



EUROPEAN COMMISSION

Brussels, 30.10.2001
C(2001)3265 fin

Subject: State aid n° N 6/A/2001 - Ireland
Public Service Obligations imposed on the Electricity Supply Board with respect to the generation of electricity out of peat

Sir,

1. PROCEDURE

1. By letter registered by the Commission on 22 November 2000, the Irish authorities notified to the Commission the compensation scheme related to public service obligations imposed on the *Electricity Supply Board* (ESB) with respect to the generation of electricity out of peat (hereafter "the scheme").
2. By letter dated 23 January 2001, ref. D/50249, the Commission asked for further information. This information was provided by the Irish authorities by letter dated 8 March 2001, registered by the Commission on 13 March 2001.
3. By letter dated 4 April 2001, ref. D/51438, the Commission asked for further information. This information was provided by the Irish authorities by letter dated 31 May 2001, registered by the Commission on 6 June 2001.
4. By letter dated 16 May 2001, ref. D/52013, the Commission asked for further information. This information was provided by the Irish authorities by letter dated 29 August 2001, registered by the Commission on 31 August 2001.

2. DESCRIPTION OF THE MEASURE

5. The object of the notification is the implementation of a scheme aiming at offsetting the charges incurred by the Irish company *Electricity Supply Board* (ESB) in relation to its obligation to have in its possession a certain quantity of electricity generated out of peat.

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6. Ireland has liberalised its electricity market in February 2000¹, in accordance with Directive 96/92/EC². It is planned that the Irish electricity market will be further liberalised to an extent of 40% in 2002, and 100% in 2005.
7. ESB is the historical actor of the electricity Sector in Ireland. It is an Irish Government owned company with a 8000 staff. It is a vertically integrated undertaking, whose activities range from the production of electricity to its supply to final customers. It operates a variety of electricity production plants, ranging from gas turbine to hydro power, with a total installed capacity of 4 526.5 MW.
8. Through article 39(2)(a) of the Irish Electricity Regulation Act 1999, the Irish Government may impose on ESB the obligation to have each year at its disposal a certain quantity of electricity generated out of peat, equivalent to that quantity of electricity that would have been generated with 15% of the overall primary energy necessary to produce the electricity consumed in Ireland in one year (hereafter "the obligation").
9. The existing six ESB peat fired stations are not in the position to deliver this amount of electricity in the medium-term, because:
 - They are old stations, that were planned to be dismantled in the next years. The closer they come to their end of life expectancy, the more security restrictions have to be imposed on their output, which hinders to an important extent their generation capacity.
 - Within a few years, they will no longer comply with the Irish and Community environment regulations, especially as regards SO₂ and NO_x emissions, both because such regulations become tighter and tighter and because the stations pollute more and more as they get older.
10. In collaboration with the Irish Department of Public Enterprise, ESB has examined a large range of industrial scenarios that would allow it to have the capacity to fulfil the obligation in the next years while keeping in compliance with environment and safety regulations. A combination of scenarios were envisaged, including different close down, construction and refurbishment options, together with purchase from other sources.
11. The more economical option was chosen. It consists in accelerating the closing down of the existing six old peat fired plants and building two new more environment friendly and much more efficient ones, with a 15 years operation lifetime. In combination with this project, ESB will also buy part of the peat generated electricity to an independent electricity producer in Edenderry, owned by the Finish company Fortum. Prices for this purchase have been subject to an open tender. The addition of the electricity generated internally and the electricity bought to the Edenderry plant will allow ESB to meet the obligation during the next years.
12. Although the chosen option is the least costly of the possible solutions, the cost of electricity as generated by the new peat fired plants will still be above the electricity average market price.

¹ With the exception of Belgium, Greece and Ireland, the Member States were required to transpose Directive 96/92/EC into national law by 19.2.1999 at the latest. Belgium and Ireland were required to do so by 19.2.2000 at the latest and Greece by 19.2.2001 at the latest.

² European Parliament and Council Directive 96/92/EC of 19 December 1996 concerning common rules for the internal market in electricity, OJ L 27, 30.1.1997, p. 20.

The obligation imposed on ESB will therefore be a charge to the company, that will not be able to recover its costs through the market.

