1. Introduction

Between 2007 and 2009, the Commission had to take decisions in a number of State aid cases concerning preferential electricity tariffs for energy-intensive users. The *Alcoa* case, decided in November 2009, undoubtedly had the highest profile. However, the Commission already determined its position in 2007 with the *Terni* decision, which was recently upheld by the General Court.

The general context in which these investigations took place was turbulent. Since its inception in 1996, the liberalisation of the electricity market had raised high hopes. The process was expected to lead to more competition between electricity providers and, ultimately, better prices for both large and small users. However, the expected benefits for consumers had been slow to materialise. On the contrary, electricity prices had risen, sometimes spectacularly, due largely to external factors, such as increases in world oil prices. The price crisis hit energy-intensive users the hardest.

The *Alcoa* case concerned an electricity price subsidy granted by Italy for the most energy-intensive of industrial activities, the production of primary aluminium. In its final decision, the Commission concluded that the preferential price enjoyed by Alcoa since 2006 was incompatible operating aid and should be partially recovered. In particular, the Commission held that it did not consider electricity price subsidies given to a particular company to be an appropriate instrument to remedy any alleged imperfections of electricity markets.

The Commission thus confirmed the negative line it already took in 2007 with the *Terni* decision. In the *Terni* case, the Commission found against the preferential tariff granted by Italy to a group of three undertakings (the ex-Terni companies) including steelmaker ThyssenKrupp. In this case, Italy had repeatedly prolonged a tariff which had been originally granted for a period of 30 years as compensation for the nationalisation of Terni’s hydro-power plant. The tariff had been prolonged for competitiveness reasons. The Commission found that it constituted incompatible operating aid and ordered its recovery. The final decision was upheld on all points by the General Court. This judgment is currently under appeal.

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1 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 These are the largest industrial electricity end-users and can be found in particular in the metals and chemical sectors. For these companies, electricity prices are an important competitiveness factor.


6 Cases C-448/10, C-449/10 and C-450/10.
2. The main facts of the case

Alcoa had been enjoying a preferential electricity tariff in Italy since 1996, when it took over Alumix, a State-owned aluminium producer that operated two plants in Sardinia and Veneto. Under the original mechanism the Italian State-owned utility ENEL was to supply electricity to Alcoa’s plants at a fixed tariff set for ten years, i.e. until December 2005. The Commission approved this mechanism in a decision (the ‘Alumix’ decision7), regarding the deal as an ordinary business transaction, free of State aid. Considering the specific situation of the electricity market in the regions concerned (in particular the situation of overcapacity in electricity generation in Sardinia, and the inability to find alternative outlets for electricity produced in Veneto) the Commission concluded that ENEL had behaved like a rational market operator in selling electricity to its best customer at a price that covered only the variable cost of electricity production, plus a small contribution to fixed costs.

Over the years, however, Italy modified the original financing mechanism and repeatedly prolonged the tariff. The measure targeted by the investigation had very little in common with the old, non-aid tariff. It had become a subsidy financed through direct payments from the State. Alcoa still purchased electricity from ENEL, but at the ordinary price set in the supply agreement, and the State reimbursed Alcoa the sum required to ensure that the company continued paying de facto the historical tariff, which was less than half the prevailing market price. The resources were raised through a parafiscal levy imposed on electricity consumers in their electricity bills.

The Commission opened two in-depth investigations into the new tariff arrangement, one in 2004 and one in 2006. In the decision to open proceedings the Commission concluded that, due to the new financing mechanism, the extension of the tariff constituted new operating aid, the compatibility of which was doubtful.

3. Alcoa’s challenge against the opening decision

Alcoa challenged the 2006 decision to open the investigation, arguing that the tariff did not constitute aid or should be considered existing aid. Alcoa argued that, despite the changes in the tariff’s financing mechanism, which the company dismissed as ‘purely administrative’, the tariff still complied with the criteria set by the Commission itself in the Alumix decision, which according to Alcoa was unlimited in time. Alcoa maintained that the Commission should have applied those criteria before coming to the conclusion that the tariff constituted new aid.

This was an unusual challenge, since a decision to open proceedings is a preliminary act and is therefore rarely appealed, as the parties prefer to challenge a final decision. The action was nevertheless admissible: a finding of new aid — however preliminary — for a measure in the course of being implemented entails independent legal effects for recipients and alters their legal position. In these circumstances, the opening decision is subject to review by the Court.

