> In order to contribute to the underlying legislative acts such as the Renewable Energy Directive, State aid could be appropriate. The EEAG were drafted with the assumption that established renewables would be grid-competitive sometime between 2020 and 2030 therefore, in order for aid not to become more distortive than necessary subsidies and exemptions from balancing responsibilities should be phased out in a degressive way.<sup>91</sup> In order to keep the aid proportional, meaning reduced to the minimum, aid is to be awarded through market instruments such as auctioning or competitive bidding processes. In order to ensure more developed technologies not preventing the entry to the market of new and promising technologies the possibility of allowing technology specific tenders exist.<sup>92</sup> The residual market failure aid for renewable energy targets is the failure to internalize pollution costs, namely a negative externality.<sup>93</sup> The emissions trading scheme and environmental taxes attempt to internalize the costs of greenhouse gas emission but this remains difficult and therefore aid for renewable energy is an attempt at remedying this market failure.

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<sup>86</sup> EEAG at 2 (4)

<sup>87</sup> Supra note 43 at p. 4

<sup>88</sup> Supra note 62 at p. 5

<sup>89</sup> Directive (EU) 2018/2001 of the European Parliament and of the Council of 11 December 2018 on the promotion of the use of energy from renewable sources para 7

<sup>90</sup> EEAG para 107

<sup>91</sup> EEAG para 108

<sup>92</sup> EEAG para 110

<sup>93</sup> EEAG para 115

The Renewable Energy Directive was recast through Directive 2018/2001 (REDII) with the aim of establishing a common European framework for the promotion of energy from renewable sources and establishes the relevant rules for renewable energy support schemes.<sup>94</sup> The rules set out for support schemes in REDII are similar to the EEAG's approach with a focus on market-based instruments, while avoiding unnecessary distortion of electricity markets.<sup>95</sup> With renewable energy becoming grid competitive there are two interests that clash, namely the phasing out of subsidies for renewable energy to ensure a minimum distortion of competition and addressing the residual market-failure of negative externalities.

### **2.2.1.2 Aid for energy efficiency measures**

Energy efficiency measures were contributing to the common interest of a higher level of environmental protection by reducing energy consumption and fuel input.<sup>96</sup> Energy efficiency measures also targeted negative externalities by creating incentives for the reduction of greenhouse gas emissions. Furthermore, a market-failure linked to energy efficiency measures is positive externalities, meaning if a building is more energy efficient the building owner tends to not accrue the benefits but the tenant. Meaning the tenant gets the benefit of energy savings while the building owner pays the cost for renovation.<sup>97</sup> The State aid under the EEAG was assumed to have an incentive effect due to the targets of energy-efficiency falling on the Member State and not the undertaking receiving the aid.<sup>98</sup> As mentioned above progress towards reaching the energy efficiency targets has been insufficient leaving the distance to reach the 2030 targets bigger than expected.<sup>99</sup> It is also important to note the global pandemic has had on the 2020 targets, for a significant time output was greatly reduced due to lockdowns. Therefore, even if certain targets were reached it is unclear if they would have been given normal circumstance. This has led to the 'Energy Efficiency First' principle being adopted.<sup>100</sup> This principle means that energy efficiency should be treated as a crucial element and a key consideration in future investment decision on energy infrastructure in the Union.

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<sup>94</sup> Supra note 89

<sup>95</sup> Ibid Art. 4.2

<sup>96</sup> EEAG para 139 and 141

<sup>97</sup> EEAG para 142

<sup>98</sup> EEAG para 143

<sup>99</sup> Commission, '2020 assessment of the progress made by Member States towards the implementation of the Energy Efficiency Directive 2012/27/EU and towards the deployment of nearly zero-energy buildings and cost-optimal minimum energy performance requirements in the EU in accordance with the Energy Performance of Buildings Directive 2010/31/EU' (Report) COM(2020) 954 Final, at p 3

<sup>100</sup> Regulation (EU) 2018/1999 of the European Parliament and of the Council of 11 December 2018 on the Governance of the Energy Union and Climate Action

### **2.2.1.3 Aid to energy infrastructure**

Under the EEAG a modern energy infrastructure is considered a precondition for a functioning energy market. Aid for energy infrastructure was considered to be contributing to an objective of common interest on the ground that it enhances system stability, generation adequacy, integration of different energy sources and more.<sup>101</sup> The market failures concerned were coordination failures and positive externalities. There still exists a need for improved energy infrastructure if the 2030 objectives are to be achieved.<sup>102</sup>

### **2.2.1.4 Aid for generation adequacy**

The increased supply of renewable energy meant changing from a very stable source of power to more numerous and smaller-scale supply, this was a cause for concern about temporary shortages or black-outs.<sup>103</sup> The objective of system stability is a legitimate concern but aid for generation adequacy could contradict the objective of phasing out environmentally harmful subsidies.<sup>104</sup> As part of the Clean Planet for all package the regulation on the internal market for electricity was recast.<sup>105</sup> Article 21 of this regulation sets out general principles for capacity mechanisms and Article 22 establishes design principles. Generation adequacy still remains a legitimate concern.

### **2.2.1.5 Exemptions from environmental taxes or other charges on electricity consumption**

The objective of environmental taxes are to increase the level of environmental protection by increasing the cost of environmentally harmful behaviour. In principle environmental taxation should ensure that the costs to society are reflected.<sup>106</sup> The reasoning behind environmental tax reductions are that some undertakings would be placed at such a competitive disadvantage that it would not be feasible to introduce the environmental tax in the first place. Environmental taxes are a way of implementing the polluter pays principle and any reduction of these taxes would therefore be a deviation from this basic principle.<sup>107</sup> The EEAG allowed for tax reductions assuming the beneficiaries paid at least the minimum EU tax rate, set out in the Energy Tax Directive which is currently also under revision.<sup>108</sup> So the goal with tax exemptions for some undertakings, would be that the general level of environmental taxes were higher. The important interest to balance

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<sup>101</sup> EEAG para 202

<sup>102</sup> Commission, 'An EU-wide assessment of National Energy and Climate Plans' (Communication) COM(2020) 564 Final at p. 14

<sup>103</sup> Commission, 'Environmental and Energy Aid Guidelines 2014 – 2020' (Consultation Paper)

<sup>104</sup> Ibid (42) and EEAG para 220

<sup>105</sup> Regulation (EU) 2019/943 of the European Parliament and of the Council of 5 June 2019 on the internal market for electricity

<sup>106</sup> EEAG para 167

<sup>107</sup> Supra note 103 para 65

<sup>108</sup> Ibid para 66



here is that the objective of environmental taxes to discourage environmentally harmful behaviour should not be undermined.<sup>109</sup> The EEAG established a balancing test to ensure this would be the case by having the Member States prove that the reductions are well targeted to an undertaking being mostly affected by a higher tax, and that a higher tax rate is generally applicable than would be the case without the exemption.<sup>110</sup> The Clean Planet for all communication further elaborates that taxation is amongst the most efficient tools for environmental policy.<sup>111</sup> The communication also calls for a harmonized approach between the EU and Member States to avoid relocation risks or harming competition. Therefore, it is reasonable to assume the revision of the EEAG should take the revision of the Energy Taxation Directive into account as to not undermine efforts of internalizing the costs to society.

## 2.2.2 Conclusion on effectiveness

As mentioned above while good progress has been made to reach the 2020 targets there is more to be done in order to get the projections in line with the new ambitious 2030 targets as well as the goal of climate neutrality by 2050. The revision is meant to bring the EEAG in coherence with the twin green and digital transformation of the economy, and should result in a modernised, simplified, easy to apply and future-proof enabling framework for public authorities to help reach environmental and energy objectives in a cost-effective manner, with minimum distortions of competition and trade within the Union.<sup>112</sup> One of the topics under review are the compatibility criteria for environmental protection to promote the green transition while effectively controlling distortions of trade and competition. The Commission suggested that the scope should be widened, by organizing the rules around broader policy objectives, such as environmental protection, security of supply and the prevention of relocation risk due to energy related charges, making scope for further technological and market innovations.<sup>113</sup> The European Green Deal calls for the revision of the EEAG to support a cost-effective transition to climate neutrality by 2050, and to facilitate the phasing out of fossil fuels, ensure a level-playing field in the internal market as well as addressing market barriers for the deployment of clean products.<sup>114</sup>

While it has now been established that the EEAG need to be updated to align with the 2030 targets, as well as the updated secondary legislation such as REDII and the revision of the Energy Taxation Directive. The question of how to balance the interests arise, does the more ambitious climate targets change how the compatibility assessment should be applied,

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<sup>109</sup> EEAG para 168

<sup>110</sup> EEAG para 170

<sup>111</sup> Supra note 62 at p. 18

<sup>112</sup> Supra note 41 at p. 2

<sup>113</sup> Ibid at p. 3

<sup>114</sup> Supra note 43 at p. 18

is simply approving more aid going to be beneficial to society as a whole?  
The next chapter looks into the different interests that need to be balanced to  
develop a framework for how environmental considerations should be  
reflected in State aid policy.

# 3 Integration of environmental considerations into State aid policy

## 3.1 Article 11 TFEU

Article 11 TFEU establishes that Environmental protection requirements must be integrated into the definition and implementation of the Union's policies and activities, in particular with a view to promoting sustainable development. Article 191 further elaborates on what environmental policy should accomplish. Article 191(1) calls for preservation, protection, and improvement of the quality of the environment, protection of human health, rational use of natural resources, and promoting measures to deal with environmental problems, in particular climate change. Article 191(2) establishes that policy should be based on the precautionary principle, as well as the polluter pays principle. As mentioned the EEAG were adopted on the basis of Article 107(3)(c) of the TFEU which establishes that aid to facilitate the development of certain economic activities may be compatible where such aid does not adversely affect trading conditions to an extent contrary to the common interest. This is not the first time ambitious environmental and energy policies has been adopted therefore it is important to look back on how they were altered in the past and how effective it was. Integration of environmental considerations has been a part of State aid policy since before the adoption of Article 11 TFEU, dating back to the first Community framework for environmental aids in 1974.<sup>115</sup> There was an emphasis on the polluter pays principle, which according to the Commission would ensure that environmental protection and competition is mutually supportive. Aid for environmental damage would only be allowed transitionally until full implementation of the principle had been achieved, which is yet to be accomplished.<sup>116</sup>

## 3.2 Balancing test

Article 11 establishes the integration requirement, but this cannot simply mean that any State aid with an environmental objective is allowed. Simply finding any State aid measure with an environmental motive compatible would conflict with numerous other interests such as a competitive market and the polluter pays principle.<sup>117</sup> This is where balancing comes into play.

