Helping to combat climate change: new State aid guidelines for environmental protection

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In a bid to meet the ambitious environmental targets the EU has set itself in its quest to combat climate change, on 23 January 2008, the Commission tabled a series of legislative proposals for policy measures addressing this issue. This ‘energy and climate change package’ included a proposal amending the EU emissions trading Directive and a proposal for a Directive promoting renewable energy. As part of that package, the Commission also adopted new State aid guidelines for environmental protection (hereinafter ‘Guidelines’).

This article provides a short presentation of the most important features of these Guidelines. It first sets the political and economic background and briefly recalls the role State aid can play in this context. The guiding principles and the main substantive provisions are then explained, followed by an overview of the four different types of assessment available for environmental State aid measures.

Political and economic background

In recent years, the issue of environmental protection and climate change has turned from a niche issue discussed by a closed circle of learned specialists into one of the most serious concerns of our times. The EU has not only been leading international efforts to combat climate change, it has also developed an integrated climate and energy policy, including a number of headline political targets and a detailed action plan on how to achieve them. And finally, combating climate change has turned into a booming global market — defying the current economic slowdown — with almost €100 billion invested in renewables and other forms of low-carbon energy in 2007.

Negative externalities…

One of the key features of environmental protection is the existence of ‘negative externalities’. These occur when the private cost of an action, like driving a car or burning coal to produce energy, is lower than the cost of that action to society, e.g., in terms of pollution. Since under these circumstances the market fails to allocate costs correctly, private stakeholders lack the incentive to invest sufficiently in environmental protection. As a result, the market produces too much pollution.

… and the ‘polluter pays’ principle

This market failure can be remedied by ensuring that economic operators take the social costs of their action duly into account (i.e. ‘internalise’ those costs) and, consequently, reflect them in the final prices of their products. This is what the EC Treaty prescribes when it sets out, in Article 174(2) EC, that environmental policy should be based on the principle that ‘the polluter should pay’. Indeed, if pollution becomes a real economic cost, companies will tend to maximise their profits by reducing this cost component and, therefore, reduce pollution at the same time. Also, if polluting goods are more expensive, demand will revert

(1) Directorate-General for Competition, unit A-3 State aid policy. The content of this article does not necessarily reflect the official position of the European Commission. Responsibility for the information and views expressed lies entirely with the authors.


(3) For details, see ‘Questions and answers on the Commission’s proposal to revise the EU Emissions Trading System’, MEMO/08/35 of 23 January 2008.

(4) For details, see ‘Memo on renewable energy and climate change package’, MEMO/08/33 of 23 January 2007. Further components of this package are a proposal relating to the sharing of efforts to meet the Community’s independent greenhouse gas reduction commitment in sectors not covered by the Emission Trading System (for details, see ‘Questions and answers on the Commission’s proposal for effort sharing’, MEMO/08/34 of 23 January 2008) and a proposal for a legal framework on carbon capture and storage (for details, see ‘Questions and answers on the proposal for a directive on the geological storage of carbon dioxide’, MEMO/08/36 of 23 January 2008).

(5) The 2007 Spring European Council agreed on an independent EU commitment to reduce greenhouse gases by at least 20% by 2020, compared to 1990 levels, plus a commitment to extend this reduction to 30% if other developed countries were to commit themselves to comparable emissions reductions and economically more advanced developing countries contribute adequately according to their responsibilities and respective capabilities. In addition, with regard to renewable energies, the Spring Council agreed on a binding target of 20% of total EU energy consumption by 2020, with a minimum of 10% for the share of biofuels in overall EU transport petrol and diesel consumption.

to less polluting sectors offering cheaper and more environmentally friendly goods, thus creating new markets for eco-industries.

Public intervention aimed at putting the ‘polluter pays principle’ into practice generally takes the form of either regulation — setting environmental standards at a level sufficiently high to eliminate negative externalities — or market-based instruments. In the EU, among the most favoured market-based instruments are taxes, charges and tradable permit schemes because they provide a flexible and cost-effective means of correcting this market failure (7). For the purposes of this article, two of these instruments warrant being mentioned.

