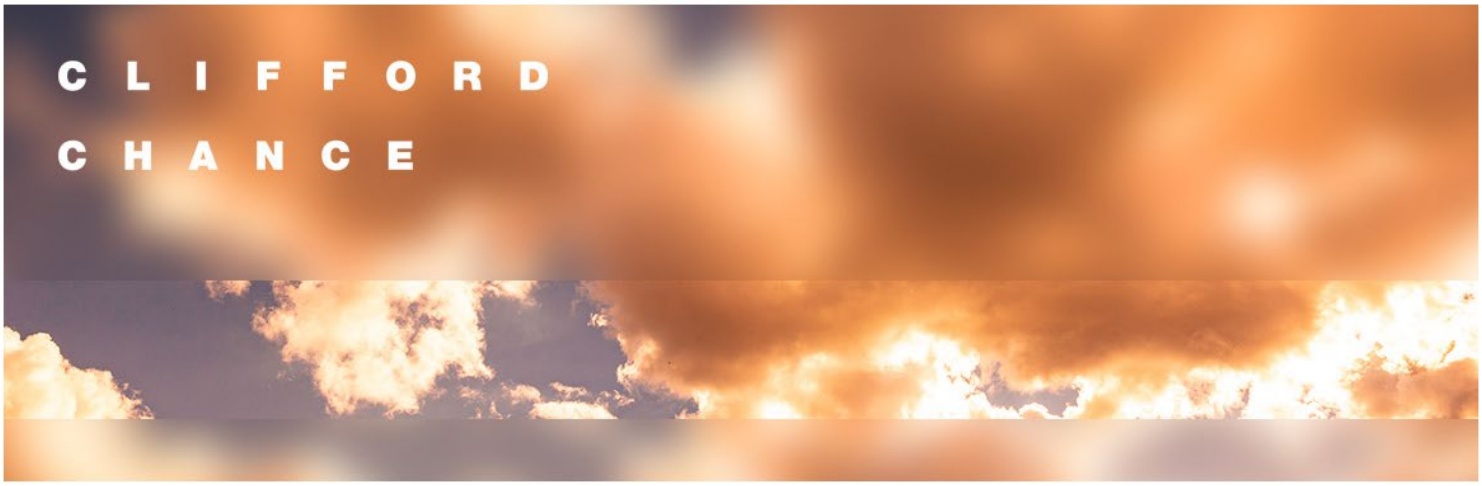

REPOWEREU: EUROPEAN COMMISSION'S PROPOSED PLAN FOR MORE AFFORDABLE, SECURE AND SUSTAINABLE ENERGY

In March 2022, in response to the unprecedented energy price crisis, the European Commission presented REPowerEU, a new set of proposed measures to create an affordable, secure, resilient and sustainable EU energy market, including a State aid Temporary Crisis Framework to support affected companies.

BUILDING A MORE RESILIENT EU ENERGY MARKET

Since September 2021, EU citizens have been facing a steep increase in gas prices, which was initially driven by a high post-COVID19 economic recovery demand and insufficient supply in conjunction with weather-related factors. In October 2021, the Commission presented a Communication on energy prices, including a toolbox, outlining what Member States could do under existing EU rules to help vulnerable consumers and businesses to face high prices.

In the gas sector, Russia provided around 45% of the EU's total gas imports in 2021, and it is the EU's largest supplier of crude oil (27%). With the Russian invasion of Ukraine, the already elevated energy prices jumped to all-time highs, and several EU Energy Ministers urged the Commission to propose concrete measures that could address the cascade effects: increased prices for other commodities resulting in higher poverty rates and high manufacturing costs leading to reduced business competitiveness. REPowerEU is the Commission's proposed plan for building a more resilient and sustainable EU energy market (**REPowerEU Communication**).