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<sup>115</sup> Supra note 9 at p. 182

<sup>116</sup> Ibid

<sup>117</sup> Ibid at p. 198

In order to ensure that the negative effects of the aid measure, in terms of distortions of competition, are outweighed by the positive impact on the environment, the compatibility assessment is carried out. There needs to be a clearly defined environmental benefit, the design of the aid must be able to provide the benefit, and the overall balance must be positive.<sup>118</sup> The balancing between competition and environmental interests is carried out through the incentive effect as well as the polluter pays principle, an incentive effect ensures aid is granted only in situations where the environmental benefit is lost without the aid.<sup>119</sup> The polluter pays principle can be integrated in three different ways, namely aid that supports the principle, aid that does not infringe upon it and aid measures that infringe upon it but are justified.<sup>120</sup> The first form of integration include aid measures that target negative externalities, by giving aid to a less polluting undertaking the competitive balance is upheld between different forms of production making the less polluting option more attractive. The second form includes State aid measures that do not infringe upon the principle include going beyond the EU standard and early adaptation of a future standard. The reason for this type of aid not infringing on the principle is because the undertaking only has to pay what EU law calls for.<sup>121</sup> The final type of aid measures are those that infringe upon the principle but are justified, such as favourable environmental tax treatment. The reasoning for allowing this type of aid is that the overall environmental impact is positive, by reducing taxes for certain undertakings a generally higher environmental tax, meaning internalization of pollution costs, can be achieved.

The implementation approach was apparent in the previous Guidelines on State aid for Environmental Protection (EAG), with them stating that full implementation of the polluter pays principle would lead to correction of the market failure.<sup>122</sup> The EAG further stated that the polluter pays principle should be the main rule and State aid should remain a second-best option. The Commission highlighted two problems with implementing the polluter pays principle in the EAG.<sup>123</sup> The first problem being that the exact cost of pollution is hard to establish, valued differently among societies, and hard to give a monetary value such as shorter life expectancy. The actual internalisation of these costs would also most likely create serious disturbances in the economy and affect the competitiveness of European industry.<sup>124</sup>

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<sup>118</sup> Ibid at p. 199

<sup>119</sup> Ibid

<sup>120</sup> Ibid

<sup>121</sup> Ibid at p. 200

<sup>122</sup> EAG para 8

<sup>123</sup> EAG para 24

<sup>124</sup> EAG para 25

## 3.3 The polluter pays principle

As established previously the polluter pays principle is very much a vital tool in ensuring environmental protection and competition are balanced. But what exactly is the polluter pays principle and how should it be interpreted?

### 3.3.1 Background

The polluter pays principle was introduced to the EU as early as in the Community's First Environment Action Programme and was added to the EEC Treaty through the Single European Act in 1987 and is now found as mentioned in Article 191 (2) TFEU.<sup>125</sup> The meaning of the principle is fairly self-explanatory but it means that the costs of pollution or other environmental damage, including the costs of restoring the environment after damage, shall be borne by whoever has caused them, namely the polluter, and not by taxpayers or the wider community. The main goal with the principle is to contribute to achieving environmental goals and prevent distortion of competition by having all polluters be responsible for their pollution and not just some.<sup>126</sup>

The EEAG explain that respect for the polluter pays principle through environmental legislation ensures in principle that the market failure linked to negative externalities will be rectified.<sup>127</sup> Furthermore, in the previous EAG the Commission established that the polluter pays principle can be implemented either by setting mandatory environmental standards or through market-based instruments. Some of the market-based instruments may involve the granting of State aid to all or some of the undertakings which are subject to them.<sup>128</sup> There are however a few questions regarding the principle such as who is the polluter and what costs should the polluter be liable for?

### 3.3.2 The different criteria

The EEAG define 'polluter' as someone who directly or indirectly damages the environment or creates conditions leading to such damage.<sup>129</sup> This seems straightforward, but it can be hard to determine in some cases. For example, in terms of traffic pollution, is it the driver, car manufacturer, producer or distributor of fuel who should be regarded as polluter or

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<sup>125</sup> Langlet, David & Mahmoudi, Said *'EU Environmental Law and Policy'* Oxford University Press 2016 at p. 55

<sup>126</sup> Ibid

<sup>127</sup> EEAG para 44

<sup>128</sup> EAG para 8

<sup>129</sup> EEAG para 26

everyone combined?<sup>130</sup> The Commission provided some guidance as to how the principle should be interpreted in a communication to the Council.<sup>131</sup> In this communication the Commission stated that identifying a polluter can prove to be impossible or too difficult. This with a particular view of cases where pollution arises from several actors or causes. In these cases, cost should be internalized in the best way from an administrative and economic point of view, which makes the most effective contribution to environmental protection.<sup>132</sup> This means that the charge should be focused on the point of the pollution chain where the number of contributors are the lowest, where the most effective environmental protection is achieved and where distortion of competition is avoided.

The implementation instruments available were mostly environmental standards as well as through charges. The standards were so called environmental quality standards, which state the level of pollution to not be exceeded, the standards could be used for both products and processes.<sup>133</sup> The Commission stressed the need to have the principle harmonized at an EU level to keep the distortion of competition between Member States at a minimum.<sup>134</sup> The Commission also established exceptions to the polluter pays principle, as well as aid measures that were compatible with it. In cases where an immediate internalization of costs would lead to great social costs it could be necessary to allow time for polluters to adapt or grant aid for a limited time.<sup>135</sup> Aid measures granted to promote development of less polluting products and processes was not seen as contrary to the polluter pays principle. Furthermore, financing designed to compensate for heavy costs some polluters would have to face in order to achieve an exceptional degree of environmental protection was also not seen as contrary.<sup>136</sup> While it has now been established that the polluter pays principle should be the first choice over environmental State aid this begs the question of what the principle actually entails in a practical sense.

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<sup>130</sup> Supra note 125 at p. 56

<sup>131</sup> Commission, 'Communication from the Commission to the Council regarding cost allocation and action by public authorities on environmental matters Principles and detailed rules governing their application' OJ 194/2

<sup>132</sup> Ibid para 3

<sup>133</sup> Ibid para 4

<sup>134</sup> Ibid para 5

<sup>135</sup> Ibid para 6

<sup>136</sup> Ibid para 7

### 3.3.3 Historical representation in the guidelines

In 1994 the first separate Guidelines on Environmental aid were adopted.<sup>137</sup> The goal with these first guidelines confirmed the need to implement the polluter pays principle but acknowledged that the traditional approach had not been enough.<sup>138</sup> The 1994 Guidelines covered aid measures for the implementation of new standards, aid to encourage efforts to go beyond mandatory standards, and aid granted in the absence of mandatory standards.<sup>139</sup> The guidelines also covered aid measures which were aimed at finding solutions to environmental problems such as less polluting technology.<sup>140</sup> There were also aid measures to alleviate the financial burden a sudden internalisation of costs would imply for some undertakings in the form of operating aid and tax reductions.<sup>141</sup> The 1994 Guidelines were an attempt to balance competition interests with environmental policy because State aid was being used to further promote environmental protection. The guidelines simply intended to ensure that the State aid was transparent and consistent so that the negative effects on competition would be outweighed by the positive environmental benefits.<sup>142</sup>

The 2001 Guidelines<sup>143</sup> also had a strong focus on the implementation of the polluter pays principle. The 2001 Guidelines also saw the addition of energy saving measures and the use of renewable energy as action to protect the environment.<sup>144</sup> The 2001 Guidelines also shed light on the fact that some forms of aid would counter the objectives of sustainable development by artificially reducing the cost and thereby hiding the cost of environmental protection to consumers.<sup>145</sup> Mirroring the 1994 Guidelines the 2001 Guidelines established once more that State aid represent a temporary second-best solution to the polluter pays principle.<sup>146</sup> The 2001 Guidelines established that aid granted to ensure compliance with new or existing standards were no longer compatible with the internal market, stating that prices had to accurately reflect costs.<sup>147</sup>

The 2008 EAG were adopted in the light of the Energy Policy for Europe aiming to increase the security of supply, ensure competitiveness of the European economy, ensure energy was affordable for consumers, promote environmental sustainability and combat climate change.<sup>148</sup> The EAG also

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<sup>137</sup> Commission, 'Community guidelines on State aid for environmental protection' OJ 1994 C 72/3

<sup>138</sup> Ibid 1.2

<sup>139</sup> Ibid 1.5.1

<sup>140</sup> Ibid 1.5.2

<sup>141</sup> Ibid 1.5.3

<sup>142</sup> Ibid 1.6

<sup>143</sup> Commission, 'Community guidelines on State aid for environmental protection' OJ 2001/C 37/03

<sup>144</sup> Ibid para 6

<sup>145</sup> Ibid para 16

<sup>146</sup> Ibid para 18 (a)

<sup>147</sup> Ibid para 20

<sup>148</sup> EAG para 1

had the goal of contributing to the realization of the 2020 targets, meaning 20% reduction of greenhouse gas emissions, 20% energy consumption from renewables as well as the 20% energy efficiency target.<sup>149</sup> Like prior State aid policy on environmental protection the EAG had a focus on the implementation of the polluter pays principle. The primary objective of State aid in the field of environmental protection, according to EAG, were to ensure a higher level of environmental protection than would occur without the aid, overall balance should be positive taking account of the polluter pays principle.<sup>150</sup> Here we see the focus on incentive effect with the requirement that the aid leads to a higher level of environmental protection than the counterfactual scenario where no aid is granted. The balancing between positive effects on the environment and negative effect on distortion of competition saw the criteria of taking the polluter pays principle into account. The EAG also stated that although there were limits to the application of the polluter pays principle, this should not prevent Member States from reducing negative externalities beyond Community standard to the greatest extent possible.<sup>151</sup> The EAG presented two ways of using State aid to achieve a higher level of environmental protection the first one being positive individual incentives to reduce pollution and negative impacts on the environment, and the second one being positive incentives to introduce national environmental regulation going beyond Community standards.<sup>152</sup> The first method would be to grant aid to an undertaking for it to change its current behaviour to a less polluting one. Meaning the reduction of pollution would not occur without the aid. The second method was to introduce national wide standards, these standards would affect some undertakings more than others and therefore reducing their competitiveness. In order to keep these undertakings competitive State aid could be seen as necessary, as long as the standards went beyond what was required at a community level.