13. The scheme aims at compensating this burden until 2019, which is the foreseen operation lifetime end for the new peat fired plants.
14. Each year, the Irish electricity system regulator (Commission for Electricity Regulation - CER) will compute the cost incurred by ESB in relation to the obligation.
15. This cost will be defined as the difference between:
 - on the one hand, costs incurred by ESB for the generation of the electricity out of peat (or the purchase of electricity to the Edenderry plant), including:
 - Costs associated to the closure of existing plants, including: dismantling costs and staff severance costs. Only costs associated to the acceleration of the standard closure procedure and timeframe for such plants will be included. These acceleration costs are estimated to 29 M€ out of a total 153 M€ costs for the closure of the six plants.
 - Costs associated to the production of electricity by existing power plants to the date they close down, including: fuel costs (peat is bought by ESB from peat industry under market conditions), payroll (taking account a 554 to 332 staff decrease), operation and maintenance costs, centralised service and overheads, plus a [...] ³, real, allowed return on investment.
 - Costs associated to the building of new power plants and generation of peat based electricity by these plants, including: capital costs, fuel costs, payroll, operation and maintenance, centralised service and overheads, future carbon taxation where relevant, plus a [...] ⁴, real, allowed return on investment.
 - Purchase prices for the electricity bought from the Edenderry plant. The establishment of prices for this electricity has been subject to an open tender.

All costs categories will be exactly computed yearly by the CER. This computation will take into account the actual evolution of parameters subject to fluctuation, like taxes or fuel prices. However, in order for ESB to share a part of the risk with the Irish Government, controllable price categories will be subject to a cap.

- on the other hand, the price at which ESB could have sold this electricity on the market, as computed yearly by the CER on the basis of a time weighted average of the electricity market price as sold by electricity producers in a fully liberalised Irish market. Until the full liberalisation of the Irish electricity market, in year 2005, it is likely that such market price will not exist. In the absence of market price, the CER will compute the benchmark value on the basis of the assumption that such price would be driven by the costs of a best new entrant using 15 years operation lifetime, 400 MW Combined Cycle Gas Turbine plants and taking a [...] ⁵, real, annual rate of return. As an example, this method would have led to a 33 €/MWh benchmark for year 2000.

³ Confidential information

⁴ Confidential information

⁵ Confidential information

The arrangement between ESB (power generation) and its public supply business for the purchase of peat generation at best new entrant prices and the existence of the proposed levy is expected to be fully taken into account by the regulator in setting the price at which ESB (power generation) sells to its supply business for the remainder of the non-eligible market. That is, the costs of peat generation will be excluded from the calculation of the general purchase price for electricity generated from other sources.

16. Once the costs incurred to ESB in relation to the obligation are determined, the necessary funds for their compensation will be collected from all subscribers to the electricity network by the Transmission System Operator through a levy imposed on connections to the grid.
17. The levy will be based on the capacity of the connection subscribed by each of the electricity network users. The levy rate will vary depending on whether the connection serves a domestic account or a professional account.
18. Once collected by the transmission system operator, and upon control of the CER, the collected compensation funds will be granted to ESB.
19. It was estimated by the Irish authorities that compensations should amount to a total of 568 M€ for the 2001-2019 period, with an approximate mean value of 30 M€ per year.

3. ASSESSMENT

3.1 Existence of State aid in the meaning of Article 87(1) of the EC Treaty

20. The Commission considers that the scheme gives an advantage to ESB, which may lead to a strengthening of its position with regard to its competitors which do not receive such support.
21. Moreover, it seems clear to the Commission that the scheme is likely to have an effect on trade between Member States, given that exchange between undertakings from different Member States is possible within the electricity market, in particular in the wake of the entry into force of the aforementioned Directive 96/92/EC. Favouring one of these enterprises may therefore have an effect on intra-Community trade and lead to distortions of competition.
22. The scheme may therefore affect trade between Member States and distort or threaten to distort competition by favouring one enterprise.
23. The scheme imposes a legal obligation on certain companies and individuals to pay contributions to an account controlled by the Transmission System Operator and the CER. The Commission notes that, according to constant practice of the Court, the implementation of such an obligation by national law may constitute a State resource in the meaning of Article 87(1) of the EC Treaty⁶. The criteria developed by the Court are that the fund or account was created or designated by the State, that it is funded by contributions imposed by the State and that it is used to favour certain enterprises.
24. An application of the said criteria to the case in question seems to imply that the amounts transferred under the scheme constitute State resources. However, the Commission notes that the transfer of the amounts through the Transmission System Operator is essentially of an accounting nature. The CER can only check the correctness of the sums before having the sums

⁶ See for instance case C-173/73, Ruling of the Court of 02.07.1974, Italy vs. Commission and case C-78/79, Ruling of the Court of 22.03.1997, Steinike vs. Federal Republic of Germany

paying out to the beneficiary by the Transmission System Operator. Any excess amount would have to be paid back to the contributors through a decrease of the levy on the following year.