In its judgment of 25 March 20098, the General Court dismissed Alcoa’s application. As regards the Commission’s preliminary conclusion that the tariff constituted State aid, the Court confirmed that it contained no manifest error of assessment. As regards the classification as new aid, the Court found

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that Alcoa could not draw from the *Alumix* decision any legitimate expectation that the tariff was an ‘existing’ measure, because (a) the challenged tariff was not covered by the temporal scope of the *Alumix* decision (10 years), and (b) the modifications in the financing mechanism, far from being ‘purely administrative’, were of a substantive nature, and therefore the tariff was materially different from the original Alumix mechanism.

Alcoa has appealed the judgment upholding the opening decision.9

4. **The assessment**

The in-depth assessment confirmed that the Alcoa tariff should be classified as new, unlawful operating aid. Since the conditions for the grant of regional operating aid (contribution to regional development, proportionality, etc.) were not met, there was no legal basis for approval under State aid rules. Operating aid relieves companies of burdens which they would normally have to bear in the course of their business, and puts at a competitive disadvantage EU competitors that do not receive the same subsidy. Operating aid is one the most distortive forms of aid, and is in principle incompatible with the common market.

This conclusion would normally have been sufficient to come to a final position on the compatibility of the tariff.

However, during the administrative procedure the Commission had explored at one stage the idea of a favourable outcome for Alcoa's Sardinian tariff, linked to the introduction by Italy of a pro-competitive remedy. A letter sent in January 2007 suggested that, taking into account the specific situation of the Sardinian electricity market, characterised by insufficient electrical interconnection, it might be possible to authorise a phasing-out of the tariff over a period of two years, provided Italy introduced rapidly a Virtual Power Plant (VPP) mechanism10 in Sardinia. The existence of this proposal prolonged the investigation, as for almost two years Italy did not give its views on the VPP and only took up the idea during the final phase of the procedure, when it was faced with the prospect of a negative decision with recovery.

In the final decision, the Commission considered after a detailed analysis that the VPP could not constitute a basis for declaring the Alcoa tariff compatible with the common market.

The possibility of declaring aid compatible to further the process of liberalisation of the electricity sector had been established in the past with the ‘stranded costs’ approach.11 The stranded costs approach allowed Member States to grant State aid, for a certain period of time, to electricity producers to compensate for the losses incurred as a result of liberalisation, on the ground that the aid was necessary to achieve the liberalisation objective.

However, the differences between the *Alcoa* case and the stranded costs scenario appeared too large for a direct analogy to be applied. In the *Alcoa* case, it could not be concluded that the subsidised

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9 Case C-194/2009, pending.
10 A Virtual Power Plant programme involves the auctioning of virtual electricity generation capacity to alternative power suppliers.
The tariff had a compensatory function or that it was necessary to allow the achievement of liberalisation as in the stranded costs approach. Even assuming that insufficient competition on the market could have been one of the causes of high prices in Sardinia, the tariff was granted only to Alcoa. It was also difficult to see why the tariff was necessary to achieve the objective of a better functioning electricity market in Sardinia.

The Commission also examined whether, in the case at hand, there was a liberalisation problem that could be effectively addressed through a remedy such as the VPP.

The Commission did not rule out the possibility that, in exceptional circumstances, a remedy furthering market liberalisation could constitute a basis for the compatibility of a State aid measure. In the Alcoa case, however, the Commission came to a negative conclusion after examining the nature of the competition problem on the Sardinian electricity market, the existence of any causal links between that problem and the aid, and the effectiveness of the VPP as a correcting instrument.

Firstly, as regards the nature of the problems in Sardinia, the Commission noted that high prices in Sardinia were caused by a combination of factors, most of which were related to insularity rather than liberalisation. The only discernible competition factor was the duopoly situation, insofar as it might possibly encourage the dominant operators to set high prices.

Secondly, the Commission assessed the existence of a meaningful link between the market situation and the Sardinian preferential tariffs (which benefited Alcoa and, for a few months, three other companies\(^\text{12}\)). The Commission noted that the tariffs had not been introduced to remedy the competition problem identified in Sardinia: as conceded by Italy itself, the objective of the tariffs was to align the electricity prices paid by the beneficiaries on prices prevailing in other European countries. In other words, the aid was granted for competitiveness reasons.