The EAG gave some clarity as to why it was hard to fully implement the polluter pays principle and why State aid was considered appropriate in some cases. There were two reasons for why it was hard to internalize the costs of pollution, first one being the actual cost was hard to establish. It was technically complicated to calculate the extra costs for all types of production, different producers have different pollution. The valuation of the cost could change among individuals, societies, impact on future generations. Some costs such as reduced life expectancy or environmental damage were also hard to express in monetary value.<sup>153</sup> Second reason was even if the true cost could be calculated an abrupt introduction of this cost would greatly disturb the economy, leading to a more gradual internalization being more reasonable.<sup>154</sup>

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<sup>149</sup> EAG para 3

<sup>150</sup> EAG para 6

<sup>151</sup> EAG para 9

<sup>152</sup> EAG para 22

<sup>153</sup> EAG para 25

<sup>154</sup> Ibid



The 2014 EEAG however seemed to not have a big emphasis on the polluter pays principle, they do however contain a definition of the principle. Furthermore, the EEAG mention that respect for the principle through environmental legislation ensures in principle that the market failure linked to negative externalities will be rectified. State aid is not to be regarded as an appropriate instrument if the aid beneficiary could be held liable for pollution under existing Union or national law.<sup>155</sup> The European Green Deal has placed further emphasis on the use of State aid for environmental protection and energy. Increasing the role of State aid in the implementation of the European Green Deal implies that the polluter pays principle is receding in importance.<sup>156</sup> However, from a global perspective it could also be seen as if the EU is recognizing its responsibility to pay for the costs of tackling climate change, meaning it is not a shift away from the principle but rather an imperfect application of it on an international scale.<sup>157</sup>

### 3.3.4 The polluter pays principle's role in State aid law

While the polluter pays principle is apparent in legislation its implementation remains difficult because neither the polluter nor the costs the polluter should bear are defined in the principle itself.<sup>158</sup> The role of the polluter pays principle was highlighted in the *GEMO* case by Advocate General Jacobs.<sup>159</sup> According to the opinion the Commission uses the polluter pays principle for two distinct purposes, namely to determine whether a measure constitutes State aid within the meaning of Article 107(1)(b) TFEU, and to decide whether a given aid may be declared compatible with the treaty under Article 107(3) TFEU. The polluter pays principle provides guidance in each case on who bears responsibility for the costs and a State aid measure that alleviates the costs constitutes aid within the meaning of Article 107(1)(b) TFEU.<sup>160</sup> As mentioned previously this means State aid will only be accepted if it is justified by the need to apply more stringent environmental protection standards than current EU law requires, if there are no Union standards, and the aid is likely to increase the level of protection resulting from the beneficiaries activities.<sup>161</sup> The polluter pays principle in turn ensures that there is an incentive effect to the aid,

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<sup>155</sup> EEAG para 44

<sup>156</sup> Suzanne Kingston, 'The Polluter Pays Principle in EU Climate Law: An Effective Tool Before the Courts?' (August 24, 2020). *Climate Law* 10 (1) 1-27, UCD Working Papers in Law, Criminology & Socio-Legal Studies Research Paper p. 10 (2020)

<sup>157</sup> *Ibid* p. 9

<sup>158</sup> Kleoniki Pouikli, 'The Polluter Pays Principle and the EU State Aid Law for Environmental Protection' (2016) *Journal of Law, Policy and Globalization* (Vol. 55, 2016)

<sup>159</sup> Case C.126/01 *GEMO* [2003] ECLI:EU:C:2003:622, Opinion of AG Jacobs, paras 67-70

<sup>160</sup> De Sadeleer Nicolas, 'Consistency between the Granting of State Aid and the Polluter-Pays Principle: Aid Aimed at Mitigating Climate Change' (March 19, 2020). *Climate Law* 10 (1) 28-49, at p. 47

<sup>161</sup> *Ibid* at p. 48

meaning the environmental protection is a direct result of the aid being awarded.

## 3.4 Hinkley Point C<sup>162</sup>

A recent judgement from the CJEU has had some important implications on the role State aid can play in delivering the European Green Deal, namely the case Hinkley Point C. The judgement sheds light on the “common interest” criteria of the common assessment principles. Furthermore, the judgement also sheds light on what impact the consideration of environmental protection has when balancing the positive and negative effects of the aid.

### 3.4.1 Background to the case

In October 2013, the United Kingdom of Great Britain and Northern Ireland notified three aid measures for a nuclear power station, namely Hinkley Point C.<sup>163</sup> The first measure was to ensure price stability for electricity sales during the operational phase, second measure was compensation if the plant were to be shut down due to political reasons, and the third measure was a credit guarantee.<sup>164</sup> The aid was found to be compatible with the internal market by the Commission on the grounds of Article 107(3)(c) TFEU.<sup>165</sup>

The Republic of Austria brought an action for annulment of the decision stating that the promotion of nuclear energy does not constitute an objective of common interest.<sup>166</sup> The CJEU found that there were two conditions to Article 107(3)(c) TFEU, first one being that the aid must be intended to facilitate the development of certain economic activities or of certain economic areas, and the second condition being that the aid must not adversely affect trading conditions to an extent contrary to the common interest.<sup>167</sup> Even if the Commission has in Communications and in practice called for Member States to demonstrate that aid under 107(3)(c) TFEU contributes to an objective of common interest, the Commission does not have the power to reduce the scope of a treaty.<sup>168</sup>

The Republic of Austria had further claimed that granting State aid for nuclear energy was against the principle of protection of the environment, the precautionary principle, the polluter pays principle and the principle of sustainability.<sup>169</sup> In regard to this the CJEU stated that State aid which

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<sup>162</sup> Case C-594/18 P *Austria v Commission* EU:C:2020:742.

<sup>163</sup> *Ibid* para 2

<sup>164</sup> *Ibid* para 3

<sup>165</sup> *Ibid* para 5

<sup>166</sup> *Ibid* para 15

<sup>167</sup> *Ibid* para 19

<sup>168</sup> *Ibid* para 24

<sup>169</sup> *Ibid* para 34

contravenes provisions or general principles of EU law cannot be declared compatible with the internal market.<sup>170</sup> The CJEU stated that on the grounds of security of energy supply and the choice of energy being a matter left to the Member States there was no conflict between the principles and the granted aid in this case.<sup>171</sup>

The second grounds of appeal were that the measure could not be considered compatible with the market failure due to there not being a market failure.<sup>172</sup> The CJEU confirmed that the existence of a market failure was not an essential condition and in the case at hand the generation capacity would not be delivered without the granting of State aid.<sup>173</sup>

Austria had further argued on its first part of the third ground of appeal that the Commission should have considered whether and to what extent there were other more proportionate means of covering electricity needs.<sup>174</sup> The CJEU finds in regard to this argument that the intermittent nature of many renewable technologies did not allow them to be a suitable alternative to a baseload technology such as nuclear energy.<sup>175</sup> Furthermore in the light that it is the United Kingdom's right to determine its own energy mix and to maintain nuclear energy as a source in that mix, the decision to maintain nuclear energy in the supply structure could not be considered to be disproportionate.<sup>176</sup>

In the second part of the third ground of appeal Austria criticized the Commission and the General Court for having disregarded the effect of the decision as a precedent, by limiting the examination of proportionality solely to distortions of competition and adverse effects on trade.<sup>177</sup> The CJEU confirmed the General Courts decision in this regard and stated that the examination cannot be based on speculation as to the precedent effect of the decision. The examination of proportionality is according to the CJEU correctly limited solely to the distortions of competition and adverse effects on trade caused by those measures according to Article 107(3)(c) TFEU.<sup>178</sup>

In the fourth ground of appeal Austria had argued that the Commission and the General Court had failed to weigh the positive effects against their negative effects.<sup>179</sup> The argument was that the balancing exercise was carried out inadequately by not taking into consideration the cost of treatment and storage of nuclear waste, therefore failing to take the negative impacts on the environment into account.<sup>180</sup> The CJEU found that the

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<sup>170</sup> Ibid para 44

<sup>171</sup> Ibid para 48 and 49

<sup>172</sup> Ibid para 52

<sup>173</sup> Ibid para 68

<sup>174</sup> Ibid para 71

<sup>175</sup> Ibid para 78

<sup>176</sup> Ibid para 79

<sup>177</sup> Ibid para 82

<sup>178</sup> Ibid para 85 and 86

<sup>179</sup> Ibid para 94

<sup>180</sup> Ibid

General Court had not erred in its assessment of whether or not the balancing exercise had been performed adequately.<sup>181</sup> The General Court had stated that when identifying the negative effects of the measures, the Commission did not have to take into account the extent to which those measures were detrimental to the implementation of the principle of protection of the environment, applying equally to the precautionary principle, the polluter pays principle and the principle of sustainability.<sup>182</sup> The reason the Commission was not obliged to take these principles into consideration was that the aid measure at hand were not specifically intended to give effect to those principles.<sup>183</sup> The examination of negative effects on the aid is limited specifically to the effect on the internal market.<sup>184</sup> In its decision the General Court refers to Article 26(2) TFEU stating that the internal market ‘shall comprise an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of the Treaties’.<sup>185</sup> This in turn confirms that an aid measure being detrimental to the polluter pays principle does not have to be considered when balancing the positive and negative effects of the aid.

