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**PUBLIC VERSION
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**Subject: State aid N 372/07
Support for biofuels**

Excellency,

The Commission wishes to inform Lithuania that, having examined the information supplied by your authorities on the matter referred to above, it has decided to raise no objections to the aid measure.

I. PROCEDURE

1. By electronic notification of 29 June 2007, the Lithuanian Republic notified, according to Article 4(2) of Regulation (EC) n° 794/2004 of 21 April 2004¹ implementing Council Regulation (EC) No 659/1999 laying down detailed rules for the application of Article 93 of the EC Treaty², the above-mentioned measure.
2. The Commission asked additional information by letters of 20 August, 22 November 2007, 19 February, 15 May, 14 August and 7 November 2008. The Lithuanian authorities submitted the requested information by letters registered on 7 September, 12 and 18 December 2007, 17 March, 30 May, 28 August and 19 November 2008. On 2 April 2008 and 16 July 2008 a meeting between representatives and the services of the Commission took place. With the aforementioned letter of 30 May 2008 the Lithuanian authorities notified also an increase of the proposed aid amounts.

¹ OJ L 140, 30.04.2004, p. 1.

² OJ L 83, 27.03.1999, p. 1.

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3. The notification concerns a modification of several approved aid schemes described below:

Support for the production of bioethanol

4. By letter dated 31 May 2005, registered on 8 June 2005, the Lithuanian Republic notified its intention to amend the existing aid measure “Support for the development of biofuels”. The notified scheme N 294/05³ partly replaced the existing aid measure “Support for the development of biofuels” which was communicated to the Commission by letter of 31 August 2004, registered on the same day, pursuant to provisions on existing aid laid down in Chapter 4, Annex IV of the Treaty of Accession⁴. The notification concerned an increase of aid intensity and an extension of the duration with respect to dehydrated bioethanol and rape methyl ester (RME). The Lithuanian authorities withdrew the notification with respect to RME. The scheme N 294/05 was approved by the Commission on 24 January 2006.
5. By electronic notification on 30 May 2007 the Lithuanian Republic notified some amendments to the abovementioned scheme N294/05. This notification (N 306/07⁵) concerned: change of the allocation method of aid and resulting increase of maximum subsidised amount of cereals. The aid intensity and eligible costs remained the same. The modifications were approved by the Commission on 9 August 2007.

Support for the production of biodiesel

6. With a letter of 2 July 2006 the Lithuanian Republic notified an aid scheme called; Aid for the development of the production of bio-diesel (N 436/06⁶). Under this scheme the Lithuanian Republic reimburse the beneficiaries LTL 160 per each ton of raw material acquired (rapeseed). The rapeseed oil produced from cultivated or purchased raw materials shall be delivered to the manufactures of rapeseed methyl (ethyl) ester.

The notification under scrutiny

7. This notification concerns the integration and a modification of the three above described and approved aid schemes for biofuels. The measures N 294/05 and 306/07 (support for the development of biofuel production) and N 436/06 (aid for the development of biodiesel) will be withdrawn before commencing the application of this new – combined - state-aid measure.
8. In the notification, the Lithuanian Republic held that the scheme respects the conditions laid down in the Community guidelines on State aid for environmental protection⁷ hereafter referred to as ‘the environmental aid guidelines’.

³ http://ec.europa.eu/community_law/state_aids/comp-2005/n294-05.pdf

⁴ http://europa.eu.int/comm/agriculture/stateaid/newms/index_en.htm
<http://europa.eu.int/comm/agriculture/stateaid/newms/lt/measures/23.pdf>

⁵ http://ec.europa.eu/community_law/state_aids/comp-2007/n306-07.pdf

⁶ http://ec.europa.eu/community_law/state_aids/agriculture-2006/n436-06.pdf

⁷ OJ C 82, 1.04.2008, p.1.