25. It could possibly be argued that the mechanism is essentially equivalent to one in which the CER would order each contributor to pay the corresponding sums directly to ESB. Then, the mechanism would not constitute more than an obligation imposed by the State on customers to transfer certain sums to one undertaking, as it is the case for example if the State imposes an obligation to purchase at fixed minimum prices.
26. In its ruling of 13 March 2001 in Case C-379/98 PreussenElektra AG, the Court established that a national law of a Member State, which requires private electricity supply undertakings to purchase electricity produced in their area of supply from renewable energy sources at minimum prices higher than the real economic value of that type of electricity, does not involve any direct or indirect transfer of State resources to undertakings which produce that type of electricity. The mobilisation of a State resource is a necessary condition for the qualification of a measure as State aid in the meaning of Article 87(1) of the EC Treaty.
27. Therefore, the Commission considers that it cannot be determined whether the notified scheme constitutes State aid in the meaning of Article 87(1) of the EC Treaty.
28. Therefore, the Commission does not decide if the compensations are State aid in the meaning of Article 87(1) of the EC Treaty. Such a decision is not necessary as, in any case, as it will be demonstrated below, such a potential aid would be compatible with the EC Treaty.

3.2 Compatibility of the potential State aid with the State aid rules

29. The scheme does not have a social character and is not granted to individual consumers. It is not aiming at making good the damage caused by a natural disasters or a exceptional occurrence. It is not granted to the economy of certain areas of the Federal Republic of Germany. The potential aid could therefore not benefit from any of derogation of Article 87(2) of the EC Treaty.
30. The scheme does not promote the execution of an important project of common European interest, nor remedies a serious disturbance in the economy of a Member State. The potential aid could therefore not benefit from the derogation of Article 87(3)b of the EC Treaty.
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32. The scheme does not promote culture and heritage conservation. The potential aid could therefore not benefit from the derogation of Article 87(3)d of the EC Treaty.
33. The Commission considers that the potential aid would be an operating aid, and could therefore be authorised under the derogation of Article 87(3)a or 87(3)c of the EC Treaty only in very specific circumstance and under specific duration and degressivity conditions, that are not met by the scheme. The potential aid could therefore not benefit from the derogation of Article 87(3)a or Article 87(3)c of the EC Treaty.
34. The Irish authorities have argued that this potential aid is in accordance with Article 86(2) of the EC Treaty. In these circumstances, the Commission must check whether the aid may be authorised in application of Article 86(2) of the Treaty.

35. Article 86(2) provides: “*Undertakings entrusted with the operation of services of general economic interest or having the character of a revenue-producing monopoly shall be subject to the rules contained in this Treaty, in particular to the rules on competition, in so far as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them. The development of trade must not be affected to such an extent as would be contrary to the interests of the Community*”.
36. It follows from the wording of that provision, in particular from the words “*in so far as the application of such rules (which are those contained in Article 87 of the Treaty) does not obstruct the performance (..) of the particular tasks*”, that, where Article 86(2) may be relied upon, a State measure caught by article 87(1) may nevertheless be considered to be compatible with the common market. Although the aid involved is still State aid within the meaning of the latter provision, the effect of the competition rules may nevertheless be curtailed in such a case so that a prohibition on giving effect to new aid, inferred from Articles 87 and 88(2) and (3) read together, may be declared inapplicable⁷.
37. For an authorisation under Article 86(2) to be granted, it must be established whether the following cumulative conditions are fulfilled:
- The aid compensates for a service of general economic interest;
 - The beneficiary is entrusted by law with this service;
 - The compensations are in line with the proportionality principle;
 - There is no affectation of the trade contrary to the interests of the Community⁸.

Regarding the existence of a service of general economic interest

38. Article 3(2) of Directive 96/92/EC provides: “*Having full regard to the relevant provisions of the Treaty, in particular Article 86, Member States may impose on undertakings operating in the electricity sector, in the general economic interest, public service obligations which may relate to security, including security of supply, regularity, quality and price of supplies and to environmental protection.*”.
39. Article 8(4) of Directive 96/92/EC reads: “*A Member State may, for reasons of security of supply, direct that priority be given to the dispatch of generating installations using indigenous primary energy fuel sources, to an extent not exceeding in any calendar year 15% of the overall primary energy necessary to produce the electricity consumed in the Member State concerned*”.
40. In its Green Paper “*Towards a European strategy for the security of energy supply*”⁹, the Commission reiterates the importance of security of supply, stating that “*Security of supply*

⁷ Court Ruling of 27.2.1997 “La Poste”, case T-106/95, ECR 1997 II-229, grounds 171-172.