Thirdly, the extent to which the VPP was likely to remedy the lack of effective competition in Sardinia did not appear proportionate to the scale and intensity of aid granted. The effects of the remedy on the Sardinian market appeared to be too limited. The remedy would have an impact only on the behaviour of the dominant operators, but could not improve interconnection or generation costs, nor lead to a change in market structure at the generation level.

Therefore, the Commission considered that the VPP could not constitute a basis for the compatibility of the Alcoa tariff.

The Commission also weighed up the argument that the Alcoa tariff served the purpose ofremedying the alleged shortcomings of the electricity markets, which had not yet delivered competitive prices, and was necessary to prevent the relocation of the company outside Europe.

After noting that Alcoa was not at risk of relocating outside Europe, since it had recently carried out new investments in Iceland\(^\text{13}\), the Commission made the general statement that the imperfect functioning of electricity markets could not be considered a market failure. The notion of market

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\(^\text{12}\) In 2004, Italy had extended the ‘Alcoa treatment’ to three other energy-intensive undertakings, also located in Sardinia. However, payments of aid to these three undertakings lasted only a few months. After discontinuing payments, Italy notified the tariffs to the Commission. The assessment of these cases (Case C 38/b/2004 and C 13/2006) is still ongoing.

\(^\text{13}\) Which is part of the EEA.
failure implies that a competitive market alone cannot deliver a socially optimal result, whereas the problem referred to here is that the markets concerned are not sufficiently competitive. The Commission underlined that the solution could only lie in more — and not less — competition, through the creation of a genuinely integrated energy market. Therefore, the Commission considered that, as a matter of principle, ad hoc operating aid in the form of artificially low electricity tariffs for selected end-users was not the appropriate instrument to remedy any alleged imperfections of electricity markets.

As regards the objective of preventing the relocation of energy-intensive industries, the Commission did not make general statements of principle, but confirmed the negative stance it took in the Terni decision14, where the argument had also been raised. In Terni, the Commission had noted that there was no precedent in its earlier decisions or in the case-law of the Community courts where such an argument had been accepted as a justification for the grant of State aid, and that there was no need for the Commission to even consider this question since the authorities had not provided any substantiation for such an allegation. In particular, they had not shown that the tariff was necessary and proportionate to prevent that risk.

On this basis, the Commission declared that the Alcoa tariff was incompatible aid and ordered its partial recovery.

5. Recovery

The recovery obligation was partially waived for Alcoa’s Sardinian plant on the basis of the principle of sound administration. The decision acknowledged that the excessively long discussions on the possible remedy proposal envisaged in the 2007 Commission’s letter might possibly have influenced the beneficiary’s perception of the risk of recovery. In these circumstances, it was recognised that full recovery of the aid for Sardinia would possibly have breached the principle of sound administration. Therefore, the Commission decided to waive recovery for the Sardinian plant for the period subsequent to the 2007 letter. Full recovery was imposed for the Veneto plant, which was not covered by the letter. The amount to be recovered is approximately €295 million.

6. Alcoa’s challenge against the final decision

Alcoa has challenged before the General Court the Commission’s final negative decision of November 200915. The company requested interim measures (suspension of the recovery order), alleging that it would suffer serious and irreparable damage in the event of recovery, because the parent company would not provide any financial help and the Italian plants would be irreversibly closed. The request for interim measures was rejected in July 201016. The General Court found, in particular, that the requirement of urgency was not met, since Alcoa belonged to a multinational group which was legally able and financially capable of assisting its Italian subsidiary. The Court also held that, according to the case-law, the group’s alleged unwillingness to support its subsidiary was irrelevant and in any event seemed contradicted by facts. For example, during the investigation the group provided the Italian State with a €700 million parent company guarantee covering the risk of

14 Reference in footnote 1; see paragraphs 144 and 145 of the decision.

15 Case T-177/2010, pending.

16 Decision of 9 July 2010 in Case T-177/2010 R.
recovery and recapitalised Alcoa. Moreover, there appeared to be no immediate threat of closure of the Italian plants. Alcoa has appealed the judgment on the interim measures before the ECJ\textsuperscript{17}. The case on substance is pending before the General Court.

7. Conclusions

This is an important decision in policy terms because the Commission has confirmed for the second time its refusal to authorise operating aid given in the form of electricity price subsidies in favour of energy-intensive industries based on the alleged ‘imperfect state of liberalisation’ of the EU electricity market or the threat of relocation outside the EU. State aid control aims generally to prevent this type of aid, which is liable to generate subsidy races between Member States.

\textsuperscript{17} Case C-446/10, pending.