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Subject: **State aid No N 178/2010 – Spain**

Public service compensation linked to a preferential dispatch mechanism for indigenous coal power plants

Sir,

1. PROCEDURE

(1) On 12 May 2010, following pre-notification contacts, Spain notified the Commission of the above measure pursuant to Article 108(3) TFEU (hereinafter: "the notified measure").

(2) Additional information was submitted by letters of 14 and 15 June 2010, registered on 16 June 2010.

(3) The Commission requested additional information by letter dated 13 August 2010. Spain replied by letter dated 31 August 2010, registered on the same day.

(4) Spain's Minister for Industry, Tourism and Trade sent a letter dated 3 September 2010, registered on 6 September 2010.

(5) Spain submitted additional information by letter dated 17 September 2010, registered on the same day.

(6) Between February and September 2010, the Commission received complaints and letters concerning the measures envisaged by Spain from various companies active in the Spanish electricity and natural gas markets, as well as from business associations

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representing the Spanish natural gas and coal sectors. The Commission also received complaints and letters from a former and a current member of the European Parliament, three Spanish local authorities and two environmental non-governmental organizations.

2. DESCRIPTION OF THE MEASURE

2.1. Legal basis

(7) Spain notified:

- a Royal Decree adopted on 12 February 2010: *Real Decreto 134/2010, de 12 de febrero, por el que se establece el procedimiento de resolución de restricciones por garantía de suministro y se modifica el Real Decreto 2019/1997, de 26 de diciembre, por el que se organiza y regula el mercado de producción de energía eléctrica* (hereinafter: "Royal Decree 134/2010");

- a draft Royal Decree intended to amend Royal Decree 134/2010 (hereinafter: "the draft amending Royal Decree").

(8) Those provisions are based on Article 25 of Law 54/1997 of 27 November 1997 on the electricity sector (*Ley 54/1997, de 27 de noviembre, del Sector Eléctrico*), which stipulates that the Government may establish procedures, compatible with the free market in electricity production, in order to ensure the continued operation of generation units using indigenous sources of primary energy, up to a limit of 15% of the total primary energy required to generate sufficient electricity to meet demand on the national market, calculated on an annual basis.

(9) Spain indicated that Royal Decree 134/2010 had not yet been implemented and will not be implemented without having been modified by the draft amending Royal Decree.

(10) The legal basis of the measure in national legislation will thus be Royal Decree 134/2010 as modified by the draft amending Royal Decree. It will be referred to hereinafter as "the modified Royal Decree".

2.2. Objective and context of the measure - beneficiaries

(11) The notified measure is a financial compensation which Spain intends to grant to the owners (*titulares*) of ten power plants running on indigenous coal together with other fuels[1]. These undertakings will be subject to an obligation to produce certain volumes of electricity out of indigenous coal, under conditions specified in the modified Royal Decree. This production obligation will be implemented through a mechanism whereby priority will be given to the dispatch of these ten indigenous coal power plants over other power plants ("preferential dispatch mechanism"). The following table provides the list of these indigenous coal plants and their ownership structure:

[1] Most of these plants consume mixtures of indigenous coal and imported coal. All imported coal currently used for power generation in Spain originates from non EU Member States.

Table 1: indigenous coal plants covered by the preferential dispatch mechanism

Power plant	Ownership
Soto de Ribera 3	Hidrocantábrico (HC Energía)
Narcea 3	Gas Natural Fenosa
Anllares	Gas Natural Fenosa (66%) – Endesa (33%)
La Robla 2	Gas Natural Fenosa
Compostilla	Endesa
Teruel	Endesa
Guardo 2	Iberdrola
Puentenuevo 3	E-On
Escucha	E-On
Elcogás	Endesa, EDF, Iberdrola, and EDP-HC Energía

The power plants included in this list are all those for which an indigenous coal procurement agreement is currently in force.

(12) The preferential dispatch mechanism, called in the modified Royal Decree "*mecanismo de restricciones por garantía de suministro*", is a mechanism whereby every day, the outcome of the clearing of the Spanish organised day-ahead electricity market will be modified to the extent necessary to ensure that the above-mentioned coal-fired power plants can place pre-defined volumes of electricity generated out of indigenous coal on that market.

(13) Spain considers that the production obligation imposed on the owners of the above-mentioned indigenous coal plants corresponds to the operation of a genuine service of general economic interest relating to security of energy supply based on Article 11(4) of the Second Electricity Market Directive[2]:

"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."

The Second Electricity Market Directive will be repealed and replaced by the Third Electricity Market Directive[3] as from 3 March 2011. However, the wording of Article 11(4) of the Second Electricity Market Directive has been kept unchanged in Article 15(4) of the Third Electricity Market Directive.

(14) Spain considers that the notified financial compensation is a public service compensation which constitutes State aid and should be declared compatible with the internal market on the basis of Article 86 (2) of the EC Treaty (now Article 106 (2) TFEU).

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2 Directive 2003/54/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in electricity and repealing Directive 96/92/EC (OJ L 176, 15.7.2003, p. 37)

3 Directive 2009/72/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC (OJ L 211, 14.8.2009, p. 55)

(15) The measures laid down in the modified Royal Decree will provide the assurance that the ten above-mentioned coal-fired power plants will have a minimum level of activity and will cover their production costs.

(16) Spain considers that these measure are necessary to address concerns relating to security of energy supply, which arise from a combination of several elements affecting the Spanish electricity market:

- the steady and significant increase of electricity production from renewable energy sources, which benefits from specific support measures whose objective is to ensure that Spain will comply with its EU commitments relating to the penetration of energy of renewable origin[4];
- the fact that electricity production from renewable energy sources is "intermittent": even though the installed capacity of renewable generation units is relatively high, the actual available generation capacity of these units at each point in time is highly variable since it depends on weather conditions. This is the case in particular for wind turbines;
- the lack of adequate interconnection capacities between the Spanish electricity system and the other major European electricity markets.

(17) Spain indicated that because of the penetration of renewable electricity, which will continue at a fast pace until 2020, the part of the national electricity demand that has to be satisfied by production from gas and coal-fired power plants is going down and will continue to do so. Therefore, these plants are experiencing a more and more reduced access to the Spanish wholesale electricity market, which limits revenues generated by the sale of their production on that market. Furthermore, Spain stresses that the lack of interconnection capacities with other major European electricity markets limits the opportunities for the owners of gas and coal-fired plants to use the spare capacities of these plants for exports, even though the production of these plants could be competitive on other major European wholesale electricity markets, such as the French and German ones, where prices are currently markedly higher than in Spain. Spain provided the following data concerning the current and planned level of interconnections with neighbouring Member States:

Table 2: Current and planned electricity interconnections (in MW)

With Portugal			**With France**		
	Portugal-> Spain	Spain-> Portugal		France-> Spain	Spain-> France
Before 2004	580- 600	750-1050	1997-1998	550	400
2004-2009	1200- 1300	1100- 1500	1998-2002	1100	400

[4] In Spain, electricity of renewable origin – including from large hydropower plants - already accounted for around 23% of total electricity production in 2008. This share is constantly growing as Spain is committed to producing more than 40% of its total electricity production from renewable energy sources by 2020.

2010	1500- 2500	1600- 2300	2002-2009	1400	500
2014	3000	3000	2010	1400	<1400
			2014	2500- 3000	1700- 2800

Source: submission of 31 August 2010

(18) As illustrated by these data, even though several important investment projects are going on, that are expected to increase interconnection capacities in a significant manner over the next four years, interconnections will remain modest in this period: by 2014, Spain's both total import and total export capacities are not expected to exceed 6,000 MW, i.e. around 6.6% of mainland Spain's installed generation capacity in 2008 (i.e. 91,000 MW).

(19) The factors listed in point 16 above tend to weaken the economic profitability of gas and coal-fired plants. This trend has been exacerbated by the consequences of the global economic downturn, which resulted in a 5% fall in electricity demand in Spain in 2009, and consequently, in a significant fall in wholesale electricity prices. In particular, the functioning of power plants using indigenous coal as one of their fuels (hereinafter: "the indigenous coal plants") has been drastically reduced. Spain considers that under these circumstances, operators of thermal power plants might be tempted to close down a number of assets so as to increase their operational margins.

(20) Yet, according to Spain, existing gas and coal-fired power plants are necessary to ensure security of electricity supply because of the stability that they provide to the Spanish electricity system under regular extreme weather conditions occurring in the summer and winter periods. Under those conditions, electricity demand may be relatively high whilst the available capacity of renewable generation units may be limited, both phenomena being influenced by weather conditions. Therefore, under those conditions, a significant part of electricity demand has to be satisfied by production from coal and gas-fired plants. Spain notes that coal-fired plants are normally sufficiently reliable, apart during isolated periods of outage, to assure proper operation of the electricity system and electricity supply, serving as manageable output plants. With the exception of two plants which underwent major maintenance works in 2009, the availability rate of each of the ten above-mentioned indigenous coal plants was higher than 84% in 2009. Moreover, their available capacity at each point in time is highly predictable as it depends on stable technical parameters.

(21) Moreover, all these indigenous coal plants provide balancing services to the Transmission System Operator (resolution of technical restrictions (*soluciónes de restricciones técnicas*), deviation management *(gestión de desvíos)* and tertiary regulation *(regulación terciaria*)), which are primarily intended to maintain the frequency of the transmission network and thereby avoid black-outs. Schematically, these services consist in adjusting the output of the power plants that supply them, either downwards or upwards, within a certain period of time[5], upon request of the Transmission System Operator. Normally,

[5] For deviation management, this response time is between one and three hours, whereas for tertiary regulation, it is lower than 15 minutes.

these services cannot be provided by nuclear power plants and plants with non-manageable output such as wind turbines and run-of-river hydropower plants. To the contrary, the growth of renewable-based intermittent electricity production increases the needs for such services, precisely because of its intermittent character. The main suppliers of these services are coal, gas and fuel oil power plants. In addition, for some of these services, when they are required by the Transmission System Operator, they can be provided only by power plants that are already on line. Consequently, the fact that indigenous coal power plants face a reduced access to the day-ahead electricity market reduces their ability to provide balancing services accordingly. The following table illustrates the sharp decrease in the provision of deviation management and tertiary regulation services by the indigenous coal power plants in 2010, which is correlated to the sharp reduction in volumes supplied on the day-ahead electricity market.

Table 3: Provision of balancing services by indigenous coal power plants (output adjustment of power plants in GWh)

		2007	2008	2009	2010 (until July)
Deviation management	Adjustment upwards	49	134	63	10
	Adjustment downwards	129	140	334	13
Tertiary regulation	Adjustment upwards	94	211	116	15
	Adjustment downwards	242	307	286	20

Source: submission of 31 August 2010

The Spanish authorities indicated that even though indigenous coal plants were somewhat less flexible than gas-fired combined cycle turbines, they nevertheless met the technical requirements necessary to provide these system services. Altogether, the indigenous coal power plants offer a substantial power reserve of 2,370 MW above the plants' minimum technical output, which can be used to secure network stability.

(22) It follows from the issues raised in points 20 and 21 that even though coal and gas-fired plants are on average called on to produce only limited volumes of electricity, they would nonetheless be necessary to satisfy demand under regular extreme weather conditions and also because they play an important role for the provision of balancing services to the Transmission System Operator. This situation is linked to a specific feature of electricity, namely the fact that it cannot be stored economically in large quantities, hence the need to ensure that available generation capacities are sufficient to meet instant demand at each point in time and not only on average.

(23) Spain provided estimates of the "mid-term coverage index" under various scenarios, on the basis of data retrieved from a report drawn up by *Red Eléctrica de España*

(hereinafter: REE)[6]. REE, which is the operator of the Spanish electricity transmission network, is also responsible for estimating future electricity demand in Spain and for identifying the potential needs for additional generation capacities. REE has to notify the Ministry of Industry, Tourism and Trade of its assessments. The "mid-term coverage index" is defined in the notification as the ratio forecasted for every year until 2014 between on the one hand, available generation capacities, as estimated on the basis of installed generation capacities[7], and on the other hand, maximum instant electricity demand (peak demand). Spain considers that in order to maintain a sufficient safety margin, the mid-term coverage index should be maintained above 1.1.

(24) In particular, Spain calculated the mid-term coverage index under a scenario where no specific measure would be adopted. Given the main features of the Spanish electricity market and the impact of the global economic downturn, as described above, Spain based its assessment of this scenario on two main assumptions: 1) the ten above-mentioned indigenous coal plants would be all closed down, 2) no additional combined cycle gas turbines would be brought into line during the period concerned, except those already in construction. The results of this calculation indicate that the mid-term coverage index would fall below 1.1 between 2012 and 2014, which would thus lead to unacceptable risks of disruption of electricity supply.

(25) In view of this result, the Spanish authorities consider that it seems reasonable to take specific measures aimed at increasing the mid-term coverage index up to the requisite level. Moreover, they consider that in the absence of the measures such as those laid down in the modified Royal Decree, whose purpose would be, amongst others, to avoid the closure of the existing indigenous coal power plants, it would be necessary to provide financial support for the installation of new generation capacities.

(26) However, according to Spain, the provision of financial support for the construction of new gas-fired generation capacities would be more costly than a measure intended to secure the economic viability of existing indigenous coal plants. Spain provided quantified estimates in support of that finding. Moreover, Spain also mentioned the time-span needed to have new generation capacities available on the market: usually, three years lapse between the decision to invest in a new gas-fired power plant and the end of the construction, and that duration may be increased depending on the time taken by the environmental analysis of the project and the administrative permitting procedures. Spain also stressed that in addition to the "mid term" risks, that is to say, risks of disruption of supply in the coming years, there were also "short-term risks" which could be identified on the basis of situations observed in some specific days during the winter. For example, on 11 January 2010, the whole capacity of the combined cycle gas turbines and 5,000 MW out of 11,000 MW of total coal-based capacities were required to satisfy demand, despite the abundance of hydropower available capacities.

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6 Integración de Generación Renovable a Medio Plazo 2009-2014, Octubre 2009. Red Eléctrica de España. This report was attached to the notification.