The Commission's October 2021 Communication was criticised for lacking concrete measures directly applicable across Member States. Given the exceptionally high energy prices exacerbated by Russia's invasion of Ukraine and the fact that energy is a shared responsibility / competence between Member States and EU, the Commission is now putting forward the REPowerEU plan. This sets out specific measures that Member States are encouraged to take and announces forthcoming legislative proposals that will aim at building an EU energy market resilient to price volatility and less dependent on energy imports.

Key issues

- **Minimum gas storage filling target at 90%** and fair allocation of security of supply costs mechanism.
- **Full tariff rebates** at gas storage points.
- New State aid **Temporary Crisis Framework** for aid granted to companies affected by the crisis
- Temporary **tax measures on windfall profits**.
- Recommendation on **fast permitting** for renewable energy projects and a dedicated communication on **solar energy** to be put forward by June 2022.
- Setting up a **Hydrogen Accelerator initiative** that will aim at developing integrated infrastructure, storage facilities and port capacities. Hydrogen IPCEI State aid notification assessment to be concluded within 6 weeks.
- Member States are allowed to **intervene and regulate electricity prices** ensuring protection for energy poor and vulnerable households and microenterprises.

This briefing aims at presenting and analysing the Commission's proposal in light of the everchanging global energy landscape and the relevant EU energy legal and regulatory framework.

Temporary State Aid and Tax Measures

EU State aid rules offer Member States options to provide support to companies affected by high energy prices and help reduce companies' exposure to energy price volatility in the medium to long term. Indicatively, the EU Emissions Trading System (**ETS**) State aid guidelines enable Member States to specifically support sectors that are most at risk of carbon leakage because of indirect emission costs. On that basis, in March 2022, the Commission approved schemes to compensate energy-intensive companies for indirect emission costs of EUR 2.9 billion in Spain and EUR 1.4 billion in the Czech Republic.

Further, Member States may grant reductions from levies on electricity consumption as per the recently adopted Climate, Energy and Environmental Aid guidelines (**CEEAG**).

Similar to its response to the serious disturbance in the EU economy caused by the COVID-19 outbreak, the Commission's reaction has been immediate and on 23 March it published **a new State aid Temporary Crisis Framework** to grant aid to companies affected by the crisis, in particular those facing high energy costs. The Temporary Crisis Framework provides for three types of aid under certain conditions:

i. **Limited amounts of aid**: Member States will be able to set up schemes to grant up to EUR 35,000 per company affected by the crisis active in the agriculture, fisheries and aquaculture sectors and up to EUR 400,000 per company affected by the crisis active in all other sectors.

ii. **Liquidity support in form of State guarantees and subsidised loans**: Member States will be able to provide subsidised State guarantees, to ensure banks keep providing loans to all companies affected by the current crisis, and public and private loans with subsidised interest rates, subject to conditions in particular related to the loan's overall amount or minimum margins / premiums.

iii. **Aid to compensate for high energy prices**: Member States will be able to partially compensate companies, in particular intensive energy users, for additional costs due to exceptional gas and electricity price increases. This support can be granted in any form, including direct grants with the overall aid per beneficiary not exceeding 30% of the eligible costs and up to a maximum of EUR 2 million at any given point in time. Member States may grant aid exceeding these ceilings, up to EUR 25 million for energy-intensive users, and up to EUR 50 million for companies active in specific sectors, such as production of aluminium and other metals, glass fibres, pulp, fertilizer or hydrogen and many basic chemicals.

The Temporary Crisis Framework will be in place until 31 December 2022. Further, State aid measures covered by this Framework may be cumulated with aid granted under the COVID-19 Temporary Framework, provided their respective cumulation rules are respected.

At the same time, the Commission has consulted Member States on targeted amendments to the ETS State aid guidelines to expand the list of sectors eligible for support, while ensuring that they are subject to reinforced incentives to improve energy efficiency and/or decarbonise their production. The Commission also encourages Member States to use ETS revenues to finance emergency measures to offset higher energy bills.