### **3.4.2 Implications on State aid for environmental protection**

Hinkley Point C has prompted a need to rethink the Commissions approach to Article 107(3)(c) TFEU, most notably in the balancing exercise as well as the common assessment principles.<sup>186</sup> As mentioned previously in this thesis in order to deem State aid measures compatible they had been assessed under certain compatibility criteria. This had granted the Commission a substantial amount of power in determining what an objective of common interest was.<sup>187</sup> The existence of a market failure was also an important part of the assessment principles, stating that State aid could improve the functioning of markets in light of these failures.<sup>188</sup> While the existence of a market failure was not essential even before Hinkley Point C this judgement further confirms it.<sup>189</sup> The judgement does however imply that the Commission can no longer require aid under 107(3)(c) to demonstrate a contribution to a common interest. The common interest criteria can then only be considered by the Commission when weighing the negative effects

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<sup>181</sup> Ibid para 102

<sup>182</sup> Ibid para 99

<sup>183</sup> Ibid para 97

<sup>184</sup> Ibid para 101

<sup>185</sup> Ibid

<sup>186</sup> Suzanne Kingston, ‘State Aid and the European Green Deal: The Implications of Case C-594/18 P Austria v Commission (Hinkley Point C)’ (March 19, 2021). Forthcoming, *European Law Review* (2021), UCD Working Papers in Law, Criminology & Socio-Legal Studies Research Paper No. 6/202. at p. 10

<sup>187</sup> Ibid

<sup>188</sup> Ibid

<sup>189</sup> Ibid at p. 11

on competition.<sup>190</sup> This is important for the revision of the EEAG, and it is now up to the Member States to determine which economic activities are subject to Article 107(3)(c) and up to the Commission to determine if this adversely affects trading conditions to an extent contrary to that common interest.<sup>191</sup>

The judgement has also established a new balance between State aid and environmental protection as well as given clarity as to how the integration of Article 11 TFEU should be handled.<sup>192</sup> When the State aid is intended to facilitate development of an economic activity in accordance with Article 107(3)(c) the Commission has a positive obligation to ensure this aid does not infringe rules of EU law on the environment.<sup>193</sup> In the case that the aid infringes on the rules of EU law on the environment the Commission is obliged to declare the aid incompatible with the internal market without any other form of examination. The precedence here entails that if a State aid measure is found to pass the test of not infringing upon EU environmental law then the second part of the test, balancing the positive and negative effects, only considers the negative effects on competition and trade between Member States.<sup>194</sup> State aid with negative environmental effects can of course also have a negative effect on competition, for example State aid for fossil fuel might reduce import of green energy and thereby impacting the balancing test.<sup>195</sup> The effect of this precedence could be that State aid notifications must show compliance with EU environmental law but also aid in phasing out environmentally harmful subsidies.<sup>196</sup> Which is an objective of the European Green Deal.<sup>197</sup> The need for phasing out environmentally harmful subsidies has long since been a part of EU policy.<sup>198</sup>

### 3.5 European Climate Law

The European Climate Law could have some interesting implications on State aid for environmental protection and energy. The European Climate Law enshrines the EU 2050 climate-neutrality objective in legislation, thereby enhancing certainty and confidence on the EU's commitment as

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<sup>190</sup> Ibid

<sup>191</sup> Ibid

<sup>192</sup> Ibid at p. 13

<sup>193</sup> Ibid and Hinkley Point C para 100

<sup>194</sup> Ibid at p. 14

<sup>195</sup> Ibid at p. 15

<sup>196</sup> Ibid

<sup>197</sup> Supra note 43 at p. 17

<sup>198</sup> EEAG para 6

well as transparency and accountability.<sup>199</sup> The Climate Law originally stated that the increase of the greenhouse gas emission reduction target for 2030 would be between 50 and 55% compared to 1990 levels and has since been amended to at least 55% reduction as that is both feasible and beneficial.<sup>200</sup>

The legal basis for the Climate Law is Article 192(1) TFEU stating that The European Parliament and the Council, acting in accordance with the ordinary legislative procedure and after consulting the Economic and Social Committee and the Committee of the Regions, shall decide what action is to be taken by the Union in order to achieve the objectives referred to in Article 191.<sup>201</sup> The co-legislators came to a provisional agreement on the European Climate Law which in addition to the 2050 climate neutrality target strengthened the European framework for climate action.<sup>202</sup>

It follows from the agreement that the polluter pays principle is being brought back into focus. The agreement states that the Union's and the Member States' climate action aims should be guided by the precautionary and polluter pays principles and should also take into account the 'energy efficiency first' principle of the Energy Union and the 'do no harm' principle of the European Green Deal.<sup>203</sup> The European Climate Law further states that the Union-wide 2050 climate-neutrality objective should be pursued by all Member States collectively, and that the Member States, the European Parliament, the Council and the Commission should take the necessary measures to enable its achievement.<sup>204</sup> The Commission is also required to assess how the Union legislation implementing the Union's 2030 target would need to be amended in order to enable the achievement of the new 55% target.<sup>205</sup> The European Climate Law places the legal obligation on the Commission to not only eliminate Union measures inconsistent with the legally binding target for climate neutrality, but they also need to take necessary measures to ensure climate neutrality is attained. In light of this a framework for State aid that authorises aid measures inconsistent with climate neutrality may be contrary to the European Climate Law.<sup>206</sup>

### **3.6 What should State aid control protect?**

This chapter has thus far highlighted the balancing between the positive contribution to the facilitation of an objective pursued by a Member State and the negative effects on competition. In order to get a clear vision for

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<sup>199</sup> Amended Proposal for a European Climate Law p. 1

<sup>200</sup> Ibid

<sup>201</sup> Ibid p. 2

<sup>202</sup> Press release Commission welcomes provisional agreement on the European Climate Law

<sup>203</sup> Commission, 'Amended proposal for a Regulation of the European Parliament and of The Council on establishing the framework for achieving climate neutrality and amending Regulation (EU) 2018/1999 (European Climate Law)' COM(2020) 80 Final, recital 5

<sup>204</sup> Ibid recital 12

<sup>205</sup> Ibid Article 3

<sup>206</sup> Supra note 186 at p. 17-18

what it is State aid for environmental protection and energy should accomplish there is a need to consider what kind of distortions State aid should prevent.

As Hinkley Point C pointed out the Commission does enjoy a great deal of power when determining what aid is compatible, but they may not reduce the scope of a treaty.<sup>207</sup> Therefore, in order to properly discuss what the EEAG could provide for environmental protection and energy, it is important to understand why and how Article 107(3)(c) permits aid only on the condition that it does not adversely affect trading conditions to an extent contrary to the common interest.

In order for State aid to be compatible there are four conditions that are apparent from Article 107(3)(c) TFEU. The State aid must support a public policy objective, meaning an objective pursued by a Member State. Furthermore, the measure must generate benefits or positive effects, as well as the negative effects should not outweigh the positive effects. Lastly, one or more Member States may be adversely affected as long as trade is not excessively distorted.<sup>208</sup> There is however no guidance from either the Commission or EU courts on how distortive or acceptable magnitude of negative effects before State aid would be deemed incompatible, aside from the requirement that the effects of the aid must be proportional.<sup>209</sup> As mentioned the Commission did however in the EEAG state that, the negative effects of the aid must be sufficiently limited, so that the overall balance is positive.<sup>210</sup> The EEAG also state that in principle, an aid measure and the context in which it is applied need to be analysed to identify the extent to which it can be deemed distortive.<sup>211</sup> There are however situations where the negative effects manifestly outweigh any positive effects.<sup>212</sup> The EEAG provide two examples of this, first one being where the State aid would exceed maximum aid intensities established by the Commission, and the second one being where the aid merely leads to a change in location without improving the existing level of environmental protection.<sup>213</sup> A review of the Commissions Guidelines came to the conclusion that the Commission does not precisely explain how they measure or calculate the positive and negative effects, and it is in reality not a balancing weighing of positives and negatives, but rather a check if the negatives are limited and whether there are no manifest negative effects.<sup>214</sup>

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<sup>207</sup> Hinkley Point C case para 24

<sup>208</sup> Phedon Nicolaides, 'What should State aid control protect? A proposal for the next generation of State aid rules.' *European Competition Law Review* 2019 40(6), 276–283 at p. 4

<sup>209</sup> *Ibid* at p. 5

<sup>210</sup> EEAG 3.1 (26)(f)

<sup>211</sup> EEAG (94)

<sup>212</sup> *Ibid*

<sup>213</sup> EEAG (94)-(95)

<sup>214</sup> *Supra* note 208 at p. 6

Two questions arise from this conclusion, namely if there should be a true balancing exercise and if not, what distortions should be prevented?<sup>215</sup> A true balancing exercise would imply to perform a cost-benefit analysis of every aid measure, which would not only be hard to quantify in terms of how to quantify benefits for one country and negative effects for the other.<sup>216</sup> Even if possible, this approach would also not be efficient which leaves the second question to be answered.

It is important to note that by definition aid that may be exempted under Article 107(3)(c) TFEU is already found to be distortive by being classified as State aid under Article 107(1). This means that State aid may be distortive, but the distortion must not be excessive.<sup>217</sup> One argument for change is that the Commission should expand upon the list of manifest negative effects and that the primary criterion should be to simply limit the negative effects to the minimal amount.<sup>218</sup> This approach would be consistent with the principle of proportionality which implies that a measure is proportional when it can achieve its objectives with the minimum possible negative effects.<sup>219</sup> This approach could be beneficial to the revision of the EEAG, given that the Commission cannot prohibit an aid measure that fulfils the first requirement of Article 107(3)(c) TFEU, meaning the aid facilitates the development of certain economic activities or of certain economic areas. By expanding upon manifest negative effects and keeping negative effects limited the Commission could ensure that the development of these activities are achieved at the minimum possible distortion.<sup>220</sup>

### 3.7 Conclusion on integration

This chapter has discussed to what extent environmental considerations has been integrated into State aid law in the past, as well as some recent developments that have implications on future integration requirements. An important consideration for the discussion on the role of State aid for environmental goals is that EU State aid regulations were not established to protect the environment and do not have environmental objectives.<sup>221</sup> Article 3(3) TFEU states that The Union shall establish an internal market. It shall work for the sustainable development of Europe based on balanced

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<sup>215</sup> Ibid

<sup>216</sup> Ibid

<sup>217</sup> Ibid at p. 7

<sup>218</sup> Ibid

<sup>219</sup> Ibid

<sup>220</sup> Ibid

<sup>221</sup> Marcin Stoczkiewicz: *'Environmental Aspects of State Aid for Energy Investment Projects'* in Vanheusden, B and Squintani L *EU Environmental and Planning Law Aspects of Large-Scale Projects* (Intersentia 2016) at p. 11



economic growth and price stability, a highly competitive social market economy, aiming at full employment and social progress, and a high level of protection and improvement of the quality of the environment. Based on this article it is apparent that a highly competitive social market economy and high level of protection and improvement of the quality of the environment are both objectives with equal legal status. This means that in the case of conflict between these objectives the Union's authorities will seek agreement between the objectives and implement them as far as possible.<sup>222</sup> Just as it is true that State aid rules do not include any environmental objectives, the TFEU's environmental provisions do not incorporate objectives around a competitive economy. The link between competition rules, meaning State aid rules, and environmental protection objectives, as mentioned above, is the polluter pays principle in Article 191(2) TFEU and the integration clause in Article 11 TFEU.<sup>223</sup>