7 The available generation capacity is estimated on the basis of statistical and historical data concerning for example the duration of unavailability periods due to planned or unexpected maintenance for each of the main generation technology groups (coal, gas, nuclear etc.).

(27) Spain thus concludes that a measure intended to secure the economic viability of existing indigenous coal plants is cost-effective in view of the objective pursued.

(28) Spain added that in the absence of such a measure, the expected closure of indigenous coal plants would put in jeopardy the coalmining activity in Spain[8]. If the coal mines were closed down, the only fossil fuel that is present in large quantities in Spain would be no longer available. Moreover, according to the draft amending Royal Decree, the dramatic reduction in the functioning of the indigenous coal plants, which is currently observed and results from the fall in electricity demand, is itself putting in jeopardy the continuation of the coalmining activity in Spain, because most of the coal produced in Spain is consumed in these plants. Spain indicated that the coal mines concerned all received operating aid in accordance with Council Regulation (EC) No 1407/2002 on State aid to the coal industry[9] and will continue to receive such aid while the measures laid down in the modified Royal Decree are implemented, in accordance with Regulation (EC) No 1407/2002 or any successor to that Regulation. That aid is based on a National Strategic Coal Reserve Plan (*Plan Nacional de Reserva Estratégica de Carbón 2006-2012 y Nuevo Modelo de Desarrollo Integral Sostenible de las Comarcas Minerias*), which foresees that the production of these mines should decline from approximately 11.9 million metric tonnes in 2005 to 9.2 million tonnes in 2012. That State aid is insufficient to secure the viability of the coal mines because the sales targets stemming from the National Strategic Coal Reserve Plan are not reached. Furthermore, it appears that specific measures are also necessary to absorb the coal accumulated by national coalmining company Hunosa in 2009 and 2010 in its capacity as manager of the "temporary strategic coal stockpile"[10].

(29) Spain considers that maintaining a certain proportion of indigenous primary energy sources would significantly enhance its security of energy supply, in addition to other measures also benefitting security of supply, such as the promotion of renewable energies.

(30) It stressed that the use of indigenous coal contributed to security of supply, notably because mines supplying indigenous coal to the power stations are located in the vicinity of the said power stations. Therefore, according to Spain, in case of problems affecting international transport, "unmanageable" weather conditions or political tensions liable to affect international trade in fossil fuels, Spain's security of supply may be enhanced if indigenous coal continued to be available. Furthermore, should the coalmining activity be ended in Spain as a consequence of the current fall in electricity demand, the owners of indigenous coal plants would have to modify their fuel procurement strategy, which may

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8 Most of the hard coal produced in Spain (anthracite, bituminous coal and black lignite) is used for power generation in Spain. Each of the ten indigenous coal plants covered by the notified measure is located in the immediate vicinity of coal mines and consumes most of the coal produced by these mines.

9 OJ L 205, 2.8.2002, p. 1

10 The temporary strategic coal stockpile system is a mechanism put in place in 2009 in order to ensure the viability of Spanish coal mines, when they started to face a drastic reduction of sales to power generating companies because of the global economic downturn. Hunosa was entrusted by the State with the obligation to purchase coal from other coal producers at the same price as that foreseen in the indigenous coal procurement contracts of electricity generating companies. The mechanism will end when the modified Royal Decree enters into application. It is foreseen that the quantities stockpiled by Hunosa in its capacity as manager of the temporary strategic coal stockpile will be included in the quantities that power generators will have to purchase and consume as part of their public service obligations.

lead some of them to immediately close down their power plants, whilst others would have to enter into new coal procurement agreements. Spain indicated that none of the ten indigenous coal plants covered by the notified measure could appreciably reduce the percentage of indigenous coal in its fuel mixture without altering its efficiency, possibly with the exception of the only integrated gasification plant covered by the scheme. In addition, Spain put forward the example of two Spanish power plants for which very substantial investments had to be made in the past to allow a complete shift to imported coal[11]. In view of these elements, Spain sees a clear risk that the end of coal extraction may trigger the closure of the indigenous coal power plants, and therefore, negatively impact security of electricity supply. Finally, as regards the importance of indigenous coal, Spain considers that the freedom of Member States to choose their energy sources has to be taken into account.

(31) This is on the basis of those considerations that Spain regards measures aimed at ensuring a certain level of electricity production out of indigenous coal, and providing a compensation intended to cover the costs associated with this electricity production, as both necessary and cost-effective.

2.3. Duration of the measure – transitory nature

(32) Spain stressed that the notified measure had a transitory nature, since it is directly related to the demand fall that has been hitting the Spanish electricity market for two years. According to Spain, the best estimation available at present concerning electricity demand evolution shows that electricity demand will reach its 2007 level in 2013, and is expected to grow from then on until 2020.

(33) The sole transitional provision *(disposición transitoria única)* of the modified Royal Decree stipulates that the preferential dispatch mechanism will apply until 31 December 2014 at the latest. According to Spain, even though electricity demand is expected to reach its 2007 level in 2013, it is necessary to foresee the possibility to maintain the system in application until 31 December 2014 at the latest, as a matter of caution. Spain underlined that current electricity demand forecasts for the coming years were fraught with uncertainties, stemming in particular from existing uncertainties as regards recovery of the Spanish economy. However, according to the modified Royal Decree, the measures laid down in that Royal Decree could be ended at an earlier date by a decision of the Minister for Industry, Tourism and Trade, if the conditions prevailing on the Spanish electricity generation market allowed the indigenous coal plants to function through market mechanisms that secure their mid-term economic viability, so that electricity demand can be satisfied in conditions of security of supply.

(34) Finally, in his letter of 3 September 2010, Spain's Minister for Industry, Tourism and Trade expressed the firm commitment of the Spanish authorities to keeping unchanged the content of the above-mentioned sole transitional provision *(disposición transitoria única)* in any possible future revision of the Royal Decree. The Commission takes note of this commitment of the Spanish authorities that no prolongation of the preferential

[11] EUR 306 million for one of the plants (1,500 MW of installed capacity) and EUR 94 million for the other one (600 MW).

dispatch mechanism beyond 31 December 2014 at the latest will be possible, even in the case of a possible future revision of the Royal Decree.

2.4. Description of the preferential dispatch mechanism and of the associated public service compensation

(35) The modified Royal Decree specifies the list of indigenous coal plants to which the preferential dispatch mechanism will apply. For each of these plants, the owner will have to submit to the *Comisión Nacional de Energía* (hereinafter: "the CNE"), that is to say, the independent Spanish energy market regulatory authority, a commitment letter (*carta de compromiso*) for the acquisition of indigenous coal until 2012, signed by each of the coal suppliers concerned.

(36) The modified Royal Decree contains a detailed methodology for the calculation of the "unit production cost" of each of the power plants concerned. The unit production cost corresponds to the total production costs, that is to say, the variable and fixed costs, including a reasonable return on invested capital, per MWh produced. The Office of the Secretary of State for Energy (*Secretaría de Estado de Energía*) will issue every year a Resolution setting the "unit production cost" of each plant, as calculated in application of that methodology. The Resolution will identify the variable and fixed production costs of each plant.

(37) Every year, the Office of the Secretary of State for Energy will set by way of a Resolution, the maximum volume of electricity[12] which each of these plants may be required to produce during the year in the framework of the public service obligation associated with the preferential dispatch mechanism, as well as the quantities of indigenous coal to be purchased by the owners of the plants[13]. The Office of the Secretary of State for Energy will also set the quantities that power generators will be obliged to purchase from Hunosa in its capacity as manager of the temporary strategic coal stockpile. Besides, the price at which the indigenous coal will have to be purchased by power generators will be set by Royal Decree.

(38) On that basis, REE will draw up every week an "operating plan" for each of these plants, and will communicate it to the owner of the plant. These weekly operating plans will be designed in such a way as not to oblige the plants to produce more electricity during the year than the volume foreseen in the above-mentioned annual Resolution of the Office of the Secretary of State for Energy. In principle, REE will be led to include an indigenous coal plant in a weekly operating plan as long as the plant has not produced the maximum volume of electricity set by the Office of the Secretary of State for Energy for the year in question. REE may have to update the operating plans drawn up for a given week in the

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[12] In case of duly justified periods of unavailability, that lead a power plant not to produce the maximum volume of electricity set for the year in question by the Office of the Secretary of State for Energy, the latter will take this shortfall in production into account when setting maximum volumes of production in subsequent years.

[13] However, the modified Royal Decree will allow the Office of the Secretary of State for Energy to authorise transfers of stocks of indigenous coal between power plants, so as to optimise the management of stocks. In case of such authorisations, the maximum volumes of electricity and unit production costs will be revised accordingly.

course of that week, due to factors such as changes in demand forecasts, changes in supplies of energy from renewable installations, outages of production plants or technical constraints affecting the transmission network.

(39) Every day, the owner of any of the indigenous coal plants that is covered by a weekly operating plan issued by REE, will be obliged to submit bids on the organised day-ahead electricity market[14], for a volume of electricity equal to the one foreseen in the said weekly operating plan, and at a price not higher than the "variable cost" set in the above-mentioned annual Resolution of the Office of the Secretary of State for Energy that will determine the "unit production cost" of each of the power plants.

(40) Every day, after the clearing of the day-ahead electricity market, REE will modify the production programmes resulting from the clearing of the market, to the extent necessary to allow the indigenous coal plants covered by a weekly "operating plan" to place the volume of electricity foreseen in that plan on the market. More precisely for a given indigenous coal plant covered by an operating plan on that day, two situations may arise:

- First possible situation: the plant is selected through the clearing of the market and as a result of the clearing, it can place on the market a volume of electricity at least equal to that foreseen in the weekly "operating plan". In this first possible situation, this volume of electricity will be sold on the day-ahead market and no change will need to be introduced in the production programmes resulting from the market clearing with respect to the indigenous coal plant concerned. The volume concerned will be taken into account by REE for the purposes of determining the remaining volume that needs to be specified in further weekly operating plans for this power plant, in order to reach the maximum volume set by the Office of the Secretary of State for Energy for the year in question. If the clearing price is higher than the "unit production cost" set in the annual Resolution of the Office of the Secretary of State for Energy, this will generate for the owner of the plant a "payment obligation" (*obligación de pago*) corresponding to the difference between the market clearing price and the "unit production cost": the owner of the plant will have to pay the corresponding amount to MEFF, an entity which acts as an intermediate between REE and the power generators for the management of the financial flows associated with the "capacity payment mechanism"[15]. If on the contrary the market clearing price is lower than the plant's "unit production cost", this will generate a "collection right" (*derecho de cobro*) for the owner of the plant: the latter will be entitled to receive an amount corresponding to

[14] The day-ahead Spanish electricity market functions as a classical "spot" electricity exchange: every day, electricity operators submit bids indicating the quantities of the electricity that they offer and the minimum price that they are asking for it. The market operator determines the combination of bids that matches demand and leads to the lowest price (which is typically, the highest price amongst those proposed in the bids that are selected to satisfy demand). This operation is known as the "clearing" of the market, and the resulting price is known as the clearing price. The clearing of the market thus allows not only to determine a price, but also a production programme for each of the power plants for which bids were submitted. Typically, the power plants for which a bid higher than the clearing price had been submitted are not selected and have no production programme for that day.

[15] See section 2.5

the difference between its unit production cost and the market clearing price, as part of its public service compensation.

- Second possible situation: the indigenous coal plant in question has not been selected through the clearing of the market. In that case, the preferential dispatch mechanism will be activated: the indigenous coal plant will be called on to produce the volume of electricity foreseen in REE's weekly production plan. In order to ensure balance between demand and supply on the day-ahead electricity market, REE will modify the production programme resulting from the clearing of the market for power plants not using indigenous coal (notably plants consuming exclusively imported coal, or running on fuel-oil or natural gas). In practice, REE will reduce the volumes to be produced by these plants, in comparison to the volumes foreseen in the production programmes resulting from the clearing of the market. The owner of the indigenous coal plant in question will receive a collection right ("*derecho de cobro")*, certifying its right to receive from the "capacity payment mechanism" as part of its public service compensation, the product of its "unit production cost", as set in the Resolution of the Office of the Secretary of State for Energy, and the volume of electricity that it is called on to produce by REE. Besides, a payment obligation ("*obligación de pago")* will be imposed to the power plants whose production has been reduced by REE (hereinafter: the "displaced plants"), corresponding to the product of the market clearing price and the volumes of electricity deducted from their production programmes by REE: in other words, the owners of the "displaced plants", which will have obtained revenues from buyers on the day-ahead electricity market for the full volume of electricity set by the production programme resulting from the market clearing, will have to pay to the "capacity payment system" the part of the revenues that correspond to the volume of energy deducted from their production programmes.

(41) When the preferential dispatch mechanism is activated, REE will determine the power plants that will be "displaced" according to rules precisely defined in the modified Royal Decree. First, REE will select fuel-oil and coal-fired power plants according to a descending order of merit based on the CO_2 emission levels of these plants: the most CO_2 emissive plants will be selected first. Then, if further power plants need to be "displaced", REE will select gas-fired power plants, which are less emissive than fuel-oil and coal-fired plants. Since the CO_2 emissions of gas-fired power plants are all within the same range of magnitude, REE will reduce the volumes to be produced by these plants *pro rata* to the volumes set in the production programmes resulting from the clearing of the market for these plants.

(42) The public service compensation allocated to a given indigenous coal power plant will thus be made up of amounts corresponding to the difference between:

- the collection rights ("*derechos de cobro")* allocated to the plant when the preferential dispatch mechanism is activated or when the plant is selected through the market clearing and the clearing price is lower than the plant's "unit production cost";

- the payment obligations ("*obligaciónes de pago")* imposed when the plant is selected through the market clearing and the clearing price is higher than its "unit production cost".