The Commission proposes that Member States may consider financing the aforementioned support to offset companies' higher energy bills through temporary tax measures on windfall profits that certain electricity generators may earn. Annex 2 of the REPowerEU Communication provides guidance on the application of infra-marginal profit fiscal measures noting that:

- The revenues generated from such measures should be passed on to households or in non-selective and transparent measures supporting all end consumers.
- These measures should equally apply to all generators regardless of whether they are covered by support schemes or capacity remuneration mechanisms.
- Any infra-marginal units operating in the hours of application of the tax, (*e.g.*, infra-marginal rents from hard coal and lignite-fired generation, renewables, including hydropower, and nuclear) should be included in such fiscal measures.
- To avoid any arbitrary use that would result in heavy distortions, the 'windfall profits' and the 'trigger/deactivation' mechanism would have to be defined on the basis of objective and verifiable criteria and events.

Ensuring sufficient gas storage

In the REPowerEU Communication, the Commission reassures that gas supplies are sufficient until the end of this winter even in the event of full disruption of supplies from Russia, with the storage filling level currently being at approximately 30%. At the same time, the Commission outlines proposals to achieve higher gas storage filling levels to deal with any supply disruption that may arise next winter. More specifically, by April 2022, the Commission will put forward a legislative proposal on minimum gas storage fillings, setting a 90% target by 1 October each year, designating gas storage as critical infrastructure and tackling the storage infrastructure ownership risks. Critical Infrastructures are defined at EU level by Directive 2008/114/EC, as '*any system which is essential for providing vital economic and social functions: health, food, security, transport, energy, information systems, financial services.*' This is particularly relevant to foreign investments and the protection of key energy infrastructure from hostile foreign ownership, considering also the high scrutiny under FDI rules.

To further incentivise the refilling, the Commission notes that Member States can provide aid to suppliers under Article 107(3)(c) TFEU, including in the form of guarantees (e.g., two-way contracts for difference).

The Commission will also propose to give full tariff rebates at storage points and will design a mechanism for fair allocation of security of supply costs. In that context, the Commission intends to take a more active role in coordinating refilling operations, for example through joint procurement, collecting orders and matching supplies, while it proposed the establishment of a joint European platform for contractualisation of gas supply based on bilateral negotiations with major gas producers ensuring security of supply on favourable terms.

An important issue is the time required for the adoption of the announced proposals and the alignment with already proposed legislation taking into consideration that in December 2021 the Commission put forward the Hydrogen and Decarbonised Gas Market Package which extends the scope of security of supply regulations to support gas storage, including a tool for joint gas procurement. Against this background, Commission officials recently stated that parts of this package could be fast-tracked to address the current security of supply issues.

Accelerating clean energy transition

The proposed REPowerEU plan builds on several policy and legislative initiatives that the Commission has put forward to accelerate the clean energy transition in the context of the European Green Deal and its ambitious 2030 and 2050 climate targets.

The Commission highlights the important role of renewables and energy efficiency in reducing EU's energy dependency on Russia and encourages an accelerated roll-out of solar, wind and heat pumps. It estimates that full implementation of the *Fit for 55 package* could decrease EU gas consumption by 30% (*i.e.*, 100 bcm by 2030). Furthermore, the Commission announced publishing a Recommendation on fast permitting for renewable energy projects in May 2022, while it will present a dedicated communication on solar energy in June 2022. Member States are asked to swiftly map, assess and ensure suitable land and sea areas that are available for renewable energy projects.

In terms of incentivising investments in clean energy, during 2022, the Commission and the European Investment Bank Group will agree on the financing mechanisms best suited to promote the development of power purchase agreements (**PPAs**) in Europe, including how to offer better access to PPAs for new off-takers such as SMEs.

Boosting uptake of low-carbon and renewable gases

EU's dependency on Russian gas can be eliminated to a large extent through increased use of biomethane and renewable hydrogen. To this end, the REPowerEU plan would aim for 35bcm of biomethane by 2030 produced from biomass sources such as agricultural wastes and residues, supported by Member States' funding.

