EUROPEAN COMMISSION

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PUBLIC VERSION

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Subject: State Aid SA.44725 (2019/NN); and SA.45193 (2016/FC) – Lithuania
‘Public service obligation (PSO)’ for security of electricity supply:
strategic reserve; and complaint on Lithuanian electricity PSOs

Sir,

The Commission wishes to inform Lithuania that, having examined the information supplied by your authorities on the aid/measure referred to above, it has decided to initiate the procedure laid down in Article 108(2) of the Treaty on the Functioning of the European Union.

1. PROCEDURE

1. By electronic submission dated 2 March 2016 the Commission received a complaint from the Lithuanian Confederation of Industrialists and three of its members: AB Achema, AB ORLEN Lietuva and AB LIFOSA. The complaint raised concerns about alleged state aid granted to various market participants through the system of ‘public service obligations (PSOs)’ defined by Lithuania in the electricity sector, including those related to security of supply addressed in this decision and those related to renewable electricity addressed separately in case SA.45765. This complaint was registered under case number SA.45193. On the same day, 2 March 2016, the measure relating to security of electricity supply was pre-notified to the Commission in an electronic submission by Lithuania. This pre-notification was registered under case number SA.44725. As the measure was already implemented, the Commission has classified the case as non-notified.

2. On 20 June 2016, a non-confidential version of the complaint was sent to Lithuania. Lithuania provided comments on 22 July 2016.

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3. On 13 July 2016, the Lithuanian Confederation of Industrialists withdrew its participation in the complaint. AB Achema, AB ORLEN Lietuva and AB LIFOSA maintained their interest in pursuing the complaint.

4. On 3 March 2017, further information building on this complaint was submitted by AB Achema, AB ORLEN Lietuva and AB LIFOSA (the complainants). A non-confidential version of this further information was sent to Lithuania on 22 March 2017 and Lithuania provided comments on 27 April 2017.

5. On 30 May 2017 and 15 January 2018 the complainants provided more information on the measure subject to the complaint. On 9 March 2018, the complainants requested access to Lithuania’s comments on the complainants’ submissions. Non-confidential version of Lithuania’s comments were sent to the complainants on 19 September 2018.

6. On 18 December 2017 the Supreme Administrative Court of Lithuania lodged a request with the Court of Justice of the European Union (ECJ) for a preliminary ruling in relation to national proceedings brought by AB Achema, AB ORLEN Lietuva and AB LIFOSA. The case was registered under the reference C-706/17. The ECJ delivered its judgement on 15 May 2019.

7. There were several exchanges between the Commission and Lithuania in 2016, 2017 and 2018 on the security of electricity supply aspects of the complaint. On 13 July 2018, the Commission sent a preliminary assessment by which it informed Lithuania that continuation of the security of supply measure might be incompatible with the Guidelines on State and for environmental protection and energy 2014-2020 (EEAG).1

2. DETAILED DESCRIPTION OF THE AID

2.1. Introduction

2.1.1. Legal basis and scope of this decision

8. Article 74 of the Lithuanian Law on electricity No VIII-1881 of 20 July 2000 and its subsequent amendment No XI-1919 that came into force on 7 February 2012 (the Electricity Law) are the legal basis for the Lithuanian government to entrust public service obligations (PSOs) in the electricity sector.2

9. Lithuanian government resolution of 18 July 2012 (Resolution 916) further defined support for various services in the Lithuanian electricity market.

10. In particular, points 7.3 and 7.4 of Resolution 916 defined two PSOs related to security of electricity supplies, which are the subject of this decision:

   a. Point 7.3 - 'the production of electricity at established power plants where electricity must be produced in order to ensure security of electricity supply' (service 7.3).

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b. Point 7.4 - ‘provision of electric power system reserves at established power plants whose activities are necessary to ensure national energy security’ (service 7.4).

11. Each year Lithuanian Transmission System Operator, AB Litgrid, (the TSO) identified the level of the services required to achieve a reliability standard of zero hours of lost load (ie. Lithuania aimed to procure sufficient security of supply services so that on average no customer could ever be expected to be disconnected due to a lack of generation capacity). Based on the recommendations of the TSO, the Lithuanian government adopted a resolution confirming the required amount of these services.

12. According to the Lithuanian government resolutions service 7.4 was delivered throughout the period 2013-2018, while service 7.3 was only delivered during 2013 and 2014. A list of government resolutions specifying the services to be delivered for the period 2013-2018 is provided below:

   a. Government Resolution No 1035 of 29 August 2012 (and its corrigenda no 1538 of 19 December 2012) “Regarding the approval of the public service providers and the volume of services under public service obligation for 2013”;

   b. Government Resolution No 1051 of 20 November 2013 “Regarding the approval of the public service providers and the volume of services under public service obligation for 2014”;

   c. Government Resolution No 1091 of 15 October 2014 “Regarding the approval of the public service providers and the volume of services under public service obligation for 2015”;

   d. Government Resolution No 1083 of 7 October 2015 “Regarding the approval of the public service providers and the volume of services under public service obligation for 2016”;

   e. Government Resolution No 1178 of 23 November 2016 “Regarding the approval of the public service providers and the volume of services under public service obligation for 2017”; and

   f. Government Resolution No 966 of 29 November 2017 “Regarding the approval of the public service providers and the volume of services under public service obligation for 2018”.

13. Lithuania phased out the measure at the end of 2018. The compensation provided for the delivery of these services for the period 2013-2018 inclusive constitutes the measure subject to this decision.