2.5. Financing of the compensation and budget

(43) The amounts corresponding to the "payment obligations" and "collection rights" mentioned in section 2.4 will be transferred according to the rules governing the "capacity payment mechanism", as described below. The capacity payment mechanism is an existing financial support system aimed at ensuring that enough power generation capacities are installed and available in Spain so as to reduce the risks of disruption of electricity supply[16]. Under this system, power generators may, under certain conditions, benefit from certain payments ("capacity payments") in exchange for ensuring the availability of existing generation capacities over a given time-span or for investing in new generation capacities. The amounts that each power generator is entitled to receive, as well as the conditions under which these amounts may be received are entirely defined in regulatory provisions.

(44) The capacity payment mechanism is financed through a levy imposed by national law[17] on electricity retail suppliers and direct consumers (*consumidores directo en mercado),* that is to say, electricity end-users that purchase electricity directly on the wholesale electricity market. Electricity producers are exempted from this levy (hereinafter: "the capacity payment levy") for the electricity consumed for their own production, including for pumping. The amount to be paid by each electricity supplier or direct consumer is calculated according to formulae set in regulatory provisions, on the basis of the volumes of electricity acquired by the supplier or consumer concerned on the Spanish wholesale electricity market and destined for consumption in Spain.

(45) Electricity retail suppliers and direct consumers transfer the amounts levied on them onto a bank account opened by MEFF, the entity entrusted by REE with the management of these amounts. REE calculates the amounts that power generators allowed to benefit from the capacity payment system are entitled to receive, and communicates that information to MEFF, which transfers the corresponding amounts to the power generators.

(46) The amounts of "capacity payments" that power generators are entitled to receive are calculated independently of the proceeds from the capacity payment levy. Therefore, the balance between the amounts that power generators are entitled to receive and the proceeds from the levy can be either positive or negative. This is why the "capacity payment" system is linked to the general system of settlement of the regulated activities

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[16] The legal bases for this mechanism are: Article 16 of Law 54/1997 on the electricity sector, Annex III to Order ITC/2794/2007 of 27 September 2007, Order ITC/3860/2007 of 28 December 2007 (Second Additional Provision) and Order ITC/3801/2008 of 26 December 2008.

[17] Referred to in the Seventh Additional Provision of Orden ITC/3860/2007, de 28 de diciembre, por la que se revisan las tarifas eléctricas a partir del 1 de enero de 2008

(*liquidación de las actividades reguladas*) of the electricity system laid down by Royal Decree 2017/1997[18].

(47) Under the system of settlement of regulated activities, the CNE identifies the "payable costs" (*costes liquidables)* acknowledged to the operators of electricity transmission and distribution networks, that is to say, the remuneration due to each network operator so that it can cover its costs. The CNE also identifies various other costs of the Spanish electricity system[19]. Moreover, the CNE identifies the "payable revenues" (*ingresos liquidables)* obtained by operators of transmission and distribution networks, which primarily stem from the proceeds from regulated network charges paid by all electricity end-users. For each entity subject to the system of settlement of regulated activities (essentially, the distribution and transmission network operators), the difference between *costes liquidables* and *ingresos liquidables* can be either positive or negative and thus result in an amount to be either received or paid by that entity. On that basis, the CNE organises a transfer of money between bank accounts that it opened for that purpose and the bank accounts of the entities subject to system of settlement of regulated activities: the entities for which difference between *costes liquidables* and *ingresos liquidables* is negative transfer the corresponding amount onto bank accounts opened by the CNE. Conversely, the CNE transfers from the same bank accounts the amounts to be paid to entities for which that difference is positive[20]. The rules governing that settlement process are entirely defined by national law, which does not leave any margin of discretion to the CNE, which it entrusts with the management of that system.

(48) As regards the "capacity payment system", if the difference between the proceeds from the capacity payment levy and the amounts that power generators are entitled to receive is positive, this surplus amount is qualified as a payable revenue (*ingreso liquidable)* in the meaning of Royal Decree 2017/1997, and consequently, transferred by MEFF to REE and then from REE onto a bank account opened by the CNE. If on the contrary, the difference is negative, the missing amount is regarded as a payable cost (*coste liquidable)* in the meaning of Royal Decree 2017/1997, and the CNE transfers that missing amount to REE, which retransfers it to MEFF.

(49) When the modified Royal Decree enters into application, REE will pay their public service compensation to the owners of indigenous coal plants through the "capacity payment mechanism", in the same conditions as the amounts of "capacity payments" are currently paid to power generators entitled to benefit from such payments.

(50) Similarly, the operators subject to a "payment obligation" under the conditions described in section 2.4 above will transfer the corresponding amounts to MEFF. These amounts will be added to the proceeds from the capacity payment levy and will thus contribute to

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18 *Real Decreto 2017/1997, de 26 de diciembre, por el que se organiza y regula el procedimiento de liquidación de los costes de transporte, distribución y comercialización a tarifa, de los costes permanentes del sistema y de los costes de diversificación y seguridad de abastecimiento*

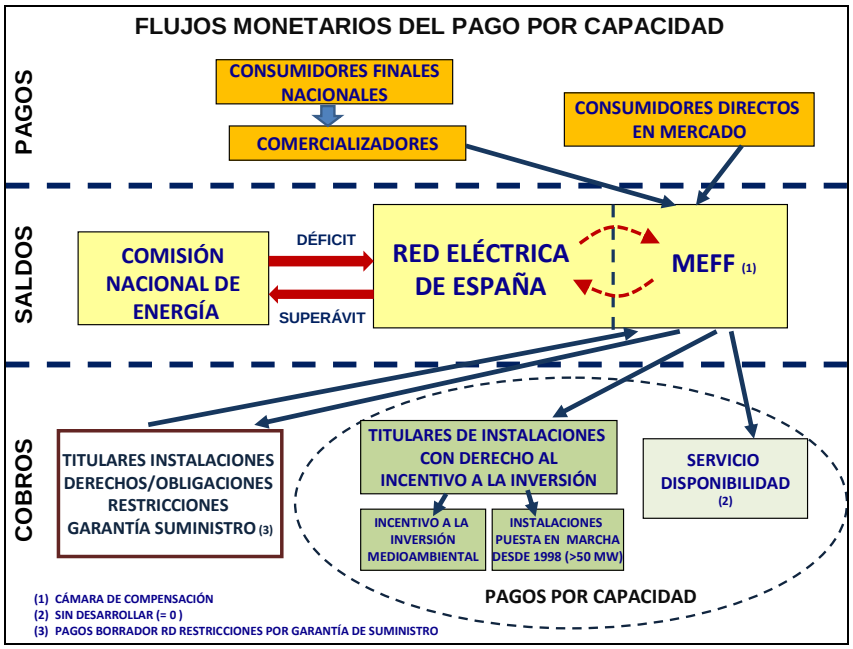
19 such as the production premiums paid to the installations benefiting from the Special Regime (*Primas a la producción del régimen especial).* The Special Regime is the main financial support scheme for cogeneration and renewable production units in Spain.

20 On the system of settlement of regulated activities, see Commission Decision of 24 January 2007 opening the formal investigation procedure in State aid case C 17/2007 – Spain – *Electricity regulated tariffs* (OJ C 43, 27.2.2007, p. 9), paragraphs 9 and 10 of the letter to the Member State.

the financing of the capacity payments as well as of the public service compensation for indigenous coal plants.

(51) The following chart summarises this mechanism:

Chart 1: monetary flows associated with the capacity payment mechanism



Source: notification

(52) Spain indicated that the maximum budget foreseen for the aid is EUR 400 million per year. This amount corresponds to the financial impact of the modified Royal Decree on the capacity payment system, that is to say, the maximum forecasted difference between collection rights and payment obligations arising from the implementation of the modified Royal Decree.

2.6. Methodology for the calculation of the "unit production costs" – Arrangements foreseen for controlling and reviewing the compensation and for repaying any overcompensation

(53) The "unit production cost" set every year by the Spanish authorities for any indigenous coal plant i covered by the notified measure will be calculated *ex ante* as the sum of the variable costs (CV_i) and of the fixed costs (CF_i) of plant i (in EUR /MWh):

(54) The variable cost component CV_i will be calculated on the basis of the following formula:

$$CV_i = CC_i + Cf_i + CVOM_i + CO_{2i}$$

Where:

- CC_i is the fuel cost;

- Cf_i is the "financial cost" which corresponds to the market value of the coal lost on the power plant's stocks: these costs reflect the fact that coal stocks undergo losses in terms of quantities of coal due to rain and wind, but also in terms of energy content due to oxidation and auto-combustion. The Spanish authorities will resort to a "standard value"[21] commonly used in Spain to estimate these losses (1 % per year for anthracite and bituminous coal and 2 % for black lignite);
- $CVOM_i$ is the operation and maintenance variable cost. It is estimated on the basis of historical standard values of EUR 2 /MWh for plants using black lignite and EUR 1.5 /MWh for the remaining power plants. These costs are increased by EUR 0.5 /MWh if the power plant is equipped with a desulphurisation installation;
- CO_{2i} is the cost of CO_2 emission allowances. These costs are estimated *ex ante* as the product of the average price for the EUA futures contract for the following year, as observed on the ECX exchange, multiplied by the latest available emission factor of the plant and the maximum volume of electricity to be produced by the plant according to the annual Resolution of the Office of the Secretary of State for Energy[22].

(55) The fuel cost component CC_i will be calculated *ex ante* on the basis of the following formula:

$$1000 \times FCA_i \times \left[PRCA_i \times \frac{ConsEsp_i}{PCS_i} \right] + 1000 \times (1 - FCA_i) \times \left(\frac{P_p}{C_{\$€}} + PRL_i \right) \times \frac{ConsEsp_i}{PCS_i'}$$

Where:

- FCA_i (%) is the proportion of indigenous coal in the fuel mixture used by the plant, as estimated *ex ante* by an annual Resolution of the Office of the Secretary of State for Energy;
- $PRCA_i$ (€/tonne) is the indigenous coal price as fixed by the Spanish authorities, which is the historical price paid by power generators in 2009, annually increased by 2% until year 2012, to which, in the case of indigenous coal purchased from Hunosa in its capacity as manager of the temporary strategic coal stockpile, will be added the specific logistical and management costs incurred by Hunosa in the management of these stocks. If the price level prevailing on the international coal market exceeds the indigenous coal price, the Spanish authorities will increase the latter accordingly;

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21 i.e. a value retrieved from existing literature on thermal power plants.

22 However, *ex post* (see description of the *ex post* adjustment process in the following points), the CNE will calculate the actual value of the CO_{2i} component as the net costs actually incurred by the company in purchasing CO_2 emission allowances on the market to satisfy its public service obligation, in addition to those allocated for free on the basis of the National Allocation Plan. More precisely, CO_2i will be calculated as the difference between on the one hand, the market value of the emission allowances surrendered in order to cover the volume of electricity produced in the context of the public service obligation, and on the other hand, the market value of the CO_2 emission allowances allocated free of charge for the functioning of the plant (or power generation unit) for the year in question. Therefore, thanks to the *ex post* adjustment of the compensation carried out on the basis of the review of actual costs performed by the CNE, the public service compensation eventually received by the plant for a given year will not cover the market value of the CO_2 emission allowances allocated for free in the context of the National Allocation Plan. It will only cover the costs incurred in purchasing additional allowances and will be netted of the possible revenues generated by selling surplus allowances on the market.

- P_p is the international market price paid for fuels other than indigenous coal used by the power plant;
- $C_{\$€}$ is the euro-dollar exchange rate;
- PRL_i is the logistical cost incurred in relation to fuels other than indigenous coal consumed by the power plant;
- $ConsEsp_i$ is the specific consumption parameter of the plant, estimated on the basis of available data relating to the historical performance of each power plant;
- PCS_i and PCS'_i are, respectively, the real calorific value of indigenous coal and that of the other fuels used by the power plant.

(56) The fixed cost component CF_i will be calculated on the basis of the following formula:

$$CF_i = (CFOM_i \times P_i + CIT_i) / Ep_i$$

Where:

- $CFOM_i$ is the operation and maintenance fixed cost in EUR /MW of net installed capacity. These costs are estimated *ex ante* on the basis of historical standard values: EUR 33,000 / MW, except for the only integrated gasification plant covered by the scheme, for which the value will be set at EUR 140,000 / MW. A further component, set at EUR 5,000 / MW will be added if the plant is fitted with a desulphurisation unit. Those values will be updated every year on the basis of the consumer price index;
- P_i is the net installed capacity in MW;
- CIT_i is the investment cost component;
- Ep_i is the scheduled electricity production for the year in question.

(57) The investment cost component, CIT_i will be calculated *ex ante* on the basis of the following formula:

$$CIT_i = A_i + R_i - CP_i$$

Where:

- R_i is the remuneration of invested capital, calculated on the basis of the following formula:

$$R_i = VNI_i \times Trn$$

VNI_i corresponds to the part of the investment costs incurred by power generators in relation to the indigenous coal plants covered by the notified measure, that can be associated with the public service obligation. For the integrated gasification plant, VNI_i is the residual book value of the whole plant, whilst for other plants, only the investment costs associated with desulphurisation units are taken into consideration, as the other elements of the power plants are considered fully amortised. For plants fitted with a desulphurisation unit, the Spanish authorities will estimate the investment costs *ex ante* as the minimum between EUR 60 million per desulphurisation unit (a conservative value obtained from data provided by power generators) and the residual book value of the plant. Trn is the rate of return on capital, equal to 300 basis points

above the average market value of the 10-year Spanish bond over the preceding 12 months (Trn is currently estimated at 7.86%, on the basis of the latest available market price of the 10-year Spanish bond);

- A_i is the annual depreciation value. For the only integrated gasification plant covered by the scheme, this parameter is calculated on the basis of an expected total operating lifetime of 25 years, which corresponds to a residual operating lifetime of 6 years[23]. This approach is in line with the depreciation methodology applied by the owner of the plant. As regards the indigenous coal plants fitted with desulphurisation units, the depreciation value is calculated on the basis of a depreciation period of 10 years, which corresponds to the common useful lifetime of a desulphurisation unit;
- CP_i is the "capacity payment" for power plants entitled to receive it.

(58) In addition, any aid or other revenues associated with the functioning of the plant in the context of the discharge of the public service obligation will be deducted from the public service compensation.