The first is the EU Emissions Trading Scheme (hereinafter ‘ETS’). Based on a Directive (8), the world’s first and biggest international emissions trading scheme began operating on 1 January 2005. The ETS requires Member State governments to draw up national allocation plans (hereinafter ‘NAPs’) for each trading period. NAPs set the total amount of CO₂ that can be emitted by all the installations in each country covered by the scheme, as well as the number of emission allowances allocated to each individual installation. An installation that emits more CO₂ than it has allowances for would need to buy additional allowances on the market, while one that emits less has the possibility of selling its surplus allowances (‘cap and trade’) (9). Thus, in theory, those that can readily reduce emissions most cheaply will do so, thereby reducing pollution at the lowest possible cost to society. The energy and climate change package of 23 January 2008, referred to above, includes a proposal to improve how the current system works (10).

The second instrument is the Energy Taxation Directive (hereinafter ‘ETD’) covering taxes levied on energy consumption (11). Among other things, the Directive sets minimum levels of taxation for the energy products covered by it. Member States are free to set higher national rates, thus increasing the incentive to use energy more efficiently and thereby reduce levels of emissions still further. The Commission plans to review the Energy Taxation Directive in an effort to combine fiscal and environmental goals more effectively (12).

Complementing the polluter pays principle with State aid

There are a number of practical and political limitations to fully implementing the polluter pays principle. Internalising costs may not be feasible because their true value cannot be determined in money terms or because it conflicts with other policy objectives (e.g. social policy considerations). Similarly, it is not easy to set a tax at exactly the optimal level. Finally, there is the prisoner’s dilemma faced by national regulators in the EU, who are all aware that higher environmental targets would be beneficial to the whole Union but none of them wants to be the first to move and thus create additional compliance costs for busi-

(9) The Commission scrutinises NAPs against 12 allocation criteria listed in the Emissions Trading Directive. The criteria seek, among other things, to ensure that plans are consistent with reaching the EU’s and Member States’ Kyoto commitments, with actual verified emissions reported in the Commission’s annual progress reports and with technological potential to reduce emissions. Criterion 5 provides that allocation must not discriminate between companies or sectors in such a way as to unduly favour certain undertakings or activities, in accordance with the requirements of the Treaty, in particular Articles 87 and 88 EC thereof. The Commission decisions approving, in part or in full, the different NAPs can be found on the Environment DG’s website: http://ec.europa.eu/environment/climat/2nd_phase_ep.htm. In this context, it is important to stress that those approval decisions contain only a prima facie State aid assessment and do not, therefore, constitute decisions pursuant to Article 88 EC, see CFI in case T-387/04, EN BW Energie Baden-Württemberg v. European Commission, ECR 2007, II-1197, point 133.
(10) Under this proposal, there will be a single EU-wide cap on the number of emission allowances, instead of national caps, which decreases along a linear trend line, including beyond 2020; a much larger share of allowances will be auctioned instead of allocated for free; and harmonised rules governing free allocation will be introduced. The scope of the system will be widened to include a number of new industries. Finally, Member States will be allowed to exclude small installations from the scope of the system, provided that they are subject to equivalent emission reduction measures.
(11) The Directive provides that electricity and certain uses of certain energy products should be taxed. The main taxable energy products are mineral oils, natural gas, coal and other solid hydrocarbons. Energy products are only liable for tax when they are used as motor fuel and for heating. Taxation of energy products is not harmonised when they are used as raw materials in industrial processing. See Council Directive 2003/96/EC of 27 October 2003 restructuring the Community framework for the taxation of energy products and electricity, OJ L 283, 31.10.2003, p. 51.
nesses in their respective countries, whereas competitors from other jurisdictions do not have to contend with such costs.

One solution for this dilemma is for all Member States to agree on a common approach (15). This was achieved, for example, on minimum levels of energy taxation (i.e. ETD). In the same vein, the Commission has proposed legislation to reduce the average CO₂ emissions of new passenger cars by 2012 (16). The difficulty with a harmonised approach is that, because of the EU decision-making process, the final outcome tends to reflect the lowest common denominator and features a multitude of exceptions and derogations.