Recent case law from the CJEU has further explained how environmental considerations should be integrated into State aid as shown above. How integration should be handled has been under much debate and the case law has evolved in the past years. With the important *British Aggregates* case mentioned above where certain aggregates, that were deemed to be environmentally friendly had been excluded from the scope of an imposed levy. The CJEU pointed out that the Commission did have to take into account the environmental protection requirements in Article 6 EC (Article 11 TFEU) when assessing a measure. The integration of environmental objectives could however not justify the exclusion of selective measures from qualifying as State aid, but instead they may have been useful when assessing the compatibility of the aid measure.<sup>224</sup>

The case *Castelou Energia v Commission*,<sup>225</sup> was another important case in the interpretation of the integration requirement. The case further stated environmental considerations were useful when assessing the compatibility of the aid, and the polluter pays principle should especially be taken into account.<sup>226</sup> The court however narrowed the interpretation to only taking into account aid measures with environmental goals, stating that when assessing an aid measure which does not pursue an environmental objective, the Commission is not required to take account of environmental rules. Stating the reason for this being that aid which has harmful effects on the environment does not, by that fact alone, adversely affect the establishment of the internal market.<sup>227</sup> This interpretation garnered criticism for being too narrow as well as not having appropriate ground in TFEU.<sup>228</sup>

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<sup>222</sup> Ibid at p. 15

<sup>223</sup> Ibid

<sup>224</sup> Ibid at p. 19 and Supra note 19 at paras 90-92

<sup>225</sup> Case T-57/11 *Castelou Energia v Commission* [2014] CLI:EU:T:2014:1021

<sup>226</sup> Ibid para 188

<sup>227</sup> Ibid para 189

<sup>228</sup> Supra note 221 at p. 20

The case Hinkley Point C which was covered in this chapter established a new balance between State aid and environmental protection. The case has established that the integration obligation of Article 11 TFEU requires that when the Commission assess whether State aid is intended to facilitate the development of an economic activity in accordance with Article 107(3)(c) TFEU, to check that the activity does not infringe rules of EU law on the environment.<sup>229</sup> Furthermore, if the Commission finds that the measure infringes on any of the EU environmental rules the Commission is obliged to declare the measure incompatible without any other form of examination.<sup>230</sup> This means that if the measure infringes upon EU environmental rules, there is no room for balancing whatsoever through a proportionality analysis, justification or weighing the positives versus the negatives.<sup>231</sup> As for the second stage of the test this only examines negative effects on the State aid on competition and trade between Member States, not any negative environmental side effects that fall outside the scope of the first test.<sup>232</sup> Finally, this precedence together with the European Climate Law, which turns the 2050 target of climate neutrality into a legally binding target, could imply that if an aid measure is inconsistent with climate neutrality by 2050 that this is contrary to the Climate Law.<sup>233</sup> This then raises the question of how the revision of the EEAG should contribute to the European Green Deal.

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<sup>229</sup> Supra note 186 at p. 13

<sup>230</sup> Ibid and Hinkley Point C, para 100

<sup>231</sup> Ibid

<sup>232</sup> Ibid

<sup>233</sup> Ibid p. 18

## 4 Integration and the EEAG

This thesis has in the second chapter discussed the need for change to the EEAG to reflect the more ambitious environmental objectives and in the third discussed how environmental considerations can be integrated into State aid policy. The EEAG are as mentioned above not binding upon the Member States but onto the Commission and are a useful tool for the Member States to apply when designing national State aid policies. This chapter will look to the European Green Deal and back to the second chapter of this paper to see where change is needed. Furthermore, this chapter will discuss what the integration obligation implies for the EEAG and how State aid policy best contributes to environmental objectives.

### 4.1 How Integration has been done

As has been shown previously the polluter pays principle is the first choice for environmental protection and is used as the guiding principle for environmental and energy aid. Looking to the polluter pays principle as a guiding principle three types of aid can be identified, aid that supports its integration, aid measures that do not infringe upon it and aid which infringes upon the principle but can be justified.<sup>234</sup> The aid measures that support the integration of the principle are for example aid measures that level the competitive playing field between forms of production with varying levels of pollution. Some of the aid measures do not necessarily infringe upon the principle such as aid for environmental studies or when the aid enables an undertaking to beyond Union standard. Going beyond Union standards does not infringe upon the principle because the polluter is not liable to pay for this pollution under national or Union standards.<sup>235</sup> The important factor here is that where the polluter is complying with all obligations under EU law there is no infringement of the polluter pays principle.

Some aid types under the EEAG are technically an infringement of the polluter pays principle, for example exemptions from environmental taxes. These infringements have been justified on the basis that the overall level of environmental protection is greater due to the aid, even if some undertakings receive a favourable tax treatment.<sup>236</sup>

The polluter pays principle has thus been the golden standard for environmental protection and a competitive market. Does the Green Deal Investment plan then mean that there is a shift in focus away from the principle or is it possible that State aid's primary focus should be the implementation of the polluter pays principle?

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<sup>234</sup> Supra note 9 at p. 199

<sup>235</sup> Ibid

<sup>236</sup> Ibid at p. 200

There are two possible readings of the polluter pays principle, a narrow and a broad reading. The narrow reading simply means that the undertakings should pay the full costs of its pollution imposed by the current legal framework.<sup>237</sup> The broad reading is a guiding principle for the legislator.

As the EEAG establish, respect for the polluter pays principle through environmental legislation ensures in principle that the market failure linked to negative externalities will be rectified. Consequently, this implies that State aid aimed at resolving market failures in the form of negative externalities supports the implementation of the polluter pays principle. The aid measures that fall under this category in the EEAG are for example aid to renewable energy to ensure competitive balance with more polluting forms of energy production and energy efficiency measures.<sup>238</sup>

Aid that does not infringe upon the principle under the EEAG are for example going beyond Union standards or improving environmental protection in the absence of Union standards.<sup>239</sup> The aid amount is limited to the amount necessary to achieve the higher level of environmental protection. By limiting the aid amount to the minimum necessary the undertaking is paying for everything it is liable for under Union law and therefore anything above that is not infringing upon the polluter pays principle. The final aid measure is one that infringes upon the polluter pays principle but is justified by the importance of the system.<sup>240</sup> One of these examples are aid in the form of tax exemptions or reductions. This type of aid measure is justified on the basis that the aid would be an indirect contribution to a higher level of environmental protection.<sup>241</sup> Furthermore, a tax reduction would only be considered not to undermine the general objective pursued if it is well targeted and that a generally higher tax rate is generally applicable than would be the case without the exemption.<sup>242</sup>

In light of this the Commission has still stated that State aid can and should contribute further to the European Green Deal, what exactly could change for this to be the case? Should the polluter pays principle be set aside or is there room for further integration of the principle? In order to answer these questions, the purpose of the polluter pays principle needs to be investigated, is the ideal scenario that the polluter simply pays for its pollution while continuing to pollute or is there something else to the principle?

The main functioning of the polluter pays principle is to internalize the social cost borne by public authorities for pollution prevention and control.<sup>243</sup> This function of the principle has garnered some criticism due to

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<sup>237</sup> Ibid at p. 201

<sup>238</sup> Ibid at p. 199

<sup>239</sup> Ibid p. 200

<sup>240</sup> Ibid

<sup>241</sup> EEAG para 168

<sup>242</sup> EEAG para 170

<sup>243</sup> Nicolas De Sadeleer, *Environmental Principles: From Political Slogans to Legal Rules* (Second edition, Oxford University Press, 2020) at p. 13

the fact that it in a way grants the polluter a right to pollute. However, there is a preventative function to the principle, stating that the adoption of pollution control measures, and particularly charges related to these, should encourage the polluter to take the necessary measures to reduce the pollution he is causing as cheaply as possible.<sup>244</sup> The preventative aspect of the principle implies that the true aim is to encourage polluters to reduce emissions instead of being content with paying charges.<sup>245</sup>

## 4.2 The EEAG and the Green Deal

The Commission has proposed a review of the compatibility criteria for environmental protection, suggesting that it should be widened to promote the green transition while effectively controlling distortions of trade and competition.<sup>246</sup> The Commission proposed organizing the rules around broader policy objectives, such as environmental protection, climate neutrality, security of supply, reduced risk of carbon leakage, and other Green Deal objectives.<sup>247</sup>

The EEAG has as mentioned above set out common assessment principles which play a part in determining compatibility<sup>248</sup>. These criteria are the following:

- (a) A contribution to a well-defined objective of common interest.
- (b) Need for State intervention, for example by remedying a well-defined market failure.
- (c) State aid must be the appropriate instrument.
- (d) There has to be an incentive effect, meaning that the aid changes the behaviour of the undertaking which leads to a higher level of environmental protection.
- (e) Aid is kept to the minimal amount needed to achieve the environmental protection.
- (f) Adverse effects on trade and competition must be sufficiently limited so that the overall balance is positive.
- (g) The aid measure must be transparent.

As shown the CJEU has ruled that Member States are no longer required to demonstrate that the aid measure is targeting a “well-defined common interest”.<sup>249</sup> This means that it is up to the Member States to determine which “economic activities” are subject to Article 107(3)(c) TFEU, and up to the Commission to find out if it adversely affects trading conditions to an extent contrary to the common interest.<sup>250</sup> The Commission has however,

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<sup>244</sup> Ibid p. 14

<sup>245</sup> Ibid

<sup>246</sup> Supra note 41 at p. 2

<sup>247</sup> Ibid

<sup>248</sup> EEAG para 26

<sup>249</sup> Supra note 186 at p. 11

<sup>250</sup> Ibid

clarified that when exercising the control on State aid they do not prescribe which common objectives it has to pursue.<sup>251</sup> The role of the Commission is to verify whether the objective chosen by the Member State is a genuine one and then weigh the positive effects of the measure to reach this common objective against the negative impact on trade and competition.