II. DETAILED DESCRIPTION OF THE AID

9. The main purpose of the support measure is to meet the objectives established in European Parliament and Council Directive 2003/30/EC of 8 May 2003, i.e. to promote the use of biofuels and other renewable fuels to replace diesel or petrol for transport purposes in each Member State, with a view to contributing to objectives such as promoting renewable energy sources to meet climate change commitments and environmentally friendly security of supply. The second objective is to develop the agricultural sector, including an increase in rural employment and the use of agricultural products for non-food purposes.
10. As the production costs of biofuels are higher than the market price of fossil fuels Lithuanian government supports biofuels production in order to enable biofuels to compete with fossil fuels on the market. To cover the difference between the production costs of biofuels and the market price of fossil fuels on the market Lithuanian authorities apply two financial support mechanisms, direct grant and excise duty reduction:

I. Grant

11. The aid will be given in the form of direct non-reimbursable grants for the production of bioethanol from cereals and for the production of biodiesel from rapeseed. It is granted to biofuel producers who meet the eligibility requirements, stated in the national Financing Regulation for the development of biofuel production 2007⁸. The eligibility criteria are for example: the applicant has biofuel production activities in Lithuania, holds a permit for the production of biofuels, the farm or the enterprise from the applicant has to be registered and the applicant does not have any arrears in payments to the State budget of the Republic of Lithuania.
12. For the production of bioethanol the maximum grant equals 266 LTL⁹ per tonne for cereals when these cereals are used to produce bioethanol. For the year 2007 the maximum amount of cereals eligible for reimbursement was established at 66.686 tonnes and for the year 2008 at 78.305 tonnes.
13. For the production of biodiesel the Lithuanian authorities intend to reimburse the beneficiaries LTL 279¹⁰ per each ton of raw material acquired between 1 January and 15 November of the year in question. There is maximum amount of rapeseed eligible for reimbursement established for the year 2007 established at 111.390 tonnes and for the year 2008 at 118.581 tonnes. The authorities will divide these amounts among the biofuel producers meeting the criteria listed in point 12 above and applying for aid, in accordance with their production capacities. Only one application of the same entity shall be approved. The rapeseed oil produced from cultivated or purchased raw materials shall be delivered to the manufacturers of rapeseed methyl (ethyl) ester who benefit from the grant by 1 July each year.

⁸ This regulation will be adopted formally after the present decision of the Commission.

⁹ Originally an increase of the support up to 164 LTL per tonne of cereals was notified, with the submission of 30.05.2008 the Lithuanian authorities notified an increase of the support up to 266 LTL per tonne of cereals. The original scheme from 31 August 2004 provided for a maximum of 60 LTL per tonne of cereals.

¹⁰ Originally an increase of the support up to 220 LTL per tonne of rapeseed was notified, with the submission of 30.05.2008 the Lithuanian authorities notified an increase of the support up to 279 LTL per tonne of rapeseed. The original scheme approved on 14 March 2007 provided for a maximum of 160 LTL per tonne of rapeseed.

14. From the different support mechanisms in Lithuania, only the grant is the financial support mechanism which is the subject to the current notification.

II. Excise duty rebate

15. Lithuania applies also a reduction in the excise tax on biofuels blended with other fuel. The excise duty exemption for biofuels applies only to the biofuel component of the mixture. Consequently, the tax rate of excise duty to be applied to blended biofuel products will be reduced according to the proportion of biofuel in the final blend. The excise duty exemption partially compensates for the difference between the production costs of biofuels and the price of fossil fuels.
16. The excise tax reduction on biofuels was notified in January 2005 – against which the European Commission did not raise objections¹¹. This regime has not been modified and is not subject to this decision.

Other mechanisms

17. From the information provided by the Lithuanian authorities it appeared that the refineries are obliged to supply biofuels to the market. The refineries can fulfil this supply obligation with nationally produced biofuel and imported biofuel. The refineries blend the biofuels with fossil fuels and seem to sell them to the market for prices equal fossil fuel prices.

Production of bioethanol

18. The production costs of bioethanol are estimated in the following way:

Table 1:

	Bioethanol (LTL/litre)
1. Grain	1.864
2. Other variable expenses	0.650
3. Constant expenses	0.395
4. Profit margin (5 %)	0.146
5. Production costs (1+2+3+4)	3.055
6. Compensation grant for bioethanol	0.751
7. Production costs after grant	2.304

19. According to the Lithuanian authorities the total cost of producing bioethanol is 3.055 LTL/litre.
20. According to Lithuanian authorities compensation of 266 LTL per tonne of purchased cereals used for bioethanol production corresponds to 939 LTL per ton of bioethanol¹² and to 0.751 LTL¹³ per litre of bioethanol.