⁸ For a similar reasoning in the electricity sector, see Commission decisions of 25.7.2001 on State aid cases NN 49/99 - Spain (electricity generated out of coal), OJ C 268 of 22.9.2001, p. 7, and N 34/99 - Austria (electricity generated out of lignite), not yet published in the OJ.

⁹ COM(2000) 769 final

*must be clearly recognised, on a par with environmental protection, as an essential public service objective*¹⁰.

41. The Commission therefore considers that the obligation imposed on ESB to have at its disposal a specific quantity of electricity generated out of peat equivalent to that which would be generated annually by using 15% of the overall primary energy necessary to produce the electricity consumed in Ireland, constitutes an obligation to fulfil a service of general economic interest relating to security of supply¹¹.

Regarding the entrustment of the undertaking with the service of general economic interest

42. Article 39(2)a of the Irish Electricity Regulation Act 1999 clearly designates ESB as responsible for the accomplishment of the aforementioned service of general economic interest.

Regarding proportionality of the compensations

43. Compensations granted to offset the charges related to a service of general economic interest obligation must be proportionate to the net cost of operating the said service, that is, the total cost of operating the service less the total revenues derived from this operation.
44. In the present case, the net cost of operating the service of general economic interest is equal to the acquisition or production cost for ESB of the electricity generated out of peat, minus the revenues resulting from ESB selling this electricity to its customers. This difference will be estimated yearly by the CER. The Irish authorities have provided the Commission with detailed information on the method the CER will use in its computations.
45. In order to check that the net cost computation method does not lead to overcompensation of the charges incurred by ESB, the Commission has checked that, on the one hand, the generation costs for peat originating electricity would not be overestimated and that on the other hand, the price at which ESB could sell it would not be underestimated.
46. Regarding the generation costs for electricity out of peat, the Commission takes note that the Irish authorities and ESB have jointly examined a number of alternatives to reach their generation objectives while complying with security and environment obligations, and have selected the most economical option.
47. This option consists in accelerating the closure of the existing six peat-fired plant and building two more efficient ones. The Commission considers therefore that the whole programme, including the accelerated dismantling of the old plants and the construction of the new ones, can be viewed as aiming at fulfilling the service of general economic interest.
48. As far as closure costs of existing peat fired plants are concerned, only costs going beyond the costs that would have been incurred by ESB should the old peat-fired plant have been retired at their normal retirement date, will be included in the compensations costs.
49. As far as costs related to the generation of electricity are concerned, the categories of costs that will be compensated include: fuel costs, payroll, operation and maintenance costs, centralised service and overhead costs, carbon taxation where relevant, and capital costs for the new

¹⁰ aforementioned Green Paper, p. 84, paragraph 4

¹¹ In this regard, see also point 3 paragraphs 9 and 11 second indent of Annex I to the Communication from the Commission "Services of general interest in Europe", OJ C 17 of 19.01.2001, p. 4.

plants. Where electricity is bought from the Edenderry plant, all these costs will be included in the purchase cost by ESB. The Commission considers that all these cost categories are strictly related to the fulfilment of the service of general economic interest.

50. The Commission notes that a [...] ¹², real, return rate will be included in the cost estimate for electricity generated by ESB. [...] ¹³. It is compatible with standard rate of return hypothesis that undertakings in the electricity sector include in their investment plans for the construction of 15 years operation lifetime power plants. It is also consistent with the rate of return taken into account by the CER in its yearly electricity market price estimate. The Commission therefore considers that this rate of return constitutes a reasonable profit, that may be taken into account in the evaluation of the cost of operating a service of general economic interest ¹⁴.
51. The Commission therefore considers that all costs defined above strictly relate to the relevant service of general economic interest, and that the total cost of operating this service is therefore not overestimated.
52. The revenues that ESB generates by selling the peat-generated electricity will be computed yearly by the CER, on the basis of a time weighted market price mean value, or, in absence of such market price, on the basis of the assumption that such price would be driven by the costs of a best new entrant using Combined Cycle Gas Turbine plants and taking a [...] ¹⁵ annual rate of return. The application of this computation method for year 2000 yields a weighted market price mean value of 33 €/MWh.
53. The Commission considers that the time weighted electricity market price mean value is an appropriate benchmark to estimate the revenue derived by ESB from the operation of the service of general economic interest. As for the method used in absence of a market price, the Commission notes that its application leads to a 33 €/MWh value for the year 2000, which is consistent with the value that it has considered in its decision on State aid case N 842/2000 ¹⁶. The Commission therefore judges that this method can be viewed as a valuable tool to replace the market price benchmark for the short 2001 to 2004 period that will elapse before the Irish electricity market is fully liberalised.
54. The compensations granted to ESB are therefore proportionate to the charge incurred by the undertaking as a consequence of its fulfilling the service of general economic interest obligation.