Furthermore, State aid rules should only indicate in general terms, which objectives of common interest are normally considered as acceptable in view of the EU priorities.<sup>252</sup> It remains to be seen what the impact of Hinkley Point C will have on the common interest criteria, nevertheless it could be useful to provide guidance on which economic activities could outweigh negative effects on competition. Therefore, there could still be a place for common interest objectives in the EEAG but not as an absolute requirement, rather more in line with the market-failure criterion where it is not an essential requirement but still useful to determine compatibility.

How should the definition of common interest be in the revised EEAG?

Under the 2014 EEAG general objective of State aid for environmental protection is to increase the level environmental protection compared to what it would be without the aid. Aid measures in line with the Europe 2020 Strategy were particularly important. For aid to the energy sector the objectives pursued were to ensure a competitive, sustainable, and secure energy system in a well-functioning Union energy market.<sup>253</sup>

Demonstrating that the aid was in line with the common interest objectives could be done by comparing the amount of greenhouse gases or pollutants that would not be emitted due to the aid. Highlighting the difference between the level of environmental protection under existing Union standards compared to that the aid would achieve, and in the case of early adaption to future Union standards the reduction of pollution starting at an earlier date could be demonstrated.<sup>254</sup> This is how the general compatibility conditions apply the objective of common interest criterion and there are some specifications for certain aid measures.

The revision of the EEAG should keep a generally broad and objective based common interest criterion. The objectives of aid for environmental protection need to reflect the ambitions introduced by the European Green Deal with climate neutrality being the focus. The general objective for environmental aid is to increase the level of environmental protection compared to the level that would be achieved in the absence of the aid. The EEAG also define ‘environmental protection’ as any action designed to remedy or prevent damage to physical surroundings or natural resources by a beneficiary’s own activities, to reduce the risk of such damage or to lead to a more efficient use of natural resources, including energy-saving measures and the use of renewable sources of energy.<sup>255</sup>

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<sup>251</sup> Supra note 57 at p. 16

<sup>252</sup> Ibid

<sup>253</sup> EEAG para 30

<sup>254</sup> EEAG para 33

<sup>255</sup> EEAG para 19

Given the Hinkley Point C judgement instead of having a contribution to a common interest be a requirement in the compatibility assessment the Commission should instead ensure that the proposed measure is in line with EU law on environment and climate. This approach would ensure any aid measure that undermines reaching the Union's climate targets is rejected and aid measures that contribute to the 2030 targets as well as the 2050 target of climate neutrality, enshrined in the climate law are considered compatible.<sup>256</sup> The guidelines could contain technical guidance on what activities under the first condition of Article 107(3)(c) TFEU are compliant with the targets as well, which would increase legal certainty which is one of the underlying goals with the common interest objective.<sup>257</sup> The EU taxonomy directive also establish a list of environmentally sustainable economic activities. This directive also lays down an 'exhaustive list' of environmental objectives which are, climate change mitigation; climate change adaptation; the sustainable use and protection of water and marine resources; the transition to a circular economy; pollution prevention and control; and the protection and restoration of biodiversity and ecosystems.<sup>258</sup> Other than providing this exhaustive list of environmental protection objectives, the directive also provides how these objectives can be pursued through investment. For example, an economic activity that pursues the environmental objective of climate change mitigation should contribute substantially to the stabilisation of greenhouse gas emissions by avoiding or reducing them or by enhancing greenhouse gas removals. The revised EEAG need to refer to the taxonomy directive in order to ensure that the environmental objectives pursued are in line with the goal of climate neutrality.

In conclusion while contribution to a common interest cannot be a mandatory requirement according to the CJEU, there is still room for it in the EEAG. By instead having Member States show that the proposed aid measure is in line with the proposed climate law, which enshrines the climate objectives in legislation. Legal certainty could be provided by having the Commission provide technical guidance of which aid measures would be in line with these targets. The Commission has already suggested what the scope of the revised EEAG should be focused on broader policy objectives, such as environmental protection, which would include climate neutrality and other Green Deal objectives, security of supply, prevention of carbon leakage due to increased energy related charges and making scope for technological and market innovations.

The next compatibility criterion is showing a need for State intervention, for example through the existence of a well-defined market failure.

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<sup>256</sup> ClientEarth, 'The Hinkley Point C ruling: Why and how the Commission must implement the Green Deal in State aid rules Client Earth' May 4, 2021 at p. 1

<sup>257</sup> Supra note 57 at p. 16

<sup>258</sup> Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088, Article 9 and 10

As the CJEU stated in Hinkley Point C, even though the Commission may consider it necessary in the context of Article 107(3)(c) TFEU to examine whether the planned aid enables a market failure to be remedied when determining whether that aid is compatible with the internal market, the existence of such a failure nevertheless does not constitute a condition for declaring aid to be compatible with the internal market under that provision.<sup>259</sup> They did however, confirm the General Courts viewpoint that it may be a relevant factor for declaring State aid compatible, just that the absence of a market failure does not mean that the conditions laid down in Article 107(3)(c) TFEU are not satisfied.<sup>260</sup> This has however been the case even prior to the 2014 EEAG and the Commission has stated that State aid can help promote sustainable development among other things irrespective of the correction of market failures.<sup>261</sup>

The current EEAG assess the need for State intervention through the presence of market failures. State aid measures can, under certain conditions, correct market failures and thereby contribute towards achieving the common objective to the extent that the market on its own fails to deliver an efficient outcome. Furthermore, State aid should be targeted towards situations where aid can bring a material improvement that the market alone cannot deliver.<sup>262</sup> One clear example of a market failure is the failure to internalize costs of greenhouse gas emissions. While carbon taxes and the EU ETS attempt to internalize them, it is not fully achieved and therefore, unless the Commission has evidence of the contrary there is a presumption that a residual market failure remains.<sup>263</sup> To add to this the EEAG also state that through the setting of ambitious climate change and energy sustainability targets, several Union legislative acts already support these.<sup>264</sup> However, the implementation of this legislation does not always result in the most efficient market outcome and therefore State aid may be used to contribute to the achievement of the Union objectives. This is the case with the Clean Energy Package, Union legislation have been adopted for renewable energy,<sup>265</sup> energy efficiency,<sup>266</sup> energy performance of buildings,<sup>267</sup> and more. The Commission has also stated that there is a need for more flexibility for most of the aid measures under the scope of the EEAG.<sup>268</sup> In order to effectively contribute to the delivery of the European Green Deal, the presumption of a residual market failure should remain and state that this can be remedied through environmental aid.

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<sup>259</sup> Hinkley Point C case para 66

<sup>260</sup> Ibid para 67

<sup>261</sup> Supra note 30 para 10

<sup>262</sup> EEAG para 35

<sup>263</sup> EEAG para 115

<sup>264</sup> EEAG para 107

<sup>265</sup> Directive (EU) 2018/2001 of the European Parliament and of the Council of 11 December 2018 on the promotion of the use of energy from renewable sources

<sup>266</sup> Directive (EU) 2018/2002 of the European Parliament and of the Council of 11 December 2018 amending Directive 2012/27/EU on energy efficiency

<sup>267</sup> Directive (EU) 2018/844 of the European Parliament and of the Council of 30 May 2018 amending Directive 2010/31/EU on the energy performance of buildings and Directive 2012/27/EU on energy efficiency

<sup>268</sup> Supra note 47 p. 14



The third compatibility criteria is the appropriateness of the aid, meaning there are no better policy instruments to address the objective of common interest.<sup>269</sup> The main reason behind this compatibility criterion is to ensure the least distortive instrument is used to accomplish the environmental objective.<sup>270</sup> This criterion is necessary to ensure distortion of competition is kept to a minimum and allowing an aid measure when there already are policy instruments in place could undermine the other instruments. Something to highlight when assessing appropriateness is the form of the aid measure, meaning direct grants, repayable advances, etc.<sup>271</sup> The Commission called into question if and to what extent a distinction between operating and investment aid is still justified and to what extent rules should be aligned.<sup>272</sup> The general idea behind operating aid is that it should only be exceptionally exempted under Article 107(3)(c) TFEU since it calls for the *development* of economic activities.<sup>273</sup> In the Hinkley Point C judgement Austria had argued that operating aid would be incompatible with the internal market on this basis.<sup>274</sup> In the judgement it was held that operating aid cannot, in principle, satisfy the conditions for application of Article 107(3)(c) TFEU as such aid. Given that it does no more than maintain an existing situation or lower the usual ongoing operating expenditure which an undertaking would have had to bear in any event in the course of its normal business, cannot be regarded as being intended to facilitate the development of an economic activity.<sup>275</sup> However, in the case at hand the aid measures had allowed the beneficiary to embark on the construction of Hinkley Point C and that, without them, new nuclear energy generating capacity could not be created.<sup>276</sup> Therefore distinguishing between operating and investment aid may not be necessary, as long as the aid measure facilitates the development of an economic activity.

The fourth compatibility criterion is the incentive effect, meaning that the aid changes the behaviour of the aid beneficiary in such a way that it engages in additional activity which it would not carry out without the aid or which it would carry out in a restricted or different manner.<sup>277</sup> What the incentive effect intends to accomplish is to ensure that the aid measure does not subsidise the cost of an activity that an undertaking would anyhow incur, and must not compensate for the normal business risk of an economic activity.<sup>278</sup> Demonstrating an incentive effect should be simpler for Member States and potential aid beneficiaries in the light of the European Green Deal. The Commission considers that aid granted to adopt to future Union standards has in principle an incentive effect, including when the standard

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<sup>269</sup> EEAG para 27

<sup>270</sup> EEAG para 41

<sup>271</sup> EEAG para 45

<sup>272</sup> Supra note 41 at p. 2

<sup>273</sup> Supra note 9 at p. 192

<sup>274</sup> Judgement Hinkley Point C para 105

<sup>275</sup> Ibid para. 119

<sup>276</sup> Ibid para. 121

<sup>277</sup> EEAG para 27

<sup>278</sup> EEAG para 49

has already been adopted but is not yet in force.<sup>279</sup> The European Green Deal together with the European Climate Law establish a significant number of new Union standards.<sup>280</sup> State aid for the early adaptation to EU standards is considered to have an incentive effect due to the aid beneficiary changing its behaviour earlier than required, which also has positive impacts on the environment.<sup>281</sup>

The fifth compatibility criterion is the proportionality of the aid, aid is considered proportional when it is limited to the minimum needed to incentivise the additional investment or activity in the area concerned.<sup>282</sup> In the case of the EEAG, environmental and energy aid is considered to be proportionate if the aid amount per beneficiary is limited to the minimum needed to achieve the environmental protection or energy objective aimed for.<sup>283</sup> In other words, an aid measure is proportional when it can achieve its objectives with the minimum possible negative effects.<sup>284</sup> As mentioned previously, the Commission cannot prohibit aid measures that support the objectives of facilitating the development of economic activities or areas under Article 107(3)(c) TFEU. The Commission should ensure that the development of these activities is achieved at minimum possible distortion.<sup>285</sup> The proportionality assessment under the EEAG has been carried out by comparing the cost between a scenario when the aid is given and the counterfactual scenario where no aid is granted.<sup>286</sup> The impact the Green Deal may have on this criterion is in regard to the calculation of the aid amount. The Commission mentioned that it would assess whether, in the future, investments that are compatible with the transition to climate neutrality instead could determine the eligible costs by reference to the funding gap in particular cases where there is no hypothetical alternative investment.<sup>287</sup> This approach is currently in the EEAG but limited to certain aid categories.<sup>288</sup> It is defined as the difference between the positive and negative cash flows over the lifetime of the investment, discounted to their current value.<sup>289</sup> While the calculation method may change, keeping the aid amount to the minimal amount is necessary to keep adverse effects on competition to a minimum and therefore should not be affected by the European Green Deal.