Production of biodiesel

¹¹ State aid case N 44/2005 –, decision adopted on 28.7.2005. Published on http://europa.eu.int/comm/competition/state_aid/decisions/n44_2005/en.pdf

¹² To produce 1 tonne of bioethanol 3.53 tonnes of cereals are necessary (939 = 266*3.53).

¹³ According to table 4.1 of the EU research project “Stationary applications of liquid biofuels”, a litre of bioethanol weighs 0.8 kg. (0.751 = 939/*0.80/1000).

21. The production costs of biodiesel are estimated in the following way:

Table 2:

	Biodiesel (LTL litre)
1. Raw material	3,20
2. Reprocessing	1,03
3. Manufacturing expenditure (1+2)	4,23
4. Sales price of the by-product	-1,00
5. Production costs (3-4)	3,23
6. Compensation grant for biodiesel (5-6)	0.736
7. Production costs after grant	2.49

22. According to the Lithuanian authorities the total (net) cost of producing biodiesel is 3.23 LTL/litre.

23. According to Lithuanian authorities compensation of 279 LTL per tonne of purchased cereals used for biodiesel production corresponds to 836 LTL per ton of biodiesel¹⁴ and to 0.736 LTL¹⁵ per litre of biodiesel.

24. As described above the beneficiaries of the notified scheme are likely to benefit also from the excise tax reduction on biofuels – against which the European Commission did not raise objections. The excise duty that normally applies to petrol amounts to 1.116 LTL/litre and to diesel 0.947 LTL/litre. Under this measure, the biofuel component of blended fuels is fully exempted. In the case of ETBE, 47% of the volume is considered to be biofuel.

Legal basis

25. The national legal basis is the Law of the Republic of Lithuania on biofuel, biofuels for transport and bio-oil and the programme for the promotion and use of biofuel, 2004-2010.

Budget and duration

26. The overall budget is estimated at 310.14 million LTL (about 91.2 million EURO). The annual budget is unlimited and actual expenses will depend on the take up of biofuel. However, in practice the budget will be limited to the maximum amounts of raw materials eligible for support. The measure will be implemented after approval by the Commission until 31 December 2012.

III. ASSESMENT

Existence of State aid and legality

27. Article 87(1) of the Treaty provides that “*any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain*

¹⁴ To produce 1 tonne of biodiesel 3 tonnes of rapeseed are necessary (836 = 279*3).

¹⁵ According to table 4.1 of the EU research project “Stationary applications of liquid biofuels”, a litre of biodiesel weighs 0.88 kg. (0.736 = 836/*0.88/1000).

goods, shall, in so far as it affects trade between Member States, be incompatible with the common market”.

28. The set-up and financing of the notified scheme is the same as under the existing schemes¹⁶. The notified modifications do not cause the Commission to change its position on whether the scheme constitutes State aid within the meaning of Article 87(1) of the EC Treaty.
29. Lithuania has complied with its obligation to notify the aid in accordance with Article 88(3) of the Treaty.

Community Policy with respect to environmentally friendly fuels

30. The promotion of biofuel and other renewable fuel to replace diesel or petrol for transport is a well established Community priority, as they are expected to contribute to objectives such as reduction of CO₂-emissions and environmentally friendly security of supply. Article 3 of Directive 2003/30/EC on the promotion of the use of biofuels or other renewable fuels for transport¹⁷ establishes a reference value of 5.75% of biofuel in all petrol and diesel for transport purposes placed on their markets by 31 December 2010. The policy on biofuels fits in logically with the wider policy of promoting renewable energy sources in general¹⁸.
31. Directive 2003/30/EC defines ‘biofuels’ to mean liquid or gaseous fuel for transport produced from biomass, where ‘biomass’ is defined as the biodegradable fraction of products, waste and residues from agriculture (including vegetal and animal substances), forestry and related industries, as well as the biodegradable fraction of industrial and municipal waste.