Therefore, from an environmental protection point of view, Member States should be encouraged to individually lead the way by adopting stricter standards on their respective territories. By the same token, companies should be encouraged to improve their level of environmental protection beyond what is mandatory or profitable. This is where State aid can play a useful role, in particular by assisting both companies whose economic situation is most affected by such stricter national standards and companies who voluntarily incur additional costs in order to increase environmental protection. Thus, State aid can be a useful complementary tool in cases where the polluter pays principle cannot be applied in full. At the same time, it must be stressed that State aid cannot be allowed in cases where it would directly counteract that principle, e.g. by actually relieving the polluter of the costs of its pollution. This kind of aid would only aggravate the market failure, not remedy it.

For these reasons, the Guidelines were an important part of the energy and climate change package, the aim being to provide the right incentives for Member States and industry to increase their efforts for the environment. They strive to strike the right balance between generous support mechanisms for well targeted environmental aid and the preservation of competition, which is necessary for the market-based instruments proposed by the package to work properly. The remainder of the article focuses on the principal features of the Guidelines, in particular the guiding principles, the main substantive provisions and the different types of assessment.

**Guiding principles**

Like the Risk Capital Guidelines (17) and the Framework for State aid for research and development and Innovation (18) of 2006, the new Guidelines put into practice the balancing test (19) set out in the State Aid Action Plan. Thus, the Commission focuses, inter alia, on the incentive effect and the proportionality of the aid.

**Incentive effect**

Like any other State aid measure, to be compatible with the Treaty State aid for environmental protection must result in the aid recipient changing its behaviour in pursuance of the defined Community objective — which, in this particular case, is to increase the level of environmental protection. For this purpose, it is crucial to correctly identify the counterfactual scenario, i.e. to determine what happens without the envisaged aid (for more details, see below under proportionality). For example, the incentive effect would be lacking where the investment concerned would also have been made without the aid, e.g. because it would have been economically attractive in its own right or because it is required by Community law (20).

In this context, it is interesting to note that for most major companies it has become de rigueur to stress their credentials in the area of environmental protection and combating climate change (21). Consequently, there is good reason to believe that a number of environmental investments may not only yield important image improvements but also

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(17) The balancing test operates in three steps: 1) Is State aid aimed at a well-defined objective of common interest? 2) Is the measure designed to address the market failure or another objective (appropriate instrument, incentive effect and proportionality)? and 3) Does it involve limited distortion of competition and effect on trade, thus making the overall balance is positive?
(18) In general, aid may not be granted where Community standards are already adopted, even when these standards have not yet come into force. By way of exception, aid for the acquisition of new vehicles for road, railway, inland waterway and maritime transport complying with adopted Community standards is permissible where such acquisition occurs before they enter into force and where the new Community standards, once mandatory, will not apply retroactively to already purchased vehicles, see point 85. By derogation, aid for early adaptation to future Community standards may also be allowed, see points 87 ff.
(19) A cursory look at major European newspapers and magazines during the month of June 2008 showed advertisements by, *inter alia*, petrol companies, steel companies, computer chip producers and even shampoo producers carrying this message. The same is true of many corporate web pages.
(20) Incidentally, where the market is global this kind of EU-wide harmonised approach merely displaces the prisoner’s dilemma to a global level.
(21) See IP/07/1965 of 19 December 2007
that they have in fact become indispensable given the environmental awareness and preferences of today’s consumers.

The level of detail when assessing the incentive effect depends on whether the assessment is made in the context of a standard or a detailed assessment (see below).

**Proportionality and eligible costs: net extra cost approach**

To ensure that the amount of aid is limited to the minimum, the Commission will consider only the extra investment costs to be eligible that are necessary to achieve a higher level of environmental protection. In addition, these extra investment costs must be net of any operating benefits and/or costs (20).

The first step in calculating the extra investment cost is to determine the — credible — counterfactual situation, i.e. the level of investment that would have yielded a comparable performance but, at the same time, would have been environmentally less friendly — and thus cheaper. The difference between the costs of the two investments is the gross extra cost.21 The second step is to take account of the possible operating benefits and/or operating costs of the envisaged investment. Deducting the former and/or adding the latter gives the net extra investment cost.