The sixth compatibility assessment criterion is the avoidance of undue negative effects on competition and trade between member states, meaning

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<sup>279</sup> EEAG para 53

<sup>280</sup> Steven Verschuur and Cecilia Sbrolli, 'The European Green Deal and State aid: The Guidelines on State aid for Environmental Protection and Energy towards the Future' (2020) 2020 Eur St Aid LQ 284 at p. 287

<sup>281</sup> Ibid

<sup>282</sup> EEAG para 27

<sup>283</sup> EEAG para 69

<sup>284</sup> Supra note 208 at p. 7-8

<sup>285</sup> Ibid p. 8

<sup>286</sup> EEAG para 70

<sup>287</sup> Supra note 47 at p. 13

<sup>288</sup> EEAG para 211

<sup>289</sup> EEAG para 32

that the negative effects of the aid are sufficiently limited, so that the overall balance is positive.<sup>290</sup> As has been mentioned above, this criterion in terms of environmental aid does not view adverse impacts on more polluting technologies or products as an undue distortion of competition.<sup>291</sup> This is because the very objective of the aid is to make the economy greener. The Commission takes into account the overall environmental effect of the measure in relation to its negative impact on the market position, and thus on the profits of non-aided firms.<sup>292</sup> By ensuring that the aid beneficiary is selected through a non-discriminatory, transparent and open manner, without unnecessarily excluding companies that may compete with projects to address the same environmental or energy objectives, distortions of competition and trade will be presumed to be kept to a minimum.<sup>293</sup> There are proposals by the Commission on how this criterion could be kept more aligned with the Green Deal and these are, tendering and broadening.<sup>294</sup> While a competitive bidding process usually ensures that the environmental or energy objective is achieved at the lowest cost, there are more factors to consider for energy and environmental aid.

REDII, as an example, calls for Member States to be allowed to grant exemptions from tendering procedures and direct marketing to small-scale installations and demonstration projects in order to take into account their more limited capabilities.<sup>295</sup> This will allow for a level-playing field between different types of renewable energy as well as removing some of the market barriers for the deployment of new clean technology as the Green Deal also calls for.<sup>296</sup>

Broadening of schemes to direct competitors, various related industrial sectors and other areas of the economy could ensure that the objective is achieved with minimal cost. However, this could have a similar effect to competitive bidding processes in that it simply restricts the State aid almost exclusively to traditional market players.<sup>297</sup> The revised EEAG should therefore require tendering when it is appropriate and ensure that it does not create more market barriers for newer and potentially cleaner technology.

The seventh and final compatibility criterion is transparency, which states that Member States, the Commission, economic operators, and the public, have easy access to all relevant acts and to pertinent information about the aid awarded thereunder.<sup>298</sup> Under the current EEAG the transparency requirement is fulfilled by making public the full text of the approved aid scheme, the identity of the granting authorities, the identity of the individual

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<sup>290</sup> EEAG para 27 (f)

<sup>291</sup> EEAG para 89

<sup>292</sup> EEAG para 90

<sup>293</sup> EEAG para 99

<sup>294</sup> Supra note 41 at p. 2

<sup>295</sup> REDII para 19

<sup>296</sup> Supra note 47 p. 18

<sup>297</sup> ClientEarth, 'Revision of the State Aid Guidelines for Environmental Protection and Energy Exemption rules' January 8, 2021 at p. 31

<sup>298</sup> EEAG para 27

beneficiaries, the form and amount of aid granted to each beneficiary, the date of granting, and some other information.<sup>299</sup> A potential factor in the transparency assessment that the Commission has proposed is to what extent Member States should be required to identify the contribution to environmental protection, as well as make transparent the environmental protection cost in their aid schemes.<sup>300</sup> The contribution to environmental protection would for example be based on the EU Taxonomy directive which establishes the conditions that an economic activity must meet in order to qualify as environmentally sustainable.<sup>301</sup> By requiring Member States to show the contribution to and cost of environmental protection in their aid schemes it would ensure that the adverse effects on competition and trade in general are kept to a minimum and make the compatibility assessment easier.

### **4.3 Consistency between the Green Deal and the polluter pays principle**

As mentioned previously the Green Deal is the backdrop to the revision of the EEAG and the flagship policy for achieving climate neutrality by 2050. In delivering the Green Deal the Green Deal Investment Plan carries a vital role. The Green Deal Investment Plan aims to mobilise through the EU budget and the associated instruments at least 1 trillion EUR of private and public sustainable investments over the upcoming decade.<sup>302</sup> As part of these investments the Just Transition Mechanism plans to provide funds of over 100 billion EUR for financial assistance to territories with high employment in coal, lignite, oil shale, and peat production, as well as territories with other greenhouse-gas-intensive industries.<sup>303</sup> This would at first glance imply that the polluter pays principle is being set aside in favour of the Green Deal objectives. Setting aside the polluter pays principle could arguably be justified given the existential threat posed by climate change. There is however, depending on how the polluter pays principle is interpreted, an argument stating that these investments are an expression of the principle's role on an international stage.<sup>304</sup> From an internal EU perspective the investment plan arguably relieves the polluters from their responsibilities. From an external global perspective, the Green Deal Investment Plan could be interpreted as an imperfect application of the

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<sup>299</sup> EEAG para 104

<sup>300</sup> Supra note 41 at p. 2

<sup>301</sup> Commission, 'Provisional version of Commission Delegated Regulation supplementing Regulation (EU) 2020/852 of the European Parliament and of the Council by establishing the technical screening criteria for determining the conditions under which an economic activity qualifies as contributing substantially to climate change mitigation or climate change adaptation and for determining whether that economic activity causes no significant harm to any of the other environmental objectives' (Staff Working Document) SWD(2021) 152 - SWD(2021) 153 at p. 1

<sup>302</sup> Supra note 47 p. 1

<sup>303</sup> Supra note 186 at p. 8

<sup>304</sup> Ibid

principle. If the EU as a whole is viewed as the polluter, given that the Member States bear significant responsibility, then paying for it with EU funds could be viewed as in line with the polluter pays principle. Everything simply depends on the interpretation of who the 'polluter' is and what it is the polluter should 'pay' for, which the principle conveniently does not define.

The proposed revision of the EEAG would also significantly broaden the scope to grant aid for environmental protection, which previously mentioned above is contradictory to the polluter pays principle. As Article 191(2) states, environmental damage should as a priority be rectified at the source and that the polluter should pay. Furthermore, based on Hinkley Point C the Commission now has a positive obligation to ensure no proposed aid measure goes against EU environmental law.<sup>305</sup> This then begs the question of how to keep the broadened EEAG in line with the polluter pays principle. In order to answer this question, the first thing to answer is what the purpose of the polluter pays principle is. Should it simply be viewed as a right to pollute as long as the polluter pays for it, or is there a preventive aspect to it? Adding further to this, as was established above, the costs for pollution may be impossible to translate into a monetary value and the chain of polluters may be too long to identify a causal link between the polluters and the damage. Instead, the role of the polluter pays principle in State aid law has been as a standard for analysis.<sup>306</sup> This stance was confirmed in the GEMO case stating that in State aid practice, the polluter pays principle is used to determine whether a measure constitutes State aid within the meaning of Article 107(1)(b) TFEU and whether a given aid measure may be declared compatible under Article 107(3)(c) TFEU. In the first context, on the notion of aid, the principle is used as an analytical tool to allocate responsibility according to economic criteria for the costs entailed by the pollution in question. If the proposed aid measure relieves anyone liable under the principle of their responsibility to pay, then the measure will constitute State aid. In the second context, the principle is used in a prescriptive way as a policy criterion, meaning that the principle is used to argue that the costs of environmental protection should as a matter of sound environmental and State aid policy ultimately be borne by the polluters themselves rather than States.<sup>307</sup>

State aid is consistent with the polluter pays principle, by limiting compatible aid measures to those that are capable of applying more stringent environmental protection standards than those provided under EU law or, where there are no Union standards, that change the behaviour of the undertaking in a way that leads to greater environmental protection.<sup>308</sup> The main purpose behind the implementation of the principle in EU law was also to charge polluters the costs of action taken to combat the pollution, because this would encourage them to reduce their pollution and find less

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<sup>305</sup> Supra note 186 at p. 13 and Hinkley Point C judgement para 100

<sup>306</sup> Supra note 160 at p. 47

<sup>307</sup> Ibid and Opinion of A.-G. Jacobs in Case C-126/01 GEMO [2003], paras 68-70

<sup>308</sup> Ibid

polluting technologies or products, thereby enabling a rational use to be made of the resources of the environment.<sup>309</sup> The purpose of pollution charges were twofold, an incentive function as well as a redistribution function. By charging the polluter there would be an incentive for them to reduce or alter the polluting behaviour and the redistribution function was to have them pay for their share of costs of for example purification measures.<sup>310</sup> Another important aspect to consider when discussing cost allocation for energy pollution is the fact that a full implementation of the principle, in its literal sense, could simply pass on the cost to the consumer. Even if the polluter has to account for full internalization of pollution costs, they are simply the first to pay for it, the cost arising from the charge to the polluter will ultimately be borne by the consumer.<sup>311</sup> As the Commission has stated in the past, energy is a vital resource to our society and, the well-being of our people, industry and economy depends on safe, secure, sustainable, and affordable energy.<sup>312</sup> This can however be avoided if the full internalization of pollution costs also lead to the polluters less polluting competitors becoming more competitive.<sup>313</sup> If the polluter pays principle can be seen as an attempt to internalize negative externalities, rather than a right to pollute as long as it is paid for, then aid measures targeting these would in a way implement the polluter pays principle. These negative externalities can be targeted in two ways, either by reducing the costs of production for products or technologies that do not generate negative externalities, or by increasing the cost of those that create them. Increasing the cost of the more polluting production would most likely result in a non-competitive European energy market and could also result in carbon leakage due to undertakings relocating. If production is simply transferred outside the EU due to the ambitions of the Green Deal then there will be no reduction in global emissions and ultimately do nothing to contribute to combating climate change. The best way to ensure a level-playing field in environmental protection would then appear to be reducing the cost of production either without or significantly fewer negative externalities, until full internalization could be achieved without simply passing the cost to consumers or relocating pollution outside the EU.