Compatibility under Article 87(3)(c) of the EC Treaty

32. Article 87(3)(c) of the EC Treaty foresees an exemption to the general rule of incompatibility as stated in paragraph (1) of this Article for aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest.
33. The scheme grants aid to fuels that are more environmentally friendly than conventional fuels. The Commission therefore assessed the notified measure in the light of the environmental aid guidelines¹⁹.
34. Pure bioethanol obtained from cereals, sugar beet and molasses and wine is a processed agricultural product included in Annex I of the EC Treaty. The environmental aid guidelines also apply to those sectors which are subject to specific Community rules on State aid, such as agriculture, unless such specific rules provide otherwise (see point 61 of the environmental aid guidelines). The sectoral State aid rules applicable to agriculture are laid down in the Community Guidelines

¹⁶ N 294/05, 306/07 and N 436/06, see footnotes 3, 5 and 6.

¹⁷ See point 9.

¹⁸ See the Commission’s proposal for a Directive of the European Parliament and of the Council on the promotion of the use of energy from renewable sources, COM (2008) 19 final, 23.01.2008.

¹⁹ OJ C 82 1.4.2008, p.1, according to point 204 the Commission will apply these Guidelines to all notified aid measures in respect of which it is called upon to take a decision after the Guidelines are published in the *Official Journal*, even where the projects were notified prior to their publication.

for state aid in the agriculture and forestry sector 2007 to 2013²⁰. According to point 49(c) of the agriculture guidelines., the environmental aid guidelines also apply to environmental aid granted in the agriculture sector. Therefore, there is no need for a separate assessment of State aid granted towards biofuels which constitute agricultural products.

35. As a matter of principle, the environmental aid guidelines lay down that environmental aid must address a clearly identified market failure, have an incentive effect, be proportionate and have a limited impact on competition and trade. Compliance with such criteria is to be verified on the basis of a balancing test. However, the Commission has identified in Chapter 3 of the guidelines a series of measures in respect of which it considers *a priori* that State aid complying with the detailed conditions laid down in the guidelines will also meet the general criteria of market failure, incentive effect, proportionality and limited impact on competition and trade.
36. According to point 49 of the environmental aid guidelines, the Commission takes the view that biofuel promotion should benefit both security of supply and climate change policy in a sustainable way. Therefore, State aid may be an appropriate instrument only for those uses of renewable energy sources where the environmental benefit and sustainability is evident. More particularly, biofuels not fulfilling the sustainability criteria set out in Directive of the European Parliament and of the Council on the promotion of the use of energy from renewable sources, as agreed and laid down in the European Parliament's legislative resolution of 17 December 2008²¹ are not eligible for State aid.
37. Lithuania has confirmed that the notified State aid scheme is only applicable with regard to sustainable biofuels as defined in Chapter 2, point 2.2 (8) of the environmental aid guidelines. The Commission notes that Lithuania committed itself to make available the information on the implementation of the applicable sustainability criteria for the biofuels benefiting from State aid. . This information will be submitted to the Commission in the annual monitoring reports.
38. The Commission also notes that the scheme is formally limited to biofuel produced from raw material originating from the Republic of Lithuania²². Such a restriction could be in breach of the Article 28 of the EC Treaty, as supported by the case-law of the European Courts (e.g. C-120/78 Cassis de Dijon).
39. However, the Lithuanian authorities confirmed that the provision that only biofuel manufactured from raw materials originating in Lithuania is eligible for State aid is and will not be applied in practice.
40. To demonstrate this, the Lithuanian authorities submitted the following figures on the imports of raw material: In 2007 the company AB Biofuture imported 10.193 tonnes of maize from Hungary. Bioethanol was manufactured from this raw material

²⁰ OJ C 319, of 27.12.2006, p. 1.