(59) The modified Royal Decree foresees that if in the course of the year, an indigenous coal power plant reaches an accumulated volume of production that exceeds the maximum production volume set by the Office of the Secretary of State for Energy for that year, in such a way that the remuneration of the power plant exceeds by more than 5% that initially foreseen, the Office of the Secretary of State for Energy will revise the unit production cost accordingly.

(60) For each of the indigenous coal power plants covered by the mechanism, its owner will be obliged to hold separate accounts showing the costs and revenues associated with the production of the plant when it is covered by a weekly operating plan issued by REE (that is to say, when the plant is operated under the public service obligation). Moreover, the owners of those plants will provide their audited accounts to the CNE, which will be tasked by the modified Royal Decree to calculate *ex post* the actual production costs of the power plant when discharging its public service obligation. The CNE will perform that calculation by applying *ex post* the calculation methodology described above, substituting the values of the various parameters estimated *ex ante* with the values observed *ex post*[24]. If the CNE identifies any difference between the public service compensation received by the companies concerned and the level required to cover the difference between their actual costs and the revenues drawn from their sales of electricity on the wholesale market, it will communicate that information to REE. If this difference is negative, the companies concerned will have to reimburse it to REE. If it is positive, the corresponding amount will be paid to the company. The CNE will also be tasked to monitor and inspect the proper use of indigenous coal by the owners of the indigenous coal power plants in the context of the discharge of their public service obligation.

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[23] The plant was brought into line in 1992.

[24] With specific rules for certain parameters. For example, for the costs of CO_2 emission allowances, the CNE will deduct the market value of the allowances allocated for free on the basis of Spain's National Allocation Plan in its *ex post* review of the costs.

(61) It has to be noted that the public service compensation will not cover costs associated with the transportation of indigenous coal. It follows, as confirmed by Spain, that even if the owner of an indigenous coal plant is in principle free to decide from which coalmining company it will purchase indigenous coal, in practice, it will be led to buy only indigenous coal produced by the mine closest to the indigenous coal plant. The power generators will thus be led to buy coal from their usual coal supplier and from Hunosa in its capacity as manager of the temporary strategic stockpile[25]. Furthermore, the quantities that each power generator will buy from Hunosa in its capacity as manager of the temporary strategic stockpile will be fixed by a Resolution of the Office of the Secretary of State for Energy. Therefore, the design of the public service compensation, together with the obligation to buy certain amounts of indigenous coal, and to buy given amounts specifically from Hunosa, will in fact not leave any margin of discretion to a given power generator as to the choice of its indigenous coal suppliers and the quantities purchased from each of them in order to satisfy its public service obligations. In addition, power generators will not be able to negotiate the price of indigenous coal, which will be set by the national authorities.

2.7. Limitations on the maximum volumes of electricity and indigenous coal involved in the mechanism

(62) The Spanish authorities undertook that the maximum volumes of electricity set by the Office of the Secretary of State for Energy for any full year between 2011 and 2014 will never exceed the levels mentioned in the second column of the following table, for any of the power plants concerned, except in the following situations:

a) In case of duly justified periods of unavailability of a power plant, preventing that plant from producing the whole of the maximum volume set by the Office of the Secretary of State for Energy for the year in question, the missing volume may be carried forward to the following year, however without this resulting in a total maximum volume of electricity exceeding the level corresponding to the 15% ceiling laid down at Article 11 (4) of the Second Electricity Market Directive.

b) In case of transfers of stocks of indigenous coal between power plants, the maximum volume of electricity set by the Secretary of State for Energy may exceed the ceiling mentioned in the below table for the plant to which coal stocks are transferred, so that the plant can consume the amounts of coal transferred to it. However, since this mechanism will result in a transfer of production between power plants, the sum of the maximum volumes of electricity set by the Office of the Secretary of State for Energy for each of the plants concerned will remain below 23.35 TWh save if a plant falls in the situation mentioned under point a) above.

Table 4: Ceilings on maximum annual volumes of electricity and corresponding quantities of indigenous coal (2011-2014)

[25] Because coal purchased by Hunosa was kept on the premises of the coalmining companies that produced it.

Power plant	Maximum volume of electricity (MWh)	Corresponding quantities of indigenous coal purchased from coal producers (tonnes)	Corresponding quantities purchased from Hunosa in its capacity as manager of the temporary strategic stockpile (tonnes)
Soto de Ribera 3	1,311,940	622,250	49,301
Narcea 3	1,205,880	519,736	41,179
Anllares	1,968,151	739,513	58,592
La Robla 2	2,035,200	855,472	67,779
Compostilla	5,444,247	2,161,837	171,282
Teruel	6,183,800	2,554,871	202,422
Guardo 2	1,943,140	694,434	55,020
Puentenuevo 3	1,482,090	879,583	69,689
Escucha	371,860	134,850	10,684
Elcogás	1,400,000	236.398	0
Total	**23,346,320**	**9,398,944**	**725,948**

The volumes of indigenous coal to be purchased from coal producers for each power plant (third column in the above table), have been determined on the basis of the power generators' current indigenous coal procurement contracts and taking account of the objectives stemming from the National Strategic Coal Reserve Plan for 2006-2012 (*Plan Nacional de Reserva Estratégica de Carbón 2006-2012 y Nuevo Modelo de Desarrollo Integral Sostenible de las Comarcas Minerias*).

(63) For the part of 2010 during which the notified scheme will apply, the maximum volumes of electricity production and indigenous coal consumption will not exceed the following ceilings:

Table 5: Ceilings on maximum volumes of electricity and corresponding quantities of indigenous coal (2010)

Power plant	Maximum volume of electricity (MWh)	Corresponding indigenous coal consumption (tonnes)
Soto de Ribera 3	758,000	387,874
Narcea 3	705,000	327,991
Anllares	766,000	310,513
La Robla 2	724,000	328,295
Compostilla	2,464,000	1,056,049
Teruel	1,989,000	886,660
Guardo 2	720,000	277,594
Puentenuevo 3	592,000	379,463
Escucha	313,000	122,438
Elcogás	555,000	93,711
Total	**9,585,000**	**4,170,588**

These data have been calculated under the assumption that the notified scheme will enter into application on 1 October 2010. They have been determined with a view to ensuring a total indigenous coal production of 8.6 million tonnes in 2010, which is a lower volume than the one initially envisaged for that year under the National Strategic Coal Reserve Plan.

(64) The Commission takes note of this commitment as regards the maximum volumes of electricity and indigenous coal covered by the notified scheme. Moreover, as foreseen by the modified Royal Decree, until the end of 2012, the quantities of coal to be purchased by power generators, as set by the annual Resolution of the Office of the Secretary of State for Energy, will never exceed the sum of the quantities foreseen in the National Strategic Coal Reserve Plan for 2006-2012 (*Plan Nacional de Reserva Estratégica de Carbón 2006-2012 y Nuevo Modelo de Desarrollo Integral Sostenible de las Comarcas Minerias*), and of the quantities to be purchased from Hunosa in its capacity as manager of the temporary strategic stockpile for the year in question. This means that from the perspective of the coalmining companies, the modified Royal Decree will only result in providing them with the outlet that they need to meet the declining sales targets stemming from the National Strategic Coal Reserve Plan for 2006-2012, the instrument on the basis of which aid schemes for the coalmining industry were designed, and approved by the Commission, in accordance with Regulation (EC) No 1407/2002. No national coal plan is yet in place for the years 2013 and 2014. However, Spain confirmed that in any event, the quantity of newly produced indigenous coal[26] that power generators may be obliged to purchase in application of the modified Royal Decree in 2013 and 2014 will not exceed those imposed for the year 2012, and will be decreasing.

(65) Finally, Spain undertook that the measures laid down in the modified Royal Decree will only apply to coal benefiting from State aid in accordance with Council Regulation (EC) No1407/2002 on State aid to the coal industry or any successor to that Regulation[27]. The Commission takes note of this commitment, which implies in particular that all the coalmining companies supplying coal purchased in the framework of the power generators' public service obligations will have to comply with the requirements concerning operating subsidies imposed by Regulation (EC) No 1407/2002, or any successor to that Regulation. . In accordance with Regulation (EC) No 1407/2002, coalmining companies will have to sell coal at a price not lower than prevailing international coal prices and will receive aid only to cover the difference between their production cost, and the sales of coal in accordance with the declining sales targets stemming from the National Strategic Coal Reserve Plan for 2006-2012.

2.8. Information and arguments provided by third parties

(66) A business association representing the Spanish coalmining sector stressed the importance and urgency of the measure for that sector.

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[26] i.e. total indigenous coal to be purchased minus coal to be purchased from Hunosa in its capacity as manager of the temporary strategic coal stockpile.

[27] Preamble and Annex II, point 2 of the modified Royal Decree

(67) A business association representing the Spanish gas sector took the view that the notified measure would cause major distortions on the Spanish gas market and would harm environmental protection by substituting gas-based production with coal-based production. This association requested the Commission to open the formal investigation procedure pursuant to Article 108 (2) TFEU.

(68) Several companies active in power generation in Spain criticised the planned measures and also requested the Commission to open the formal investigation procedure in order to give interested parties the opportunity to submit comments. They notably indicated that according to them, the planned measures would entail significant distortive effects on the electricity and natural gas markets, notably by reducing the access to the wholesale electricity market for thermal power plants other than those using indigenous coal, without any compensation. These companies also argued that the measure was not necessary to ensure security of electricity supply. In particular, they contested the arguments brought forward by the Spanish authorities in relation to a risk of shortage of generation capacities of such a magnitude as to put Spain's security of electricity supply in jeopardy in the absence of specific measures. One of these companies called into question the data used by the Spanish authorities in support of their arguments about the alleged risk of generation capacity shortage. This company provided its own quantified assessment of the adequacy between forecasted demand and future available generation capacities. The same company argued that in any event, if it was found necessary to reinforce the economic viability of indigenous coal power plants and coal mines, less distortive measures could be envisaged, for example appropriate "capacity payments" for indigenous coal plants, or a mechanism such as the notified one that would however involve lower volumes of indigenous coal.

(69) Two companies argued that the preferential dispatch mechanism did not comply with Article 15 (4) of the Third Electricity Market Directive because the "reasons of security of supply" required by that provision are missing, since there is no real threat to security of supply (or security of supply risk) in Spain. According to them, the mechanism is thus not necessary for security of supply. Furthermore, they consider that this mechanism is neither proportionate, because less distortive measures than the one contemplated by Spain could mitigate any risk to security of supply, assuming that such a risk would exist, *quod non*. Furthermore, they take the view that because it does not comply with Article 15 (4) of the Third Electricity Market Directive, the mechanism cannot be regarded as resting on a genuine service of general economic interest. One of these two companies argued that Spain committed a manifest error of appreciation in qualifying the production of electricity out of indigenous coal as a genuine service of general economic interest in the present case. The same company argued that the measures laid down in the modified Royal Decree would in fact harm security of supply by jeopardising the development of and investments in new generation capacities, relying for example on imported coal or gas. Another company argued that the mechanism may have overall negative effects on security of supply, as it may threaten the viability of existing imported coal power plants and lead to the closure of such plants, whose installed capacity is higher than that of the indigenous coal power plants which the modified Royal Decree seeks to maintain on the market. This company requested the Commission to impose lower volumes of electricity

than those considered by the Spanish authorities for the preferential dispatch mechanism, in order to mitigate the negative impact of this system on imported coal power plants.

(70) Three companies argued that there were serious doubts as to the compatibility of the notified aid with the internal market, in particular because the measure may violate certain provisions of the TFEU, secondary legislation and the Charter of Fundamental Rights. The pieces of legislation allegedly infringed would be:

- the Regulation on State aid to the coal industry, by adding to the aid package already approved by the Commission in favour of the Spanish coal industry, a measure which creates an artificial demand for indigenous coal and breaches the principle of progressive decrease of aid enshrined in Article 6 of the said Regulation, as well as the principle of non-affectation of competition on the electricity market, laid down in Article 4 of the same Regulation;
- EU environmental rules, including the EU's commitments to reduce greenhouse gas emissions, because the measure promotes a particularly polluting non-renewable energy source;
- internal market rules (rules on the free movement of goods and freedom of establishment) because the measures will hinder imports of electricity generated from foreign coal and gas as well as plans for expansion of electricity generation capacities relying on gas, and will act as a disguised restriction on coal imports;
- the right to property as defined by the Charter of Fundamental Rights, because the preferential dispatch mechanism will have an expropriation or quasi expropriation effect on plants whose production programmes resulting from the clearing of the day-ahead electricity market will be reduced (the "displaced plants").

(71) One company referred to the Commission's decisional practice in similar State aid cases, notably the Slovenian *electricity tariffs* case[28], where, according to that company, the Commission carried out an in-depth analysis of the specific market context and alternatives to the measure qualified by the Member State as a public service obligation as well as of the costs of the measure.

(72) One company argued that Article 108 (3) was breached since the preferential dispatch system had already entered into force in the Spanish legislative system.

(73) Some of the above-mentioned companies provided the Commission services with reports issued by the CNE and the *Comisión Nacional de Competencia* (CNC) – the Spanish national competition authority – in which the planned measures were criticised. The CNE indicated that it would not pronounce itself on the Spanish government's energy policy decisions, the strategic character of indigenous coal or the benefit of maintaining indigenous coal power plants in relation to the objectives of the national coalmining plan. However, the CNE considered that it was in its competence to provide its analysis of the effects of the mechanism on the functioning of the Spanish electricity market, the environmental impact of the measure and its costs. The CNE considered that the measure

[28] Case C 7/2005 – *Slovenia – Electricity tariffs* (OJ L 219, 24.8.2007, p. 9)

could affect price formation mechanisms on the Spanish electricity market and increase the CO_2 emissions of the Spanish power generation sector. It suggested several technical modifications to the mechanism and mentioned two possible alternative solutions: a premium for indigenous coal plants and a system of "power guarantee payments" (*pagos de garantía de potencia*). For its part, the CNC considered that the measure would impact the price formation mechanism and the operators' behaviour on the wholesale electricity market. Besides, it called into question the necessity of the measure in terms of security of supply, arguing in particular that security of supply did not seem to be threatened in the short term. Finally, it considered that the measure was likely to involve State aid which had to be notified to the Commission.