Regarding the effect on trade

55. Ireland is a geographically isolated country. Unlike Member States in mainland Europe, it has only limited interconnection with the outside energy networks. The one electricity interconnector

¹² Confidential information

¹³ Confidential information

¹⁴ See for a similar approach Article 14 of Council Directive 75/439/EEC (OJ L 194 of 25.7.1975, p. 23) as amended by Directive 87/101/EEC (OJ L 42 of 12.02.1987, p. 43), which explicitly foresees that a reasonable profit should be taken into account in the evaluation of uncovered costs related to an obligation of general economic interest in relation to waste oil disposal and the Court of Justice Ruling of 7.2.1985 in case C 240/83, Procureur de la République c/ Association de défense des brûleurs d'huiles usagées (ECR 1985, p. 531).

¹⁵ Confidential information

¹⁶ Decision on State aid Case N842/2000 - Luxembourg - Prime d'encouragement écologique pour l'électricité produite à partir de l'énergie éolienne, hydraulique, solaire et de la biomasse. Commission letter n° SG(2001) D/260309 du 18.10.2001.

between Ireland and Northern Ireland has a 300 MW nominal capacity, representing 7.3% of the installed capacity in Ireland and is equivalent to less than a fourth of the Luxembourg installed capacity. Although further interconnection capacity with Northern Ireland may be built in the future, its development will depend on different external factors. There are also ongoing studies about the possibility to build interconnections directly with Scotland or France, but such interconnection would still be extremely costly. It is therefore unlikely that the relative isolation of Ireland changes radically in the short term.

56. The Commission considers therefore that the effect of the scheme on trade is limited, and is not contrary to the interest of the Community.
57. The scheme meets therefore the four cumulative criteria that must be fulfilled for an aid aiming at compensating an obligation of service of general economic interest to benefit from the provisions of Article 86(2) of the Treaty.

3.3 Compatibility with other Articles (in particular 25 and 90) of the EC-Treaty:

58. In accordance with the Court and the Commission constant practice, levies imposed on the consumption of a product, and the benefit of which is granted only to national undertakings producing the said product, should not be imposed on imports, and should be imposed on exports.
59. The levy that will be introduced by the Irish Government to finance the scheme is based on the electricity network subscribers connection capacity, in kilo Volt Amperes.
60. Electricity network subscribers shall pay the levy irrespective of their electricity consumption. With this system, a consumer that consumes more electricity than his neighbour may nevertheless pay a smaller levy.
61. Furthermore, the levy rate will vary depending on whether the subscriber holds a domestic or a professional account. Hence, the levy will in addition not be proportionate to the maximum potential consumption of the subscriber.
62. Under this system, where one consumer would import all its electricity, it could be argued that the imported electricity, being the only electricity bought by the said consumer, would bear alone the charge of the connection, and that, although the levy would not depend on the electricity consumption level, it should in this case be viewed as a charge on imported electricity consumption.
63. The Commission considers however that this situation remains a theoretical one, especially in view of the low level of connection of the Irish network with other community networks, as was mentioned in point 55 above.
64. Therefore, the Commission holds that the levy planned by the Irish Government can be viewed as disconnected from the consumption of electricity, and is therefore not subject to the aforementioned Court and Commission constant practice.

4. CONCLUSION

65. On the basis of the information which is at its disposal, the Commission concludes that it cannot rule out the possibility that the scheme may include State aid in the meaning of Article 87(1) of the EC Treaty.

66. Nevertheless, in view of the above, the Commission is of the opinion that the notified scheme, in case it should fall within the scope of Article 87(1) of the EC Treaty, may benefit from an authorisation as a compensation for a service of general economic interest according to Article 86(2) EC-Treaty, in the light of Articles 3(2) and 8(4) of Directive 96/92/EC.
67. If this letter contains confidential information which should not be disclosed to third parties, please inform the Commission within fifteen working days of the date of receipt. If the Commission does not receive a reasoned request by that deadline, you will be deemed to agree to the disclosure to third parties and to the publication of the full text of the letter in the authentic language on the Internet site: http://europa.eu.int/comm/secretariat_general/sgb/state_aids/. Your request should be sent by registered letter or fax to:

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Yours faithfully,
For the Commission

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