²¹ P6 TA-PROV(2008)0609

²² The Law on biofuel of the Republic of Lithuania (N. VIII-1875), Article 4 (1) stipulates: "*Production of biofuel, biofuels for transport and bio-oils from the raw material originating in the Republic of Lithuania shall be promoted through programmes approved by the Government and financed from the state budget.*"

and a direct grant was allocated in respect of this raw material. From 1 January 2008 to 19 August 2008 AB Biofuture imported 11.241 tonnes of maize from Ukraine in respect of which a direct grant will also be payable. In 2007 AB Mestilla imported small quantities of rapeseed from Ukraine. For the year 2008 5.000 tonnes of rapeseed have been purchased from Russia, and 20.000 tonnes from Ukraine. AB Mestilla received and will receive the grants due in respect of this raw material.

41. Moreover, the Ministry of Agriculture has drafted an amendment law to the Lithuanian Law on biofuel. The following amendment to Article 4(1) is proposed: the provision that only the production of biofuel, biofuels for transport and bio-oils manufactured from raw materials grown in Lithuania is to be supported will be annulled.
42. At the moment the Lithuanian authorities are unable to state an exact date by which the amendment of the Law will be adopted by Parliament, since Lithuania held parliamentary elections on 12 October 2008 and a new government will be formed following the elections. It is likely that the draft law amending the Law on biofuel will not be debated in Parliament before spring 2009.
43. The Commission notes that Lithuania has committed to amend article 4(1) of the Law on Biofuels. Moreover, the Lithuanian authorities also committed to submit information on the state of play regarding the process of amending the Law on Biofuels in their annual reports.
44. According to section 3.1.6.2., point 109(a) of the environmental aid guidelines, operating aid for the production of renewable energy may be justified in order to cover the difference between the cost of producing energy from renewable energy sources and the market price of the form of energy concerned.
45. The figures provided by Lithuania in point 18 on the calculation of the aid amount show that the grant drives the price of biofuels down to the sales price of ethanol in Lithuania. However the grant does not allow biofuel to compete with fossil fuel which is aimed to be replaced by biofuels. In Lithuania the support for biofuels to be able to compete with fossil fuel is divided into two parts: the support granted via grants and the support granted via excise duty reductions. Therefore to be able to assess the compliance of the Lithuanian system with the provisions of point 109(a) of the Guidelines the Commission assessed if the cumulated aid granted via grants and via excise duty reduction does not lead to overcompensation between the production costs of biofuels and the market price of fossil fuels.
46. In order to be able to compare the production costs of biofuels with the price of fossil fuel one need to take the lower energy content of biofuels into account in order to compete with the same energy content. The table below demonstrates that the proposed grant is driving the production costs of biofuels down, but when the energy content is taken into account the market price of fossil fuels is still lower. The excise duty reduction compensates for the remaining difference in production costs, including an adjustment for lower energy factor, and the market price of fossil fuel, and is not exceeding this difference.

	Bioethanol (LTL/litre)	Biodiesel (LTL/litre)
1. Production costs after grant	2.304	2.49

2. Energy content²³	1.065	0.22
2. Production costs adjusted for energy content	3.369	2.71
Final sales price of fossil fuel to customers	1.36	1.44
Excise duty on fossil fuel	1.116	0.947
5. Total final sales price of fossil fuel	2.48	2.39
6. Difference between production costs of biofuels and final sales price of fossil fuel²⁴ (2-5)	0.889	0.32