(74) A former and a current member of the European Parliament also criticised the measure, arguing that Spain's security of supply was by no means threatened. They added that amongst the coal mines that will benefit from the measure, there were 9 open-cast mines located in Natural 2000 areas, which would be considered by the Commission as operated in breach of EU environmental legislation, and about which the Commission referred Spain to the Court of Justice. The above-mentioned former member of the European Parliament considers that no State aid should be approved that finances violations of EU environmental legislation.

(75) Two environmental non-governmental organizations pointed to the negative environmental impact of the measure as the latter will result in increasing coal-based electricity production, which is one of the most CO_2 emissive power generation technologies. One of these organizations signalled that Spain's CO_2 emissions stood already well above its 2012 Kyoto compliance target, and that the measure envisaged by Spain in favour of indigenous coal power plants will increase the compliance costs of all the other installations covered by the EU Emission Trading Scheme (ETS). The other environmental non-governmental organization that provided comments argued that the measure envisaged by Spain would breach the Regulation on State aid to the coal industry, in particular the provisions that foresee the degressivity of State aid to the coal mining industry and that seek to prevent distortions on the electricity market. This organization also took the view that the measures envisaged by Spain would run counter to several environmental policies and pieces of legislation and argued that environmental considerations had to be taken into account by the Union in the definition of its policies in activities, including in State aid decisions. Finally, this association argued that the measure was discriminatory, not justified by security of supply considerations, and in breach of the principle of proportionality.

(76) Finally, the three Spanish local authorities that provided comments drew the Commission's attention to the negative economic repercussions of the planned preferential dispatch mechanism on power plants running exclusively on imported coal, located in their respective territories. One of these local authorities requested the Commission to open the formal investigation procedure laid down in Article 108 (2) TFEU.

3. ASSESSMENT OF THE MEASURE

3.1. Preliminary analysis: presence of a genuine service of general economic interest

(77) Spain considers that the obligations imposed on owners of indigenous coal plants by the modified Royal Decree are in furtherance of a service of general economic interest relating to security of energy supply. Spain avails itself of Article 11 (4) of the Second Electricity Market Directive, and argues that the measure satisfies the conditions laid there.

(78) Protocol (No 26) on services of general interest, annexed to the Treaty on European Union and to the Treaty on the Functioning of the European Union recognises "*the essential role and the wide discretion of national, regional and local authorities in providing, commissioning and organising services of general economic interest*". The wide discretion enjoyed by Member states when defining what they consider as services of general economic interest has long been recognised in the case law[29]. In the specific context of the electricity market, it is important that the public service requirements can be interpreted on a national basis, taking into account national circumstances and subject to the respect of EU law[30]. In particular, the strategic importance of indigenous energy sources when these are scarce, and the geostrategic considerations involved in decisions concerning security of supply must be given due consideration[31].

(79) The contribution to security of supply of a measure ensuring continued exploitation of indigenous fuels by organising a system of preferential dispatch in electricity production has been recognised by the Union legislature in Article 11 (4) of the Second Electricity Market Directive:

"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."[32]

(80) Also, Article 3 (2) of the same Directive lays down harmonised rules for public service obligations – or services of general economic interest – in the electricity sector, mentioning in particular the possibility for Member States to impose public service obligations relating to security of supply:

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29 See e.g. Case T-17/02 *Olsen* v *Commission* [2005] ECR II-2031, paragraph 216 to that effect, Case T-106/95 *FFSA and Others v Commission* [1997] ECR II-229, paragraph 99, Case C-265/08, *Federutility and others v Autorità per l'energia elettrica e il gas* (not yet published), paragraph 29; see also Case C-67/96 *Albany* [1999] ECR I-5751, paragraph 104. Hence, the definition of such services by a Member State can be questioned by the Commission only in the event of manifest error.

30 Directive 2003/54/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in electricity (O.J. L 176 of 15/07/2003, p 37), recital 26, and judgment of 22 May 2008, C-439/06 *citiworks AG*, [2008] ECR I-3913, paragraph 59.

31 See, by analogy, judgment of 23 September 2009, T-263/07, *Estonia v Commission* (not yet published) paragraphs 80-82.

32 Directive 2003/54, Article 11(4).

"Having full regard to the relevant provisions of the Treaty, in particular Article 86 thereof, 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 environmental protection, including energy efficiency and climate protection. Such obligations shall be clearly defined, transparent, non discriminatory, verifiable and shall guarantee equality of access for EU electricity companies to national consumers."

(81) The Commission has already noted[33] that Article 11(4) of the Second Electricity Market Directive, read in conjunction with Article 3(2) of the same Directive, provided the basis for public service obligations for reasons of security of supply in the form of preferential dispatch of indigenous fuel power plants within a limit of 15% of national electricity consumption.

(82) The Second Electricity Market Directive will be repealed from 3 March 2011 pursuant to Article 48 of the Third Electricity Market Directive. However, the Union legislature has maintained the provisions contained in its Articles 11(4) and 3(2) unchanged in the Third Electricity Market Directive. These provisions will thus continue to apply beyond 3 March 2011[34].

(83) According to the following table, the 15% limit foreseen in Article 11 (4) of the Second Electricity Market Directive corresponds in the present case to a maximum volume of electricity ranging between 41 and 45 TWh. It thus exceeds the maximum annual volume that the Spanish authorities undertook not to exceed, save in cases of unexpected unavailability of power plants, that is to say, 23.35 TWh[35] for each year between 2011 and 2014. As regards 2010, the foreseen maximum volume of electricity is 9.585TWh for the last three months of the year, which corresponds to 38.34 TWh for a full year. This latter volume is lower than the one that corresponds to the 15% limit laid down in Article 11 (4) of the Second Electricity Market Directive (41.261 TWh).

Table 6: Compliance with the 15% limit

	2010	2011	2012	2013	2014
Electricity consumption (GWh)	275,072	278,342	284,143	290,912	297,843
Primary energy necessary to produce it (ktoe)	50,119	50,585	51,034	51,569	51,753
15% of that primary energy (ktoe)	7,518	7,588	7,655	7,735	7,763
Corresponding volume of	41,261	41,751	42,621	43,637	44 ,676

[33] Case NN 49/99 Spain - costs of transition to competition (OJ C 268, 22.9.2001, p. 7), Case N 6/A/2001 – Ireland – Public Service Obligations imposed on the Electricity Supply Board with respect to the generation of electricity out of peat (OJ C 77, 28.3.2002, p. 27), Case N 34/99 - Austria – Stranded costs compensation (OJ C 5, 8.1.2002, p. 2), Case C 7/2005 – Slovenia – Electricity tariffs (OJ L 219, 24.8.2007, p. 9)

[34] These provisions find themselves respectively in Article 15(4) and 3(2) of the Third Electricity Market Directive.

[35] This volume may be exceeded if the maximum volume of production set for certain plants is carried forward to the following year due to unavailability of these plants. However, such carry-forward may not result in the total maximum volumes set for all plants exceeding the level corresponding to the 15% limit.

electricity (GWh)					

(84) The Commission considers that Article 11 (4) and 3 (2) of the Second Electricity Market Directive allow Spain to qualify the production obligation laid down by the modified Royal Decree as a public service obligation – in other words, the obligation to operate a service of general economic interest.

(85) In combination with Article 3(2), Article 11(4) of the Second Electricity Market Directive sets forth a rule on services of general economic interest in the electricity sector which allows Member States for security of supply reasons provided that the conditions set forth in the latter provision are met – notably, that the 15% limit laid down by Article 11(4) is not exceeded - to regard production obligations imposed on power plants using indigenous primary energy resources as public service obligations. This reading conforms with the decisional practice of the Commission, which has declared compatible aids granted as a compensation for the extra costs related to these obligations.

(86) As regards the Commission's decision in the Slovenian *electricity tariffs* case, a third party indicated that in that decision, the Commission analysed in-depth the market context as well as the alternatives to and the costs of the public service obligation contemplated by the Member State. In fact, this third party referred to a part of the Slovenian *electricity tariffs* decision which does not deal with the analysis of the presence of a service of general economic interest at all; instead, this part examines the compliance of the scheme under assessment with the 4th criterion set out in the *Altmark* judgement[36]. As indicated below, the Commission considers that, unlike the Slovenian scheme, the notified measure does not meet the 4th *Altmark* criterion. It follows that there is no inconsistency between the reasoning and conclusions contained in the present decision and those of the Slovenian *electricity tariffs* Decision.

(87) Moreover, the Commission cannot agree with the interpretation given to the Second Electricity Directive by certain third parties according to which Member States wishing to rely on Article 11 (4) of that directive in order to regard a production obligation imposed on power plants running on indigenous fuels as a genuine public service obligation, are required to identify specific and imminent threats to their security of electricity supply.

(88) The wording of Article 11 (4) does not refer to the notions of specific or imminent risks or threats, and the Commission recalls that Member States enjoy a wide discretion when determining what they regard as services of general economic interest[37], within the limits defined by EU rules[38]. In this case, a sector-specific EU piece of legislation sets out a rule explicitly referring to the definition of public service obligations by Member States in certain areas: Article 3 (2) of the Second Electricity Market Directive clearly foresees the possibility to impose public service obligations for security of supply reasons and Article

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36 Case C-280/00 Altmark Trans and Regierungspräsidium Magdeburg [2003] ECR I-7747

37 Case T-289/03 *BUPA and others v Commission* [2008] ECR II-81, paragraph 172

38 See Community framework for State aid in the form of public service compensation (OJ C 297, 29.11.2005, p. 4), point 9.

11 (4) explicitly mentions preferential dispatching of power generation installations using indigenous fuel energy resources for reasons of security of supply.

(89) In its previous decisional practice, relating to cases where there were no third parties' complaints putting into question the need to adopt specific measures for security of supply reasons, the Commission did not analyse whether Member States, relying on Article 11 (4) of the Second Electricity Market Directive, had provided detailed proof that they faced concrete specific threats to their security of supply in order to regard the production of electricity from indigenous fuel as a genuine service of general economic interest.

(90) However, the comments submitted by third parties in this case, as well as the current status of liberalisation in the energy sector in Europe, call into question the validity of Spain's arguments related to security of supply. Therefore, in the light of these comments, the Commission considers it necessary to verify whether the Spanish authorities' conclusion that the notified scheme constitutes a service of general economic interest is manifestly erroneous.

(91) In this specific case, the Commission does not find that the Spanish authorities exceeded their margin of discretion when determining that the notified measure is a service of general economic interest. A number of factual elements provided by Spain suggest that the notified measure will in fact serve the purpose of mitigating concrete risks hanging over Spain's security of supply over a transitional period that will not exceed four years.

(92) Spain argues that the proposed measure is necessary to ensure security of supply notably because of the following reasons: increase in electricity production from renewable sources and its intermittence, relative isolation of Spain from the other major EU electricity market, which prevents higher imports and exports of electricity. Spain thus considers that these factors make it important to introduce temporary measures aiming to support coal power plants over the next four years to supply back-up electricity generation to intermittent renewable-based generation. In addition, Spain considers that the market context resulting from the global economic downturn threatens the viability of indigenous coal power plants which are necessary to satisfy electricity demand at each point in time and to provide balancing services to the Transmission System Operator.

(93) First of all, the Commission notes that the data provided by Spain indeed confirm a very significant decrease in wholesale electricity prices and demand since the end of 2008, and a very significant reduction in electricity production by indigenous coal power plants, which seriously affect their economic profitability. Moreover, electricity demand is expected to reach its 2007 level only in 2013, whereas renewable electricity is expected to keep on increasing its share in Spain's total electricity production. In addition – and the Commission acknowledges it – there are uncertainties on Spain's economic recovery – and thus, on the future electricity consumption of Spanish undertakings. Consequently, the 2007 level of electricity demand may be reached after 2013. Therefore, the Commission sees no manifest error in Spain's argument according to which there is a risk that because of their insufficient profitability, indigenous coal power plants may be closed

down between 2010 and 2014 without being replaced by new power plants because of the low prices and uncertainties prevailing on the wholesale electricity market.

(94) Indeed, due to the conditions prevailing on the Spanish electricity market, with a fall in demand and prices and uncertainties as regards demand recovery over the four coming years, market forces would not by themselves deliver the necessary additional capacities because in such a context, market players' expectation would be that investments in new generation capacities, in particular gas-fired power plants, would not be profitable.

(95) Spain also provided the time-span needed to have new generation capacities available on the market: usually, three years lapse between the decision to invest in a new gas-fired power plant and the end of the construction, and that duration may be increased depending on the time taken by the environmental analysis of the project and the administrative permitting procedures. This temporal constraint would indeed add further uncertainty to security of supply, if it were decided to mitigate supply disruption risks by supporting investments in new power plants in the next maximum four years.

(96) Besides, the data provided by Spain illustrate that even with the expected increase in its interconnection capacities over the next four years, interconnections will remain modest in this period. The submitted data reveal that even in the most optimistic scenario, interconnection capacities will remain far insufficient to meet the "Barcelona" interconnection target[39] since by 2014, Spain's both total import and total export capacities are not expected to exceed 6,000 MW, i.e. around 6.6% of mainland Spain's installed generation capacity in 2008 (i.e. 91,000 MW). Due to the limited import interconnections, electricity demand in Spain will have to be essentially satisfied by power plants installed in Spain over the next four years. Moreover, the limited level of interconnection with France will result in maintaining the Iberian electricity market in relative isolation from a major European electricity wholesale market, well interconnected with other major West-European continental electricity wholesale markets (in particular the German, Dutch and Belgian markets) on which the production of Spanish coal and gas-fired plants could be otherwise sold so that the economic viability of these plants could be ensured. Moreover, in any event, major extensions of the current interconnection capacities are not expected to materialise before 31 December 2014, the date at which the notified measure is set to expire at the latest. It follows that the isolation of the Iberian electricity market will last over the whole period of implementation of the notified measure and will not allow the owners of indigenous coal power plants to mitigate the effect of depressed electricity market prices in Spain on the economic profitability of these plants by significant exports on markets where prices are higher. This tends to confirm the risk that indigenous coal plants are closed down by their owners between 2010 and 2014.