Assuming that the above methodology adequately captures all the benefits that the company might derive from the extra investment, it could be argued that State aid covering the entirety of the net extra costs would be proportionate because the beneficiary would not receive more than the costs actually incurred in the environmental investment. However, this assumption does not hold, essentially for two reasons. First, the substantive rules set out in more detail below provide for operating benefits to be taken into account merely for a limited initial period following the investment (i.e. generally five years). Second, certain types of benefits which are not always easy to measure — such as the ‘green image’ enhanced by an environmental investment — are not taken into account in this context.

Consequently, for the aid to be proportionate the Commission decided not to allow 100% cover-

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(20) The Commission did consider alternative methods of calculating eligible costs but came to the conclusion that the net extra costs approach is the best suited to ensuring necessity and proportionality.

(21) There is no need to identify a reference investment in cases where the extra environmental protection-related cost can be readily and accurately established, e.g. where an existing production process is upgraded.

(22) It is important to note that it is the State aid that is subject to the bidding process, not the project itself.
On the other hand, as in the previous Guidelines, the intensities are higher for SMEs than for large enterprises, but the new Guidelines make a further distinction between small and medium-sized enterprises, to the effect that small enterprises are now eligible for a 20% bonus whereas medium-sized enterprises maintain a 10% bonus compared to large ones. In addition, a new 10% bonus for eco-innovation is introduced. This bonus applies to projects that address the dual market failure linked to the higher risks of innovation, coupled with the environmental aspect of the project. It is important to stress that the Guidelines cover only the acquisition of an eco-innovation asset or the launching of a project that enables the beneficiary to increase the level of environmental protection resulting from its activities. In contrast, the design and manufacture of environmentally friendly products, machinery or means of transport that use less in the way of natural resources are not covered by the Guidelines. For innovation in those cases, the rules set out in the Framework for State aid for research and development and innovation \(^{(23)}\) could be relevant.

**Specific provisions for individual aid categories — novelties**

**Going beyond Community standards**

A new section was introduced dealing with aid for the acquisition of new transport vehicles which go beyond Community standards or which increase the level of environmental protection in the absence of Community standards. As a rule, State aid for investments made to comply with already adopted Community standards is not likely to change the beneficiary’s behaviour and thus will be deemed not to have the required incentive effect. By derogation from that principle, the Guidelines allow aid for the acquisition of new transport vehicles complying with adopted Community standards where such acquisition occurs before they enter into force and, once mandatory, they will not apply retroactively to already purchased vehicles. Aid may also be granted for retrofitting operations that merely upgrade a transport vehicle to Community standards, where those standards were not in force when the vehicle was put into operation.

Another exception has been made to the principle that aid may not be granted for the purposes of complying with adopted Community standards. Whereas the previous Guidelines provided for aid for SMEs for a period of up to three years after adoption, this possibility has been replaced by a better targeted measure providing an incentive to all companies to comply with adopted Community standards earlier than legally required. The aid intensity is graduated according to the size of the company concerned and according to how much earlier the adaptation occurs.

**Environmental studies**

Recognising that companies often fail to correctly gauge the actual possibilities and benefits of, for example, energy-saving measures — leading to overall underinvestment — the new Guidelines provide for aid for studies linked to possible investments enabling the company to go beyond Community standards, save energy or produce energy from renewable sources.

**Energy-saving**

The Guidelines provide for an additional incentive for SMEs to undertake energy-saving investments by shortening the generally applicable five-year period following the investment during which operating benefits related to the extra investment are deducted to three years. For large undertakings that are not part of the ETS, this period is four years and, finally, for large undertakings that are part of the ETS it is five years \(^{(24)}\). This period can be reduced to three years even for large undertakings where they can demonstrate that the depreciation time of the investment does not exceed three years.

**Energy-efficient district heating**

A new section deals with aid for energy-efficient district heating that leads to primary energy-saving. However, State aid for the financing of the necessary infrastructure only falls under the Guidelines to the extent that the provisions on energy-saving are applicable. If not, such aid will have to be assessed directly under Article 87(3)(c) EC.

**Waste management**

A section has also been introduced to deal with aid for waste management, i.e. the treatment of waste produced by other undertakings (as opposed to waste produced by the company itself). These provisions take their lead from the criteria set out in recent Commission decisions in this area.