In addition, REPowerEU will create a **Hydrogen Accelerator** that will aim at developing integrated infrastructure, storage facilities and port capacities. The Commission estimates that an additional 15 million tonnes of renewable hydrogen can replace 25-50 bcm per year of imported Russian gas by 2030.

The Commission commits to treat State aid notifications for hydrogen projects with priority and, in particular, to conclude its assessment of complete notifications of aid to Important Projects of Common Interest (**IPCEI**) on hydrogen in no more than 6 weeks. In addition, the Commission will support pilot projects on renewable hydrogen production and transport in the EU neighbourhood, starting with a Mediterranean Green Hydrogen Partnership.

Retail Prices: State intervention

In Annex I of its REPowerEU Communication, the Commission provides guidance on the application of Article 5 of the Electricity Directive 2019/944 under the current circumstances (**the Guidance**). Article 5 of the Directive sets out the framework within which Member States can in exceptional circumstances intervene and regulate electricity prices ensuring protection for energy poor and vulnerable household customers and microenterprises. The Commission notes that the current energy crisis would justify temporary state intervention so that Member States can meet their policy objectives and protect their consumers.

The Guidance sets out a list of indicative reasons for Member States to intervene and regulate retail prices, such as cementing the position of dominant players, locking in energy sources with high carbon emissions (*e.g.,* coal), passing price increases and volatility from the wholesale market directly onto the retail market.

The Commission encourages Member States that have already taken such measures to continue doing so and notes that Member States that decide to undertake market interventions must:

i. ensure protection of vulnerable and household customers during periods of exceptionally high prices;

ii. ensure continued transition to full competition; and

iii. avoid seriously impairing current levels of competition.

KEY TAKEAWAYS – OUTLOOK

In recent years, several Member States decided to rely on natural gas as a transitional fuel in the process of phasing out coal, until they could increase the share of renewables in their energy mix. Therefore, these countries are currently heavily exposed to the high natural gas prices adversely affecting almost all sectors of their economy. As a consequence, they have been forced to either reactivate their coal plants or import high-carbon content fuels from third countries. The Commission highlights the important role of gas storage and to this end it will propose binding targets for the gas storage filling levels and security of supply cost allocation amongst Member States. That said, the REPowerEU Communication does not provide for any incentives for project promoters to develop new gas storage facilities that could address the relevant security of supply issues until the eventual replacement of natural gas by renewable gases or other forms of energy.

However, it should be noted that both the recent draft EU sustainable finance taxonomy delegated act and the CEEAG underline the role of natural gas as a transitional fuel and allow new investments in natural gas by setting strict criteria and assuming it can be demonstrated that there is no lock-in effect. In particular, for gas infrastructure, it has to be shown that the projects will be ready for the use of hydrogen and that they will contribute to achieving the EU climate targets.

The idea of a Temporary Crisis Framework, similar to the one adopted at the outbreak of the COVID-19 pandemic crisis, facilitating the granting of aid to companies facing high energy costs as well as the accelerated assessment of hydrogen IPCEI aid notifications are positive measures aiming at addressing the implications of the current crisis.

Nevertheless, the REPowerEU Communication comprises a number of measures that without proper monitoring on the part of the Commission may lead to heavily regulated energy markets. In that context, compliance with the Guidance on the State intervention in the functioning of the retail energy markets and on the imposition of fiscal measures is important.

In the coming months, the Commission will put forward several legislative proposals, recommendations and communications and it remains to be seen whether these measures will provide both an effective short-term remedy and a robust long-term plan for the EU's security of supply and energy independence without having to deviate significantly from its decarbonisation targets.

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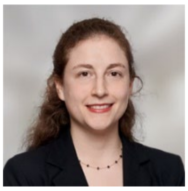

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