(97) According to Spain, existing gas and coal-fired power plants are necessary to ensure security of electricity supply because of the stability that they provide to the Spanish electricity system under regular extreme weather conditions occurring in the summer and winter periods, which affect the operation of wind and hydro-power plants in Spain. The

[39] The Barcelona Council of 2002 set a broad target for (import) interconnector capacity of at least 10% of production capacity per Member State by 2005.

Commission notes that, indeed, already in 2009 the installed wind-based generation capacity in Spain amounted to about 20% of the total installed capacity, that about 12% of Spain's electricity was produced only from wind during that year, and that Spain estimates a 22.7% renewable share in final energy consumption by 2020 (with 40% of renewable energy in electricity consumption). The Commission acknowledges that this substantial share of renewable-based electricity production is intermittent and indeed requires back-up generation capacities.

(98) Indeed, coal power plants appear to play an important role in providing back-up to renewable electricity. Furthermore, as confirmed by the historical data provided by Spain, indigenous coal plants provide balancing services to the Transmission System Operator, notably deviation management and tertiary regulation, which are primarily intended to maintain the frequency of the transmission network and thereby avoid black-outs. In addition to such data (see table 3 in point 21), Spain indicated that although indigenous coal plants are somewhat less flexible than gas-fired combined cycle turbines, they nevertheless meet the technical requirements necessary to provide these system services. At the current stage, altogether, the indigenous coal power plants offer a substantial power reserve of 2,370 MW above the plants' minimum technical output, which can be used to secure network stability. The balancing services referred to above, which cannot be provided by nuclear power plants and plants with non-manageable output such as wind turbines and run-of-river hydropower plants, are indeed essential to the stability of the electricity network. Moreover, the growth of renewable-based intermittent electricity production increases the needs for such services, precisely because of its intermittent character.

(99) Moreover it appears that a full switch to imported coal could not, at least for certain power plants currently consuming indigenous coal, be done rapidly but may require major investments. Spain put forward the example of two Spanish power plants for which very substantial investments had to be made in the past to allow a complete shift to imported coal[40]. In the absence of the notified measure, which could lead to the complete cessation of coal production in Spain, it is unlikely that indigenous coal power plants could rapidly fully switch to imported coal. Therefore, there is a risk that under such a scenario, these power plants would be no longer available to provide back-up electricity, which may cause electricity supply disruptions in the coming 4-year period.

(100) Finally, the Commission notes that apart from indigenous coal, all fossil fuels used for power generation in Spain are imported from non EU countries. For instance, in 2008, Spain imported natural gas mainly from Algeria, Egypt, Trinidad and Tobago, Nigeria, Qatar and Norway. Coal was mainly imported from South Africa, Indonesia, Russia, Australia, Columbia and the United States. Therefore, these fuels have to be transported over long distances before reaching Spain and such long-distance transports are not exempt from risks. Furthermore, these imports are also not exempt from geostrategic risks that could materialise in case of international political tensions. Consequently, the loss of indigenous coal production in Spain, which may occur in the absence of the notified

[40] EUR 306 million for one of the plants (1,500 MW of installed capacity) and EUR 94 million for the other one (600 MW).

measure, may add threats to Spain's security of supply over the period 2010-2014, additional to those mentioned above, that are linked to the specific situation of the Spanish electricity market in this period.

(101) The Commission therefore considers that the factual elements mentioned in points 93 to 100 suggest that the notified measure will serve the purpose of mitigating concrete risks hanging over Spain's security of supply over a transitional period of four years. Consequently, the Commission cannot see any manifest error in the justifications brought forward by Spain in support of the notified measure in terms of security of supply.

(102) Finally, as regards the alleged discriminatory character of the measure, claimed by certain third parties, the Commission notes that both the selection of the power plants covered by the scheme and the determination of the volumes of electricity assigned to each of them are based on objective criteria, consistent with the objective of the scheme. Indeed, Spain selected all the power plants that are technically able to consume indigenous coal and for which an indigenous coal procurement agreement is in force. As regards the volumes of electricity, and the corresponding volumes of indigenous coal, assigned to each of them, they are based on the existing coal procurement agreements and the objectives of the National Strategic Coal Reserve Plan for 2006-2012 (*Plan Nacional de Reserva Estratégica de Carbón 2006-2012 y Nuevo Modelo de Desarrollo Integral Sostenible de las Comarcas Minerias).* This is fully consistent with the objective of ensuring that the sales target stemming from the National Strategic Coal Reserve Plan for 2006-2012 can be met, without creating additional demand for indigenous coal beyond that envisaged under the National Strategic Coal Reserve Plan in the period 2010-2012. Therefore, in light of the objective pursued by the scheme, the legitimacy of which is acknowledged by Article 11 (4) of the Second Electricity Market Directive the Commission considers that the measure is not discriminatory.

(103) Taking into account all that precedes, the Commission concludes that the obligations imposed on owners of indigenous coal plants by the modified Royal Decree correspond to the operation of a service of general economic interest relating to security of supply.

3.2. Presence of State aid

(104) In order to qualify as State aid in the meaning of Article 107 (1) TFEU, a measure must confer a an economic advantage on certain undertakings or the production of certain goods, be imputable to the State and financed through State resources, distort or threaten to distort competition and affect trade between Member States.

3.2.1. Economic advantage conferred on certain undertakings or the production of certain goods (selective advantage)

(105) The owners of the indigenous coal power plants listed in the modified Royal Decree will benefit from a compensation for the operation of a service of general economic interest, that is to say, a public service compensation. In the above-mentioned *Altmark* judgement, the Court of Justice laid down as follows four cumulative conditions that must be satisfied by a public service compensation in order not to confer a real financial advantage, and therefore, to escape classification as State aid:

"[…] First, the recipient undertaking must actually have public service obligations to discharge, and the obligations must be clearly defined. […].

[…] Second, the parameters on the basis of which the compensation is calculated must be established in advance in an objective and transparent manner, to avoid it conferring an economic advantage which may favour the recipient undertaking over competing undertakings. […]

[…] Third, the compensation cannot exceed what is necessary to cover all or part of the costs incurred in the discharge of public service obligations, taking into account the relevant receipts and a reasonable profit […].

[…] Fourth, where the undertaking which is to discharge public service obligations, in a specific case, is not chosen pursuant to a public procurement procedure which would allow for the selection of the tenderer capable of providing those services at the least cost to the community, the level of compensation needed must be determined on the basis of an analysis of the costs which a typical undertaking, well run and adequately provided with means of transport so as to be able to meet the necessary public service requirements, would have incurred in discharging those obligations, taking into account the relevant receipts and a reasonable profit for discharging the obligations."

(106) In the case at hand, the Commission considers that for the following reasons, the fourth of these criteria is not met, hence the public service compensation entails an economic advantage.

(107) Firstly, the operation of the service of general economic interest has not been awarded as a result of an open public procurement procedure.

(108) Secondly, Spain has not provided any comprehensive analysis of the costs which a typical owner of indigenous coal plants, well run and adequately equipped, would have incurred in discharging the public service obligations in question. Neither has it indicated that such a comprehensive analysis had been performed for the purposes of determining the methodology for the calculation of the compensation. As a matter of fact, Spain's position is that the measure constitutes State aid which should be declared compatible with the internal market on the basis of Article 106 (2) TFEU. Spain at no point argued that the measure complied with the four criteria of the *Altmark* Judgement.

(109) Spain only mentioned certain parameters such as variable and fixed operation and maintenance costs, for which, in the *ex ante* calculation of the unit production costs, "standard values" corresponding to international best practices are used. However, as regards certain other parameters that influence costs, such as fuel specific consumption, the *ex ante* calculation of the "unit production cost" takes into account the historical values of the parameter, as observed at the level of the power plant concerned, and not the value associated with a typical and well run coal power plant.

(110) Moreover, the Commission notes that the value of the fixed operation and maintenance costs set for the *ex ante* calculation of the "unit production cost" of the integrated

gasification plant (EUR 140 000 / MW) is much higher than for the other indigenous coal plants covered by the mechanism (33 000 EUR / MW, with 5 000 EUR / MW in addition for desulphurisation units), and leads overall to a "unit production cost" that is substantially higher than for the other plants. This shows that the "unit production cost" calculated *ex ante* for the integrated gasification plant is much higher than the costs that would be associated with a usual coal power plant. They thus do not correspond to those incurred by a well run and well equipped operator, which would use a standard coal power plant rather than an integrated gasification plant such as the one included in the scope of the notified measure.

(111) Finally, it has to be underlined that the CNE will monitor *ex post* the actual costs incurred by the companies concerned, and that the public service compensation will then be adjusted either upwards or downwards, so that it covers exactly the difference between actual costs and revenues. Therefore, the actual compensation, as adjusted *ex post*, will depend on the actual costs of each company concerned and of its revenues, and not on the costs of a typical well run and well equipped power generating undertaking.

(112) The Commission thus considers that the notified compensation does not meet the 4th criterion set in the *Altmark* judgement and that the owners of the indigenous coal plants subject to the Royal Decree will thus benefit from an economic advantage.

(113) Furthermore, the Commission notes that the suppliers of the indigenous coal purchased by power generators in application of the modified Royal Decree, will indirectly benefit from the preferential dispatching mechanism. When the preferential dispatching mechanism is activated, that is to say, when REE modifies the outcome of the clearing of the day-ahead electricity market to allow a given indigenous coal power plant to produce the required volume of electricity, the power plant will consume a quantity of indigenous coal that it would not have consumed otherwise. Therefore, the preferential dispatch mechanism will result in more revenues obtained by indigenous coal producers from power generators than may have been obtained otherwise. Until 2012, these revenues will not be higher than those resulting from the sales targets set out in the National Strategic Coal Reserve Plan 2006-2012. It follows that the preferential dispatch mechanism also confers an economic advantage on indigenous coal producers.

(114) The notified measure will confer an advantage on certain undertakings operating in the power generation and coal production sectors; therefore, this advantage is selective.

3.2.2. Imputability to the State and financing through State resources

(115) The measure will be laid down in regulatory provisions issued by the national authorities. It is therefore imputable to the State.

(116) Moreover, the public service compensation will be primarily financed by the proceeds from the "capacity payment levy", and thus through State resources. Indeed, like the "price surcharge" at issue in the *Essent* judgement[41], the capacity payment levy is a charge

[41] Case C-206/06 *Essent Netwerk Noord and others* [2008] ECR I-5497, paragraphs 45 to 75.

unilaterally imposed by the State on certain entities through national law. Its proceeds thus have their origin in a State resource.

(117) Furthermore, these amounts are distributed to power generators by REE, which instructs MEFF to make payments to power generators, but like for the levy at issue in the *Essent* case, the entity entrusted with the centralisation and redistribution of the proceeds from the levy – in the present case, REE - will not be able to use these amounts for purposes other than those provided for by national law, that is to say, the "capacity payments" to certain power generators and the public service compensation to owners of indigenous coal plants. In fact, REE has no margin of discretion whatsoever in the allocation of these amounts, which is governed by rules entirely defined by national law.

(118) Furthermore, the "payment obligations" (*obligaciónes de pago)* imposed on owners of indigenous coal plants in the framework of the notified measure[42] will also contribute to the financing of the public service compensation and of the "capacity payments", together with the "capacity payment levy". These "payment obligations" will be unilaterally imposed by the State through the modified Royal Decree. The corresponding amounts will thus have their origin in a State resource. Moreover, they will be added to the proceeds from the capacity payment levy and redistributed by REE according to the rules governing the capacity payment system and the notified measure: it will not be possible to use them for purposes other than those provided for by national law. Consequently, these amounts will also constitute State resources.

(119) The "capacity payment system" has a third source of financing: when there is a shortfall in the system, the missing amount is provided by the CNE as a payable cost (*coste liquidable)* within the meaning of the system of settlement of regulated activities. This amount will have its origin in a State resource: it will stem from the payments by certain entities subject to the system of settlement of regulated activities[43] of a part of their revenues onto bank accounts opened by the CNE. Such transfers correspond to a payment obligation unilaterally imposed by the State through national law: the corresponding amounts will thus have their origin in a State resource. Moreover, the CNE will not be able to use these amounts for purposes other than those provided for by national law. When there is a shortfall in the capacity payment system, the missing amount will be paid by the CNE to REE, which will retransfer it to MEFF for redistribution to power generators according to rules entirely defined by national law. Neither the CNE, nor REE or MEFF will be able to use these amounts for purposes other than those provided for by national law.

(120) It follows that the notified public service compensation is wholly financed through State resources.

(121) At point 113 above, the Commission found that the preferential dispatch mechanism conferred an economic advantage on indigenous coal producers. Moreover, it has been

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[42] Those "payment obligations" are imposed when an indigenous coal power plant subject to a "weekly operating plan" issued by REE is selected through the clearing of the market and when the clearing price is higher than the plant's unit production cost (see section 2.4).

[43] The entities for which the difference between *costes liquidables* and *ingresos liquidables* is negative.

remarked that the design of the public service compensation, the obligation to buy certain quantities of indigenous coal and the obligation to buy specific quantities of indigenous coal from Hunosa in fact did not leave any margin of discretion to power generators as regards the quantities of coal purchased from each of their suppliers. They have no margin of discretion as regards the indigenous coal price either, as it will be set by the national authorities. Moreover, when the preferential dispatching mechanism is activated, that is to say, when REE modifies the outcome of the clearing of the day-ahead electricity market to allow a given indigenous coal power plant to produce the required volume of electricity, the remuneration of that plant for that electricity will be entirely paid by REE - via MEFF -, out of the resources of the capacity payment system. That remuneration corresponds to the volume of electricity concerned multiplied by the "unit production cost" of the plant, a component of which corresponds to the regulated indigenous coal price paid to indigenous coal producers, and is transferred via each of the power generators concerned to their usual indigenous coal supplier and Hunosa. The Commission thus considers that the preferential dispatch mechanism and the associated public service compensation organise a transfer of State resources to coalmining companies via power generators, which will not exceed, until 2012, the level necessary for coal mines to achieve the sales targets set out in the National Strategic Coal Reserve Plan 2006-2011.