**Aid for relocation**

Aid for relocation was previously confined to companies creating major pollution. The Guidelines

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\(^{(23)}\) See footnote 16 above.  
\(^{(24)}\) ETS companies have a longer period than non-ETS companies because ETS companies do not take into account their benefits from proceeds flowing from the sale of tradable permits issued under the European Trading System.
introduce a new possibility of granting aid also for the relocation of establishments posing a high risk to the environment in case of accident \(^{(25)}\).

** Tradable permit schemes**

As regards tradable permit schemes, the Guidelines first recall that these may involve State aid in a number of instances, in particular when allowances are granted for less than their market value \(^{(26)}\). The Guidelines contain two sets of assessment criteria. The first set is based on the approach used by the Commission when assessing the various NAPs under the ETS Directive \(^{(27)}\), while the second set is similar to the necessity and proportionality test applied for tax reductions/exemptions (see below). By derogation, the second set of criteria do not apply to the trading period ending on 31 December 2012.

** Operating aid**

The possibilities of granting operating aid for energy-saving, renewable energy sources and cogeneration have been maintained in principle. Therefore, operating aid for energy-saving can be granted for a maximum period of five years to cover the net extra production costs resulting from the investment. With regard to aid for renewable energy sources, Member States continue to be able to choose between compensating for the difference between the cost of producing energy from renewable sources and using market mechanisms such as green certificates or tenders \(^{(28)}\). Under certain conditions (see below), Member States may also grant operating aid to new plants producing renewable energy on the basis of the external costs avoided.

One novelty is that aid for investment and/or operating aid for the production of biofuels will henceforth only be permitted for sustainable biofuels. Indeed, the Commission takes the view that State aid is an appropriate instrument only for those uses of renewable energy sources where environmental benefit and sustainability are manifest. In particular, biofuels not fulfilling the sustainability criteria set out in the Commission’s proposal for a Directive promoting renewable energy \(^{(29)}\) will not be considered eligible for State aid.

Finally, aid in the form of reductions of or exemptions from environmental taxes — which makes up the bulk of all environmental State aid granted in the EU \(^{(30)}\) — is now subject to a specific set of rules (see below).

** Four types of assessment of environmental State aid**

Following the adoption of the General Block Exemption Regulation on 7 July 2008 \(^{(31)}\) (herein-after GBER), the ‘three stream’ model for assessing State aid measures is now in place: below a certain threshold, straightforward investment aid measures will fall under GBER while less straightforward and operating aid measures will be subject to standard assessment under the Guidelines. Above the thresholds, the investment or operating aid measure will fall under detailed assessment. Finally, exemptions/reductions from environmental taxes will either fall under the GBER or be subject to a self-standing set of provisions outside the usual standard/detailed assessment matrix.

** General Block Exemption Regulation**

A separate article in the following issue of the Newsletter will present the GBER in more detail. The following paragraphs focus on the parts that are of relevance to environmental protection.

**Incentive effect**

Aid granted to SMEs covered by the GBER is deemed to have an incentive effect if, before work on the project or activity has started, the beneficiary has submitted an application for the aid to the Member State concerned. With regard to aid granted to large companies, Member States must also, before granting the individual aid concerned, verify that the documentation prepared by the beneficiary meets one of several criteria set out in Article 8 of the GBER (e.g. material increase in the size of the project/activity due to the aid).

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\(^{(26)}\) The CFI has confirmed this approach in its ruling in Case T-233/04, Netherlands/Commission, 10 April 2008, not yet reported.

\(^{(27)}\) As mentioned earlier, those assessments were made in the context of the NAP procedure and not on the basis of Article 88 EC, which is why they do not amount to State aid decisions.

\(^{(28)}\) The same applies, *mutatis mutandis*, to cogeneration.

\(^{(29)}\) See footnote 4 above. Once the Directive has been adopted by the European Parliament and the Council, the Commission will apply the sustainability criteria set out in the final text.


Eligible costs and aid intensities

As under the Guidelines, eligible costs are limited to the extra investment costs needed to achieve a higher level of environmental protection.