State aid that provides incentives for undertakings to change their behaviour in a way that leads to more environmental protection than current Union standard provides could, interpreted this way, be seen as an imperfect implementation of the polluter pays principle. While the polluter may not necessarily pay for the negative externalities, the underlying objectives of the principle are to ensure a competitive balance between polluting and non-polluting entities in the aims that this reduces pollution.

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<sup>309</sup> Supra note 131 para 1

<sup>310</sup> Ibid para 4 (b)

<sup>311</sup> Supra note 243 at p. 56

<sup>312</sup> Commission, 'Energy 2020 A strategy for competitive, sustainable and secure energy' (Communication) COM(2010) 639 Final at p. 1

<sup>313</sup> Supra note 243 at p. 56

Broadening the scope of State aid for environmental protection and energy objectives would then not only be in line with the polluter pays principle but it would have a role in its implementation, assuming the aid measures remedy the market failure of negative externalities. The revised EEAG have the potential of implementing the polluter pays principle further than the 2014 guidelines, due to the increase in environmental ambition, as well as the obligation for the Commission to ensure that aid measures are complying with EU environmental law. This precedence set out in Hinkley Point C allows the revision of the EEAG to require that aid measures that are inconsistent with the EU's climate regime, that also distorts competition in the energy market, be declared incompatible with the internal market.<sup>314</sup> Phasing out harmful subsidies has been a goal since 2013 however, a report from 2018 shows that Member States fossil fuel subsidies are gradually increasing.<sup>315</sup> The EEAG have under aid for capacity mechanisms contributed to this increase. The EU Taxonomy regulation has further enshrined in law that power generation activities that use fossil fuels do not qualify as environmentally sustainable economic activities.<sup>316</sup> State aid for fossil fuels are also a contradiction to the polluter pays principle by increasing negative externalities further contributing to an uneven playing-field in the energy market.

As a conclusion the granting of State aid for environmental protection has since the introduction of the polluter pays principle been seen as contradictory to it. State aid has been recognized as the second-best solution due to the fact that European industry would not be competitive if full internalization were achieved. From an internal EU perspective, achieving full internalization in one Member State would significantly impact competition on the internal market as well. The granting of State aid was then allowed transitionally while the negative externalities of pollution would gradually be internalized. However, as long as global ambition on combating climate change lacks in comparison to the EU, full internalization would most likely end up causing carbon leakage and a non-competitive European industry. Recalling that the purpose of achieving climate neutrality is in order to reduce global emissions in order to be in line with the Paris Agreement one realizes that this approach is counterproductive. Therefore, granting aid for environmental protection, as it has now been defined in regulation under the European Taxonomy directive, is an appropriate solution to ensuring a level-playing field. It is only when internalizing the cost of pollution encourages the polluter to either reduce or alter their behaviour the polluter pays principle fulfils its purpose. Through achieving climate neutrality, the market failure of negative externalities for pollution would be rectified in the process. Climate neutrality can only be achieved by transforming the EU's economy into becoming resource-efficient and competitive by decoupling economic

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<sup>314</sup> Supra note 186 at p. 16

<sup>315</sup> Ibid

<sup>316</sup> Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending regulation (EU) 2019/2088 Articles 9 and 10

growth from resource use. There are two main methods to discouraging the use of greenhouse gases, and those are to either promote products and processes that do not require them, and by making the use of products and processes linked to greenhouse gas emissions more expensive. Given our society's dependency on products and processes high in greenhouse gas emissions the more reasonable route is to make the environmentally friendlier technologies cheaper, by for example using State aid. While the concept of State aid for environmental protection and the polluter pays principle seem to be contradicting there are some supportive elements, through which State aid eventually would lead to the implementation of the principle.



## 5 Concluding remarks

The purpose of this thesis was to discuss the consistency between the granting of State aid for environmental protection and the polluter pays principle. State aid for environmental protection and energy are granted either through the GBER or the EEAG mainly, while some aid measures may be found compatible outside the scope of these policies directly under Article 107(3)(c) TFEU.

The first chapter of this thesis provided the necessary context for the discussion where the discussion focused on what State aid is and also why there needs to be State aid control. Furthermore, the first chapter also presented the European Green Deal which aims to turn Europe climate neutral by 2050. The target of climate neutrality requires a complete transformation of the European economy and energy production where the EEAG play a major role.

The second chapter discussed whether or not the current framework is suitable for the challenges at hand and also learned from the application of these guidelines. While the 2020 targets were achieved, it has to be evaluated in the light of the global pandemic which reduced environmental impact without which the energy efficiency would have been hard to reach. It was also established that given the current projections not only is the 2050 climate neutrality objective out of reach, but also the revised ambitious 2030 targets. There is therefore a need to update the current framework in order to achieve the set objectives. This chapter also presented the common assessment principles which provide the foundation for how State aid can be deemed compatible with the internal market. This chapter highlighted where State aid had been effective in pursuing environmental protection, such as with making renewable energy more competitive, but also highlighted where it had granted aid to environmentally harmful behaviour such as capacity mechanisms involving aid for fossil fuels or tax relief for polluting undertakings.

The third chapter of this thesis investigated and discussed the obligation to integrate environmental considerations into State aid, through Article 11 TFEU, focusing mainly on the polluter pays principle found in Article 191(2) TFEU. Article 11 TFEU and its implications for State aid has been the topic of much debate in doctrine and through case law some clarity has been achieved, but there are still plenty of questions to be answered. The balance between a competitive internal market and also a competitive European industry is hard to balance with environmental protection, as was shown in the discussion. The thesis, does however, establish common ground between the interests, this being the polluter pays principle. Both the polluter pays principle and competition policy share the same ultimate goal, this being a level-playing field in the internal market. At first glance the polluter pays principle sounds more straightforward than it is in reality. By

discussing the principle from a teleological perspective there are not only arguments for State aid for environmental protection being consistent with it, but even supportive of it. Which then raises the question of how this can guide the revision State aid policy for environmental protection.

The fourth and final chapter of this thesis combines the need for revision established in the first chapter, as well as the balancing discussed in the third, in order to establish what State aid policy for environmental protection and energy should accomplish. The discussion first establishes in light of the environmental and energy objectives and the polluter pays principle what types of aid measures that can be compatible. The discussion looks toward past integration in the guidelines and reviews this in light of the recent developments in the field.

Through evaluating past integration as well as the purpose of integration of environmental objectives the thesis provides the necessary information to carry out a productive discussion regarding future integration. The ambition of climate neutrality as well as the recognition of climate change as an existential threat has undoubtedly justified a broadened scope to environmental State aid. However, it is important to make sure the aid is still effective because poorly directed aid can lead to more harm than good, as was shown in chapter one. The thesis discusses the general compatibility criteria once more, in light of the Green Deal and recent case law. Through this discussion the thesis provides suggestions as to where the revision should broaden the scope but also where to limit the possibilities of granting State aid. The points where the scope can be broadened are by shifting the focus away from the common interest objective, instead leaving to the Member States to decide which economic activities contribute to the goal of climate neutrality. The argument for limiting the possibilities of granting State aid is through the proposed climate law which enshrines the 2030, 2040 and 2050 environmental targets in legislation. This would imply that any aid measure that goes against the accomplishment of climate neutrality by 2050 should be deemed incompatible. The EEAG has, as the thesis established, provided aid for environmentally harmful behaviour which would contradict the objective of climate neutrality. This would also promote legal certainty and coherency with the Green Deal Investment Plan and if an aid measure does not qualify as sustainable according to this, it should place greater scrutiny on the ability to consider it compatible with the internal market. The discussion, in its nature, tries to pinpoint where to allocate the costs for achieving climate neutrality, and comes to the conclusion that regardless of policy instrument society as a whole will most likely pay for it. The purpose of the polluter pays principle has since the beginning been to have polluters take responsibility for their pollution and alter their behaviour in favour of less pollution. State aid for environmental protection has attempted to level the playing-field between technologies and products with less externalities and those with more. Furthermore, State aid has aimed at maintaining a competitive balance when internalization costs become too high for certain undertakings. The conclusion that this discussion led to, in light of energy being a vital resource, is that the best

way to achieve not only climate neutrality, but also a level-playing field is to focus resources on allowing less polluting technologies and processes to become competitive, eventually phasing out environmentally harmful ones. The aims of both State aid for environmental protection and the polluter pays principle are the same, the difference lies in how it is to be achieved. The conclusions proposed focus on the synergies between the mentioned policy instruments in order to achieve the most effective result. The synergies are for example, by removing the ability to grant aid for environmentally harmful behaviour there would be no conflict with the principle and would instead make it more expensive for the polluter, achieving consistency with the principle in the process. Another synergy is making less polluting undertakings more competitive, by detaching the economy from pollution it would be possible to fully implement the polluter pays principle. Currently a full implementation would harm the competitiveness of European Industry and go against other fundamental interests such as affordable and secure energy for European citizens. By promoting renewable energy sources and promoting an industry not reliant on pollution the fundamental purpose of the polluter pays principle would be achieved.

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