3.2.3. Distortion of competition and affectation of trade between Member States

(122) The public service compensation paid to power generators will allow the latter to recoup the fixed and variable costs associated with the indigenous coal plants covered by the scheme, whereas it is possible that under the normal market mechanisms that would have prevailed in the absence of the notified measure, power generators would not have been assured to recoup their fixed costs through the revenues drawn from the sale of the electricity produced by their indigenous coal plants. Therefore, in the absence of the notified measure, the power generators would have been faced with the risk of having to cover part of the fixed costs of their indigenous coal plants through resources other than those generated by the said plants.

(123) The public service compensation will thus strengthen their financial position, and consequently their competitive position vis-à-vis other energy companies competing with them in Spain or in other Member States, on the wholesale electricity markets or on other markets. It has to be noted that electricity generation as well as electricity and gas wholesale trading and retail supply are businesses open to competition throughout the EU. As a matter of fact, each of the indigenous coal plants covered by the notified scheme is owned by one or more large electricity / gas groups which have operations in several Member States.

(124) Moreover, the public service compensation and the associated public service obligation are liable to favour national electricity production to the detriment of imports. In fact, such imports exist, thanks to the interconnection capacities linking Spain to Portugal, and, though to a limited extent, to France.

(125) Besides, the advantage obtained by Spanish coal producers through the preferential dispatching system, combined with the public service compensation for power generators, will potentially affect intra Community trade of coal. Although Spain imports almost no coal from other Member States, there exists no legal or physical obstacle to such trade. The advantage conferred by the notified measure on Spanish coal producers will potentially affect the development of that trade. It will also potentially affect the markets for other fuels used for power generation (natural gas, imported coal, fuel-oil). These distortions are inherent to any public service obligation put in place by Member States in accordance with Article 11 (4) of the Second Electricity Market Directive.

(126) The notified scheme is thus liable to distort competition and affect trade between Member States.

3.2.4. Conclusion on the presence of State aid

(127) The notified measure constitutes State aid in the meaning of Article 107 (1) TFEU for the owners of the indigenous coal plants covered by the scheme, as well as for the producers of indigenous coal that power generators will purchase in order to satisfy their public service obligation. The State aid from which indigenous coal producers will benefit is inherent to the public service compensation allocated to power generators and cannot be assessed separately from it.

3.3. Lawfulness of the aid

(128) Spain confirmed that Royal Decree 134/2010 had not been implemented and will not be implemented without having been modified by the draft amending Royal Decree. Furthermore, the draft amending Royal Decree will introduce a clause whereby the payment obligations (*obligaciónes de pago)* and collection rights (*derechos de cobro)* resulting from the notified measure will be conditional upon the Commission's authorisation. Therefore, as confirmed by Spain, the State aid element resulting from the implementation of Royal Decree 134/2010, once modified, will not enter into application before having been approved by the Commission in accordance with Article 108 (3) TFEU.

(129) Spain has thus fulfilled its obligation according to Article 108 (3) TFEU by notifying the aid measure before its implementation. Contrary to what a third party has suggested, the fact that Royal Decree 134/2010 has already been adopted does not mean that the State aid elements contained in that Royal Decree have been put into effect in breach of Article 108 (3). Indeed, the Spanish authorities indicated that the modified Royal Decree had not entered into application yet.

3.4. Compatibility of the aid

(130) The Community Framework for State aid in the form of public service compensation[44] (hereinafter: "the Public Service Compensation Framework") sets forth the conditions under which public service compensations qualifying as State aid in the meaning of

[44] OJ C 297 of 29.11.2005, p. 4

Article 107 TFEU may be declared compatible with the internal market under Article 106 (2) TFEU. Those conditions are the following:

3.4.1. Genuine service of general economic interest within the meaning of Article 106 TFEU

(131) As indicated in section 3.1, the obligations imposed on owners of indigenous coal plants by the modified Royal Decree correspond to the operation of a service of general economic interest relating to security of supply.

3.4.2. Need for an instrument specifying the public service obligations and the methods of calculating compensation

(132) The modified Royal Decree specifies the precise nature of the public service obligations, which consist in producing electricity out of indigenous coal under precisely defined conditions. It also sets out a deadline by which an end will be put to these obligations (31 December 2014 at the latest) and the conditions under which this deadline may be brought forward by the national authorities. It also lists the indigenous coal power plants concerned, which allows a precise identification of the undertakings entrusted with the operation of the service of general economic interest. It defines a method for calculating the compensation *ex ante*, with a precise set of parameters and the methodology for estimating their values. It also lays down rules enabling the compensation to be controlled and adjusted *ex post*, in particular by entrusting the CNE to review audited accounts, calculate actual costs, and communicate its findings to REE so that any potential overcompensation is repaid. In addition, the modified Royal Decree sets out mechanisms aimed at avoiding overcompensation during the year:

- a revision of the "unit production cost" if one of the power plants reaches an accumulated volume of production that exceeds the maximum production volume set by the Office of the Secretary of State for Energy for that year, in such a way that the remuneration of the power plant exceeds by more than 5% the remuneration initially foreseen by the national authorities;
- the reimbursement by the owners of the indigenous coal plants of the difference between the market clearing price and their "unit production cost" when that difference is positive.

(133) In addition, the modified Royal Decree contains a mechanism which allows the annual revision of the unit production cost, which will be set by way of Resolutions of the Office of the Secretary of State for Energy. This mechanism and the *ex post* adjustment of the compensation on the basis of the CNE's review, constitute the means to review the compensation.

(134) The modified Royal Decree will be complemented by Resolutions issued by the Office of the Secretary of State for Energy, which will fix maximum volumes of electricity, on the basis of which REE's operating plans will be drawn up, quantities of indigenous coal to be purchased and "unit production costs", which will serve as a basis for the granting of the compensation. Together with the above-mentioned Resolutions, the modified Royal Decree constitutes an entrustment act imposing obligations on power generators and

satisfying the conditions laid down at point 12 of the Public Service Compensation Framework.

3.4.3. Amount of compensation

(135) In view of the design of the compensation, it turns out that the amount of compensation allocated in a given year before the *ex post* adjustment will correspond, for each plant, to the difference between on the one hand, the "unit production cost" determined by the national authorities multiplied by the volume of electricity produced in the framework of the service of general economic interest, and on the other hand, the revenues drawn from sales on the wholesale electricity market. After the *ex post* adjustment, the compensation will correspond to the difference between the real fixed and variable production costs, as calculated by the CNE, and the revenues. The compensation will however include a reasonable profit, embedded in the rate of return on invested capital. Moreover, in accordance with point 14 of the Public Service Compensation Framework, any advantage that the indigenous coal plants may receive on bases other than the modified Royal Decree will be deducted from the amount of compensation. This is the case in particular for the capacity payments (*pagos de capacidad*) received by power generators from REE in respect of the indigenous coal plants concerned.

(136) As required by point 16 of the Public Service Compensation Framework, the costs taken into consideration in the calculation of the compensation are only the costs incurred in producing electricity in the framework of the service of general economic interest, to the exclusion of any other costs incurred by the undertakings concerned. The calculation of these costs will follow criteria defined in the modified Royal Decree, which will be complemented by a Resolution of the Office of the Secretary of State for Energy specifying in more detail the methodology that the CNE will follow to calculate the actual costs. Those criteria are based on well accepted cost accounting principles.

(137) Moreover, also in accordance with point 16 of the Public Service Compensation Framework, the costs taken into consideration cover:

- the variable production costs, made up of fuel costs, costs of acquisition of CO_2 emission allowances additional to those allocated for free in the context of the National Allocation Plan, variable operation and maintenance costs and costs associated with coal losses at the level of stocks;
- an appropriate contribution to fixed costs, calculated as the fraction of the fixed operation and maintenance costs and of the depreciation of investment costs that can be attributed to production in the framework of the service of general economic interest[45];
- an adequate return on the own capital assigned to the service of general economic interest, equal to the regulated rate of return applied to the regulated electricity production activity in the Spanish insular and extra-peninsular systems.

[45] The part of the total fixed costs of a plant for a given year that will be covered by the compensation is calculated as the ratio between the volume of electricity produced in the framework of the service of general economic interest and the total volume produced by the plant during the year.

(138) These cost categories correspond to the costs typically incurred in electricity generation by a coal-fired power plant. The following elements lead the Commission to consider that these costs will be precisely and objectively calculated and actually correspond to the operation of the service of general economic interest:

(139) Fuel costs: the actual value of the fuel costs will be calculated by the CNE, notably on the basis of various verifications of the exact proportion of indigenous coal used in the fuel mixtures (for example, by analysing samples of ashes resulting from the combustion), as well as on the basis of checks of the contracts signed between the coalmining companies and the power generators.

(140) Costs of acquisition of CO_2 emission allowances: the CNE will calculate this cost item as the net cost actually incurred by the company in purchasing CO_2 emission allowances on the market to satisfy its public service obligation, in addition to those allocated for free on the basis of the National Allocation Plan. This calculation methodology will ensure that the "CO_2" component of the public service compensation only covers actual costs incurred to purchase emission allowances, and does not cover the market value of emission allowances received free of charge. Furthermore, this methodology will take account of the possible revenues generated by selling CO_2 emission allowances on the market, which will be treated as revenues generated by the plant and deducted from the compensation.

(141) Costs associated with "coal losses": these costs reflect the fact that part of the stored coal undergoes losses in terms of quantity, due to rain and wind, but also losses of energy content due to oxidation and auto-combustion. The exact loss of energy cannot be precisely quantified, hence the use of standard values (1 % per year for anthracite and bituminous coal and 2 % for black lignite). Those values, according to Spain, are undoubtedly conservative. The estimated losses will be valued at the prevailing indigenous coal price. The Commission considers that this category of variable costs can indeed be included in the compensation. Indeed, all the costs incurred by power generating companies in purchasing indigenous coal with a view to satisfying their public service obligation may be taken into consideration in the calculation of the compensation, including those that correspond to quantities of coal eventually lost.

(142) Operation and maintenance costs: in its *ex post* review, the CNE will not need to differentiate between variable and fixed costs, but will calculate the total operation and maintenance costs of the plant and identify the part of it that can be attributed to the service of general economic interest. The CNE will calculate the maintenance costs in particular by taking into account the periods of unavailability and programmed outages of the power plant, as well as justifications provided by the undertakings concerned as regards the number of staff hours used for the operation and maintenance of the power plant in the framework of the service of general economic interest, and the costs of external services used for the operation and maintenance of the power plant.

(143) Investment costs taken into consideration correspond to productive and environmental investments associated with the plant. The investment costs will be calculated on the basis

of "standard values" or book values corresponding to the actual investment costs not yet depreciated, whichever of the two will be lower.

(144) In accordance with point 17 of the Public Service Compensation Framework, all the revenues generated by sales on the wholesale electricity market in the framework of the service of general economic interest (that is to say, when the plant is covered by a weekly operating plan issued by REE) will be taken into consideration in the compensation.

(145) The profit embedded in the public service compensation will, in accordance with point 18 of the Public Service Compensation Framework, take into account the low level of risk associated with the activity of indigenous coal plants in the framework of the service of general economic interest, since it will be the same rate as that used for the remuneration of regulated electricity production in insular and extra-peninsular systems, which also exhibit limited risks. Moreover, this rate has been established on the basis of a standard methodology based on the Weighted Average Capital Cost (WACC) of electricity companies. This pre-tax rate of return, estimated at 7.86%, corresponds to a post-tax rate of return of 5.5%. The Spanish authorities provided detailed calculations showing that this rate of return is lower than the WACC of the Spanish electricity sector as observed in the period 2003-2009. Furthermore, this rate is also lower than the WACC of the electricity transmission and distribution network operations, which are regulated activities with very limited business risks, as electricity production out of indigenous coal under the public service obligation laid down in the modified Royal Decree. In view of these elements, the profit envisaged by Spain can be regarded as a reasonable one.

(146) In accordance with point 19 of the Public Service Compensation Framework, the power generators will have to hold separate account for the operation of the power plants that are in the scope of the notified measure, showing separately the costs and receipts associated with the service of general economic interest, so that the CNE can effect the calculation of the actual costs incurred.

3.4.4. Identification and repayment of overcompensation

(147) In accordance with point 20 of the Public Service Compensation Framework, the annual review of costs by the CNE will allow it to identify overcompensation. Moreover, the modified Royal Decree foresees the arrangements necessary to ensure that any overcompensation identified by the CNE will be clawed back by REE.

3.4.5. Conclusion on the assessment under the Public Service Compensation Framework

(148) The notified public service compensation fulfils all the conditions laid down in the Public Service Compensation Framework. Moreover, the indirect aid to indigenous coal producers is inherent to that public service compensation and does not provide overcompensation to the coalmining companies for the coal sold by them on the basis of the public service obligation imposed on power generators[46]. Therefore, the aid to power

[46] This coal is sold at a price set by the national authorities on the basis of prevailing international coal prices, lower than indigenous coal production costs.

generators and indigenous coal producers is compatible with the internal market on the basis of Article 106 (2) TFEU, unless it is found that some aspects of the aid contravene specific provisions of the Treaty other than Article 107 and 108 TFEU and "*are so indissolubly linked to the object of the aid that it is impossible to evaluate them separately*"[47].

3.4.6. Compliance with other provisions of the Treaty

(149) Certain third parties argued that the measures contemplated by Spain violate specific provisions of the Treaty.