However, given the potential complexities regarding the deduction of benefits deriving from the extra investment (see above), the GBER introduces a simplified method of calculation whereby operating benefits and operating costs are not taken into account at all. At the same time, the maximum aid intensities provided for the different categories of environmental investment aid concerned have been reduced systematically compared to the Guidelines.

Individual notification thresholds and types of measures covered

With regard to environmental protection, the GBER only covers investment aid (whether granted ad hoc or on the basis of a scheme), the grant equivalent of which does not exceed EUR 7.5 million per undertaking per investment project. Incidentally, the same threshold also triggers a detailed assessment in the context of the Guidelines.

The GBER sets out the various types of environmental aid for which the Commission has sufficient experience and can define straightforward parameters and conditions for waiving the notification requirement. Thus, the GBER covers investment aid enabling undertakings to go beyond Community standards for environmental protection or to increase the level of environmental protection in the absence of Community standards; aid allowing SMEs to adapt early to future Community standards that increase the level of environmental protection; environmental investment aid enabling undertakings to achieve energy-saving; environmental investment aid for high-efficiency cogeneration; environmental investment aid for the promotion of energy from renewable energy sources; and aid to undertakings for environmental studies.

Specific provisions apply to environmental aid schemes in the form of reductions from environmental taxes fulfilling the conditions of ETD (see below).

Guidelines: standard assessment

Measures not covered by the GBER but that are below the thresholds set out in the Guidelines — i.e. EUR 7.5 million for investment aid to one undertaking and a number of thresholds for operating aid — will be assessed under a standard assessment and will benefit from a number of legal presumptions:

For example, the incentive effect will be presumed to apply for all categories of aid granted to an SME below the individual notification thresholds) on sole condition that the aided project has not started before the aid application. Therefore, only for aided projects of big companies will the incentive effect have to be demonstrated by means of reference to the credible counterfactual situation.

Similarly, the Commission presumes that measures subject to the standard assessment address a market failure hampering environmental protection, or improve on the level of environmental protection, and that they are proportionate and have a limited negative impact on competition and trade. In other words, if the conditions under the standard assessment set out in Chapter 3 — including, of course, the aid intensities — are met, the balancing test is presumed to be satisfied.

Guidelines: detailed assessment

These presumptions no longer hold when the aid amount reaches certain levels. In order to ensure a proper assessment of such big cases under the balancing test, the Commission will conduct a more detailed assessment of any individual case of investment or operating aid, granted under an authorised scheme or on an ad hoc basis, where the aid amount or the production capacity exceed the above-mentioned thresholds or where Member States want to grant operating aid to new plants producing renewable energy on the basis of the external costs avoided.

A detailed assessment is a proportionate assessment, depending on the potential distortion of the case. Accordingly, the fact that a detailed assessment is carried out does not necessarily mean that a formal investigation procedure needs to be opened, although this may be the case for certain measures. Indeed, recent experience in the area of research, development and innovation shows that the Commission is capable of concluding a detailed assessment without formally opening an investigation procedure in the usual timeframe.

(As regards investment aid for energy-saving measures, Member States will be able to choose either the simplified method of calculation or the full cost calculation as set out in the Guidelines (see above in the main text). However, in view of the particular practical difficulties which may arise when applying the full cost calculation method, these cost calculations should be certified by an external auditor.

Note that, following the approach taken in the Guidelines, aid for the production of biofuels is exempted only to the extent that the aided investments are used exclusively for the production of sustainable biofuels.
In the course of a detailed assessment, the Commission will have a closer look at all the elements of the balancing test. In so doing, the Commission will take account of factual information and data provided by the notifying Member State, e.g. evaluations of past State aid schemes or measures, impact assessments made by the granting authority, other studies related to environmental protection and information about the beneficiary and the market in which the company operates.

**Guidelines: a facts-based assessment of tax reductions/exemptions**

The Guidelines provide a separate and self-standing set of criteria for the assessment of aid schemes in the form of reductions or exemptions from environmental taxes (34).

The first condition that has to be met by any such reduction/exemption is that it contributes, at least indirectly, to an improvement in the level of environmental protection and that the reductions/exemptions do not undermine the general objective pursued (35).