47. On the basis of these considerations it can be shown that the grant does not overcompensate the nationally produced biofuels in comparison to the market price of fossil fuels and therefore it complies with the conditions in section 3.1.6.2., Option 1 of the environmental aid guidelines
48. According to point 109(b) any investment aid granted to the undertaking in question in respect of the new plant must be deducted from production costs when determining the amount of operating aid. The Lithuanian authorities confirmed that no investment aid has been granted (or will be granted) to the beneficiaries of the scheme (biofuel producers) and therefore there is no need to deduct any possible investment aid.
49. There is no need to limit the duration of operating aid to plant depreciation, given that the fuels concerned are obtained from biomass and as such require less investment but bring higher operating costs than other renewables, in line with point 109(c) of the guidelines.
50. The notified scheme complies with the conditions in section 3.1.6.2., Option 1 of the environmental aid guidelines.
51. The Commission notes that there is also supply obligation²⁵ in Lithuania. This, concerns an obligation to blend in a certain amount of biofuels into the fossil fuels sold on the domestic market. According to this supply obligation from the 1st January 2007 the gasoline (petrol 95) shall contain not less than 7% and not more than 15% share of bio-ETBE (bio-ethyl-tertio-butyl-ether) volume sold on the Lithuanian market annually. Gasoline which is produced without bio-ETBE, shall have a 5% content of pure bio-ethanol. Also, from the 1st January 2007 the fossil diesel shall contain 5% of bio-diesel (methyl (ethyl)-ester produced from vegetable or animal oil). The bio-methyl-ester content can be more than 5%, provided that such mixture meets existing quality standards. However, if there is no biofuel available on the domestic market the supply obligation is no longer applicable and there are no penalties foreseen in the case of non-compliance.
52. As regards the introduction of the supply biofuel obligation, the Commission notes that the currently applicable laws on this "obligation" do not foresee any particular fines or penalties for non-compliance. As there are no fines introduced so far for non-compliance with this obligation the Commission are of the opinion that the

²³ The energy adjustment factor has been calculated in the following way: for bioethanol (31/21.2-1)*100%, for biodiesel (35.7/32.8-1)*100%. By applying the energy adjustment factor to the costs of bioethanol (biodiesel) the energy adjusted total price of bioethanol (biodiesel) equals 3.369 LTL (2.71 LTL).

²⁴ If the difference is positive than the level of aid is allowable. If the difference is negative, the level of aid is too high and results in overcompensation

²⁵ The Lithuanian authorities refer in this context to a quality regulation.

obligation cannot be considered to be legally enforceable. The Commission further considers it unlikely that such an "obligation" could have a clear effect on the market and therefore the existence of this obligation has not been taken into account for the assessment of the case at hand. This conclusion is supported by the fact that in the year 2008 the amount of aid for biofuels foreseen by the government, covered the majority of biofuels consumed in Lithuania i.e. 4.25%. The total production of biofuels amounted to 6% of fuels consumed in Lithuania. However the amount of biofuels exceeding the governmental consumption target was not supported with aid. The small overproduction seems however to be rather a result of overshooting of targets by companies in terms of planning and lack of information on amounts sold to the market during the year, as an influence of supply obligation. Therefore this "obligation" does not seem at this stage to have any cumulative effect on the supply of biofuels in Lithuania with the grant which is subject to this decision. However, once such a legal obligation is introduced, this will result in the change of the Lithuanian legal framework concerning supply of biofuels and consequently may have implications for the currently notified scheme.

53. The Commission notes that the Lithuanian Republic committed itself to provide annual monitoring reports to the Commission containing all relevant information on the production costs of biofuels and the market price of fuels and biofuels to show that there is no overcompensation.
54. The Commission notes that the amendment is limited in time, as the direct grant will be granted for 5 years after the Commission approval.
55. Finally, with respect to the future adoption of legislation by the Lithuanian authorities, the Commission would like to remind the Lithuanian authorities of their obligation, in accordance with Article 88 (3) of the EC Treaty to notify to the Commission any plans to alter or change the scheme pursuant to provisions of Commission Regulation (EC) No 794/2004 implementing Council Regulation (EC) No 659/1999 laying down detailed rules for the application of Article 93 [*now 88*] of the EC Treaty.

IV. CONCLUSION

56. The Commission has accordingly decided not to raise objections to the notified project at hand as the State aid can be found compatible with the common market pursuant to Article 87(3)(c) of the EC Treaty, since it respects the conditions laid down in the environmental aid guidelines.
57. If this letter contains confidential information which should not be disclosed to third parties, please inform the Commission within 15 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://ec.europa.eu/community_law/state_aids

Your request should be sent by registered letter or fax to:

European Commission
Directorate-General of Competition
State Aid Registry
B-1049 BRUSSELS
Telefax n°: + 32-2-296.12.42

Please, mention the name and number of the case in all the correspondence.

Yours faithfully,

For the Commission

Neelie KROES
Member of the Commission