(150) One third party considers in particular that the notified measure may breach Article 4 and 6 of Council Regulation (EC) No 1407/2002 on State aid to the coal industry. It is argued in particular that the notified measure adds to aid authorised on the basis of that Regulation a measure which creates artificial demand for indigenous coal, and brings about distortions on the electricity market. The Commission notes in this respect that Regulation (EC) No 1407/2002, based on Article 107 (3) (e) and Article 109 TFEU, constitutes a specific ground of compatibility for authorising State aid. This ground of compatibility cannot and does not limit or constrain the scope of Article 106 (2) TFEU. Therefore, the elements put forward by the above third party about Regulation (EC) No 1407/2002 do not call into question the analysis of the compatibility with the internal market of the notified State aid on the basis of Article 106 (2) TFEU. In addition the assertion that the notified measure grants additional aid to coal mines above and beyond that authorised by the Coal Regulation is not accurate. As already indicated, under the National Strategic Coal Reserve Plan for 2006-2012, and for the period covered by it, the modified Royal Decree will only result in providing the coalmining companies with the outlet that they need to meet the declining sales targets stemming from the Plan, the instrument on the basis of which aid schemes for the coalmining industry were designed, and approved by the Commission, in accordance with Regulation (EC) No 1407/2002. The Spanish authorities have entered into a commitment according to which the coal purchase obligations stemming from the modified Royal Decree will only apply to coal benefiting from State aid in accordance with Council Regulation (CE) No1407/2002 or any successor to that Regulation.

(151) Several third parties argued that the measures envisaged by Spain would infringe certain provision of EU law, in particular the rules on free movement of goods.

(152) According to the *Iannelli* judgement, *"the fact that a system of aids provided by the State or by means of State resources may, simply because it benefits certain national undertakings or products, hinder, at least indirectly, the importation of similar or other competing products coming from other Member States is not in itself sufficient to put an aid as such on the same footing as a measure having an equivalent effect to a quantitative restriction within the meaning of Article 30*."[48]. Therefore, the notified measure, which will benefit national electricity and coal production, cannot, for that reason alone, be regarded as a measure having an equivalent effect to a quantitative restriction. Moreover,

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[47] See Case C-225/91 *Matra v Commission* [1993] ECR I-3203, paragraphs 41-45

[48] Case C-74/76 *Iannelli /Meroni* [1977] Rec. 1977, p. 557, paragraph 10

according to the same judgement, "*the fact that the inevitable consequence of the aid itself is often protection, and therefore some partitioning of the market in question, as far as concerns the production of undertakings which do not derive any benefit from it, cannot imply that the aid produces restrictive effects which exceed what is necessary to enable it to attain the objectives permitted by the Treaty*."[49]

(153) In the present case, the aid entails restrictive effects on the electricity market and on the markets for fuels used for power generation. However, there is no indication that those restrictive effects will exceed what is necessary to attain the objective of the aid, namely, the operation of a service of general economic interest consisting in electricity production out of indigenous coal, within the limits allowed by Article 11(4), read in conjunction with Article 3(2) of the Second Electricity Market Directive. Such a service of general economic interest necessarily implies that indigenous fuels are favoured in relation to other fuels used for power generation, and that power plants using such fuels are favoured in relation to other power plants[50].

(154) Moreover, in its *Campus Oil* judgement[51], the Court recognised that public-security considerations which may justify an obstacle to the free movement of goods pursuant to Article 36 TFEU include the objective of ensuring a minimum supply of petroleum products at all times by maintaining refining capacity within the territory. The same reasoning applies to electricity, *a fortiori* when, contrary to the situation in *Campus Oil*, the preferential dispatch system notified in this case seeks to maintain the continued exploitation and availability, for the production of electricity, of strategic primary fuel resources located within the territory of the Member State. Therefore, the fact that within a well-defined limit, the Second Electricity Market Directive allows Member States to regard as a service of general economic interest the production of electricity out of indigenous coal is an indication that the potential obstacles to the free movement of coal and electricity induced by such a mechanism fall within the scope of the exemptions provided for by Article 36 TFEU, and in particular, the grounds of public security mentioned in *Campus Oil*.[52]

(155) For the same reasons, the notified measure does not appear to breach the rules of the Treaty on the freedom of establishment.

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49 *Ibidem*. paragraph 15

50 It can be remarked in addition that the actual effects of the measure on primary fuels originating from EU Member States other than Spain are expected to remain limited since currently, all natural gas and all imported coal used for power generation in Spain come from outside the EU.

51 Case C-72/83 *Campus Oil Limited and others v Minister for Industry and Energy and others* [1984] ECR 02727, p. 34-35. See also Case C-174/04, *Commission/Italy*, [2005] ECR I-4933, paragraph 40, and case C-503/99, Commission/Belgium, [2002] ECR I-4809, paragraph 46.

52 It may be noted that in Case C-379/98 *PreussenElektra*, paragraphs 68-81, the Court examined an obligation placed on traders in a Member State to obtain a certain percentage of their supplies of a given product from a national supplier and found that it was not incompatible with Article 30 EC [now Article 34 TFUE] as it was justified by a "mandatory requirement". *A fortiori*, such a measure may be justified on public security grounds, expressly foreseen in Article 36 TFUE. The grounds referred to in Article 36 TFUE, unlike mandatory requirements under Article 34 TFUE, are, by nature, capable of justifying measures that are not indistinctly applicable to domestic and imported goods.

(156) As indicated in section 2.8 above, certain third parties have suggested that the notified measure would breach EU environmental legislation to such an extent as to prevent it from being found compatible with the internal market. Certain third parties notably invoke Spain and the EU's commitment to reduce greenhouse gas emissions. Yet, the Commission fails to see which specific provision of EU environmental legislation concerning climate change would be breached by the notified measure. In fact, the indigenous coal power plants covered by the scheme, even if they will be led to emit more CO_2 than they would have released otherwise, will remain subject to the Emission Trading Scheme, which is the EU's instrument to control and reduce CO_2 emissions of large installations such as large thermal power plants. The owners of indigenous coal power plants will be led to surrender more emission allowances than they would otherwise do. This will tend to drive the price of CO_2 emission allowances upwards but will not, in principle, affect the total CO_2 emissions of the installations covered by the Emission Trading Scheme in the EU, since those emissions are globally capped[53]. Therefore, the notified measure conflicts neither with the letter of the Emission Trading Scheme Directive[54], nor with its objective, which is to reduce total CO_2 emissions but not necessarily the emissions of each and every installation covered by the Emission Trading Scheme.

(157) Similarly, the emission reduction objective that the EU has set itself is global. Therefore, the fact that a Member State adopts a measure which leads a limited number of power plants to release more CO_2 than they would otherwise do does not as such conflict with a global reduction objective, all the more when these power plants are covered by an EU-wide "cap-and-trade" system which necessarily limits the total emissions of the installations that it covers below a pre-defined limit. In the same vein, the Commission notes that the modified Royal Decree cannot as such compromise the achievement by Spain of its own CO_2 emission reduction targets as imposed by Union legislation. Indeed, the target assigned to Spain by Decision No 406/2009/EC of the European Parliament and of the Council of 23 April 2009 on the efforts of Member States to reduce their greenhouse gas emissions to meet the Community's greenhouse gas emission reduction commitment up to 2020[55] applies to emissions that do not stem from the installations covered by the Emission Trading Scheme[56]. As regards Spain's commitment under the Kyoto Protocol, mentioned by one of the interested parties that submitted comments, there is no direct causal link between the notified measure and the possible failure to comply with this commitment. Indeed, this commitment relates to the country's total CO_2 emissions, hence the possibility for Spain to offset the impact of the notified measure in terms of CO_2 emissions by measures targeting other sources of CO_2. Finally, the Commission notes that the measure is not capable either to compromise the achievement

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53 The "cap" currently corresponds to the sum of the total emission allowances allocated by all Member States in the context of their National Allocation Plans. As from 2013, the cap will be set directly at EU level.

54 Directive 2003/87/EC of the European Parliament and of the Council of 13 October 2003 establishing a scheme for greenhouse gas emission allowance trading within the Community and amending Council Directive 96/61/EC

55 OJ L 140, 5.6.2009, p. 136

56 See Article 2 (1) of the Decision

by Spain of the target assigned to it by Union legislation[57] concerning the penetration of energy from renewable sources, since Spain's support schemes for renewable generation units will not be affected by the modified Royal Decree and renewable generation units will not be "displaced" in the context of the preferential dispatch mechanism.

(158) A former and a current member of the European Parliament raised concerns in relation to 9 open-cast mines that may be operated in breach of the EU environmental legislation. Even if this infringement exists and can be imputed to the Member State, it would constitute a behaviour independent of the notified measure, and would have to be assessed separately from it. It could not be considered "s*o indissolubly linked to the object of the aid that it is impossible to evaluate it separately*"[58], all the more since the notified State aid does not pursue an environmental objective, but aims to ensure the functioning of a service of general economic interest relating to security of supply[59].

(159) A third party has also argued that the measures laid down in the modified Royal Decree would breach the right of property as defined by the Charter of Fundamental Rights, because the preferential dispatch mechanism will have an expropriation or quasi expropriation effect on plants whose production programmes resulting from the clearing of the day-ahead electricity market will be reduced (the "displaced plants"). The Commission fails to see this effect: the owners of the power plants which could be potentially "displaced" on certain days will retain full control over their assets. Moreover, they will be free to offer their production either on the day-ahead electricity market or through other channels such as bilateral agreements. The measure will only affect the dispatch of power plants on the day-ahead electricity market. Therefore, the power generators concerned will not face an absolute impossibility to produce electricity with these plants and to sell it on the market. The measures laid down in the modified Royal Decree are only regulatory interventions on the electricity market aimed at ensuring that actual priority is given to the dispatch of indigenous coal plants, as allowed by the Second Electricity Market Directive. As a matter of fact, Article 17 of the Charter of Fundamental Rights, which deals with the right to property, explicitly foresees that the "*use of property may be regulated by law in so far as is necessary for the general interest*". The preferential dispatch mechanism at issue may be regarded as a measure regulating the use of power plants in the interest of security of supply, just like certain provisions of Union law, for example, limit the number of hours of functioning of certain power plants for environmental reasons. At any rate, even if one were to assume that the preferential dispatch mechanism impinges upon the right to property, the present decision is without prejudice to the application of any general (i.e. non-selective) scheme of national law contemplating compensation in such circumstances.

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57 cf. Directive 2009/28/EC of the European Parliament and of the Council of 23 April 2009 on the promotion of the use of energy from renewable sources and amending and subsequently repealing Directives 2001/77/EC and 2003/30/EC (OJ L 140, 5.6.2009, p. 16).

58 See Case C-225/91 *Matra v Commission* [1993] ECR I-3203, paragraphs 41-45

59 See for example case T-158/99, *Thermenhotel Stoiser v Commission*, [2004] ECR II-1, paragraph 159 ("(...) the possible disregarding of Directive 85/337 by the competent national authorities is liable, in an appropriate case, to proceedings for a declaration that the Member State has failed to fulfil its obligations under Article 169 of the EC Treaty (now Article 226 EC) but cannot constitute a serious difficulty as regards the Commission's assessment of the compatibility of the disputed aid with the common market")

(160) From the point of view of Union law, without prejudice to compliance with State aid rules of a public service compensation associated with a preferential dispatch mechanism, there is no provision or general principle that would oppose a preferential dispatch mechanism as foreseen under Article 11(4) of the Second Electricity Market Directive. The Commission also notes that preferential dispatch mechanisms may also be put in place by Member States for power generating units using renewable energy sources[60] with a similar impact on the economic interests of competing technologies, and the Court did not find grounds of incompatibility with Union law in the measures at stake in the *PreussenElektra* case[61], in particular with Article 28 of the EC Treaty (now Article 34 TFEU).

(161) The Commission further notes that the method by which non indigenous coal power plants will be selected to be "displaced", which will be based on environmental criteria, is a measure severable from the public service obligation imposed on the owners of the indigenous coal plants and from the aid measure itself. Consequently, this method is not so indissolubly linked to the object of the aid that it must be taken into account in the assessment of the compatibility of the aid measure.

(162) Finally, the Commission notes that the "capacity payment levy" neither has to be taken into account in the assessment of the compatibility of the aid with the internal market since that levy, which is the method by which the aid is financed, does not "*form an integral part of the aid measure*"[62]. According to the case-law, "*for a tax to be regarded as forming an integral part of an aid measure, it must be hypothecated to the aid under the relevant national rules, in the sense that the revenue from the charge is necessarily allocated for the financing of the aid and has a direct impact on the amount of the aid and consequently, on the assessment of the compatibility of that aid with the common market*"[63]. In the case at issue, the proceeds from the capacity payment levy will be used to finance two independent measures (the capacity payments and the public service compensation for indigenous coal plants) and the amount of compensation for indigenous coal plants will be calculated independently of the proceeds from the levy. Therefore, the capacity payment levy does not form integral part of the aid measure[64].

3.4.7. Conclusion on the compatibility assessment

(163) On the basis of the above considerations, notably that Spain committed to ending the applicability of the modified Royal Decree and the State aid measures that it contains by 31 December 2014 at the very latest and that this measure is transitory because the justifications provided by Spain indicate that it serves the purpose of mitigating certain concrete risks hanging over Spain's security of supply over a period of four years, the

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60 Article 11 (3) of the Second Electricity Market Directive

61 Case C-379/98 *PreussenElektra, cited* above, paragaphs 68 to 81. .

62 See Case C-333/07 Société Régie Networks v Direction de contrôle fiscal Rhône-Alpes Bourgogne, [2008] ECR I-10807, paragraphs 89.

63 *Ibidem*, paragraph 99

64 See also Joint Cases C-266/04 to C-270/04, C-276/04 and C-321/04 to C-325/04 *Distribution Casino France SAS and others v Caisse nationale de l'organisation autonome d'assurance vieillesse des travailleurs non salariés des professions industrielles et commerciales (Organic)* [2005] ECR I-9481

Commission concludes that the notified aid is compatible with the internal market on the basis of Article 106 (2) TFEU.

4. CONCLUSION

The Commission has accordingly decided:

- to declare the aid compatible with the Treaty on the Functioning of the European Union

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://ec.europa.eu/community_law/state_aids/state_aids_texts_es.htm.

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

European Commission
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B-1049 Brussels

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Yours faithfully,

For the Commission

Joaquín ALMUNIA

Vice-President of the Commission