Another condition is that any reduction/exemption from harmonised taxes must be compatible with the relevant applicable Community legislation and comply with the limits and conditions set out therein (‘two-window’ requirement).

Under the GBER, environmental aid schemes in the form of reductions from environmental taxes fulfilling the conditions of the ETD are exempt for a period of 10 years where the beneficiaries pay at least the Community minimum tax level set by the ETD.

However, in cases where beneficiaries do not pay at least the Community minimum tax level or where no Community-wide harmonisation exists, aid in the form of reductions/exemptions will be considered compatible for a period of 10 years only if the Commission finds them to be both necessary and proportionate. This is a departure from the assessment of such exemptions/reductions under the previous Guidelines and aims at a more facts-based analysis of their justification and their impact on competition and trade.

The Commission will start its analysis by looking at the respective sector(s) or categories of beneficiaries covered by the exemptions/reductions, as well as at the situation of the main beneficiaries in each sector concerned and how the taxation can contribute to environmental protection. In this context, the Commission will want the exempted sectors to be properly described and a list of the largest beneficiaries for each sector should be provided (considering notably turnover, market shares and size of the tax base). For each sector, information should be provided on the best performing techniques within the EEA in terms of the reduction of environmental harm targeted by the tax.

On that basis, the Commission will look at whether the notified reduction/exemption is necessary for introducing or maintaining a high level of taxation, which, in turn, contributes directly to improving the level of environmental protection. The Commission will accept the aid as being necessary where the following cumulative conditions are met: (a) beneficiaries must be selected according to objective and transparent criteria and the aid must be granted in a non-discriminatory way, (b) the beneficiaries would have to bear a substantial increase in production costs if they had to pay the full tax rate (36) while (c) being unable to pass on this increase to customers without leading to significant sales reductions.

In practice, this means nothing more — but also nothing less — than requiring a facts-based justification, for each sector concerned, for granting derogations from the generally applicable tax rate. For example, with regard to the possibilities of passing on (or not) any cost increases to consumers, Member States may provide estimates of the product price elasticity of the sector concerned in the relevant geographic market together with estimates of lost sales and/or reduced profits for the companies in the sector/category concerned. Incidentally, the Commission has also suggested this facts-based approach in the context of the proposed ETS reform in order to determine, if this were to become at all appropriate, specific sectors or sub-sectors where it can be duly substantiated that the risk of carbon leakage exists.

Once the reduction/exemption has passed this necessity test, the Commission will check whether it is also proportionate. In so doing, the Commission will accept that a reduced rate of at least 20% of the generally applicable rate in the Member State concerned will be proportionate. Member States can grant bigger reductions as long as they can be justified in terms of limited distortion of competition. Another option for Member States is

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(34) In other words, such schemes are not subject to a standard assessment and nor do thresholds for the detailed assessment apply.

(35) See the Commission decision in case N 643/2006, Germany, which confirms that this is a substantive criterion.

(36) With regard to energy products and electricity, ‘energy-intensive businesses’ as defined in Article 17(1)(a) of the ETD are deemed to fulfil this criterion as long as that provision remains in force.
to make such derogations conditional on the conclusion of agreements with the recipient undertakings or associations, whereby the latter commit themselves to achieving environmental protection objectives that have the same effect as the 20% rate mentioned above or the Community minimum tax level (if applicable). A third option is to lay down criteria ensuring that each individual beneficiary pays a proportion of the national tax level, which is broadly equivalent to their specific environmental performance compared to a performance based on the best performing technique in the EEA.

**Final provisions and outlook**

The Guidelines entered into force on 2 April 2008 and will remain applicable until 31 December 2014. Together with the GBER, the major components of the new State aid architecture are now in place. On the one hand, aid measures that are unlikely to have a negative impact on competition are either exempt from the notification requirement (GBER) or they benefit from a standard assessment under the relevant horizontal rules, including a number of legal presumptions. On the other hand, measures that are more likely to raise competition concerns will be subject to a more detailed and facts-based review.

Over time, the Commission hopes that this overall approach will make life simpler for business and Member States and, at the same time, ensure that potentially harmful State aid is properly assessed.