2.1.2. Description of the measure and the beneficiary

14. In practice, two types of service were delivered:

   a. ‘Production service’: the selected beneficiary had to generate a certain predetermined quota of electricity production, and received compensation for each megawatt hour (MWh) generated within this quota; and
b. ‘Reserves service’: the selected beneficiary had to make certain pre-determined electricity generation capacity (in megawatts – MW) available, and make offers on the market to generate electricity at a price equivalent to avoidable running costs of the plant so that it would generate only when the market price matched its running costs. The beneficiary received compensation for the availability of its capacity regardless of whether it actually generated electricity.

15. As explained in recital 12, the Lithuanian government resolutions specified service 7.3 to be delivered in 2013 and 2014, and service 7.4 for every year 2013-2018. However, based on explanations from Lithuania it appears that in practice Lithuania required the production service described to be delivered in 2013, 2014, and 2015; and for 2016, 2017 and 2018 Lithuania only required the reserves service to be delivered.

**Figure 1: Services provided 2013-2018**

<table>
<thead>
<tr>
<th></th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>Production service</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>GWh</td>
<td>900</td>
<td>900</td>
<td>1100</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Compensation for production service</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Million EUR</td>
<td>136.5</td>
<td>77.6</td>
<td>50.6</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>EUR / MWh</td>
<td>151.67</td>
<td>86.22</td>
<td>46</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
</tr>
<tr>
<td>Reserves service</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>MW</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>550</td>
<td>455</td>
<td>212</td>
</tr>
<tr>
<td>Compensation for reserves service</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Million EUR</td>
<td>0.2</td>
<td>0</td>
<td>0</td>
<td>25.2</td>
<td>34.3</td>
<td>27</td>
</tr>
<tr>
<td>EUR / MW / year</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
<td>-45,818</td>
<td>75,385</td>
<td>127,358</td>
</tr>
</tbody>
</table>

*Source: Lithuania / European Commission*

16. From 2013 to 2018 the only service provider identified in the Government resolutions was the Lithuanian Power Plant (LPP). The resolutions do not identify any other company that would be entrusted with delivering the security of supply services in Lithuania. LPP is part of the Lithuanian government controlled energy incumbent group. The parent company of the group is AB Lietuvos Energija (Lietuvos Energija).

17. Lietuvos Energija controls the majority of electricity generation capacity (plants with an installed capacity over 50 MW) in Lithuania (2 055 MW out of 2 820 MW). LPP is a 1 055 MW plant comprising 600 MW (2 x 300 MW units) old (pre-1972) natural gas / heavy fuel oil combined heat and power capacity, and 455 MW relatively new (2012) combined cycle gas turbine electricity generating capacity.

18. In the case of the production service from 2013 to 2015, the service was delivered through the power plant actually generating the amount of electricity specified in the quota. This energy was remunerated at a price per MWh which was established by the National Regulatory Authority (NRA), the National Commission for Energy Control and Prices. The prices varied considerably as can be seen in the table: in 2013, the price was 151.67 EUR / MWh, and in 2015 46 EUR / MWh. The plant was free to sell any output beyond the quotas on the market (at market prices).

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3 Lithuanian authorities have explained however, that EUR 188,700 was spent on old units of the Lithuania National Power Plant in 2013, and that this was allocated to the budget for the reserves service.

4 According to Eurostat data electricity prices for household consumers in Lithuania remained stable between 2013 and 2015 at around EUR 80 / MWh.
19. In the case of the reserves service from 2016 to 2018, the service was delivered through the power plant making some of its capacity available to deliver when needed (i.e. when instructed by the Transmission System Operator) and offering this capacity into the market at a price corresponding to its marginal production costs in the range of 60-80 EUR / MWh. The plant was paid for the maintenance of this capacity but not paid for the electricity produced. As for the production service, compensation for the reserve service varied significantly from 45 818 EUR / MW / year in 2016 to 127 358 EUR / MW / year in 2018. The plant received revenues from any output sold on the market in addition to its compensation for providing its availability under the reserve service.

20. Lithuania has explained that electricity generated by the capacity providing the reserves service was sold in a total of 1 700 hours, on 100 different days in 2016. Lithuania has explained that this was due to repeated failures of the interconnector between Sweden and Lithuania. It was apparently not possible to receive replacement imports from Russia until 2 days after the fault occurred due to a lengthy process for rescheduling flows between Russia and Lithuania. Lithuania explained that this lengthy process was subsequently shortened hence the reserve was not used in 2017 nor 2018.

2.1.3. Financing mechanism

21. Resolution 916 established that the services would be compensated from a ‘PSO levy’ fund dedicated to the financing of various energy policies. Based on point 19 of Resolution 916, the PSO levy would be paid by all the electricity consumers in Lithuania and the levy would be based on their electricity consumption.

22. On 7 November 2012, the Lithuanian government appointed UAB Baltpool (Baltpool) as the administrator of the fund as of 1 January 2013 through Resolution 1338. Baltpool was the fund administrator 2013-2018. Baltpool is a State controlled company. Its shareholders are UAB EPSO-G (67%) and AB Klaipėdos Nafta (33%). EPSO-G is fully owned by the Lithuanian State and AB Klaipėdos Nafta’s controlling shareholder is the Lithuanian State.

23. While administering PSO funds, Baltpool adheres to the ‘Description of the procedure for administering the funds of public service obligations in the power sector’ established by Resolution No 1157 of 19 September 2012 (Resolution 1157).

24. Customers connected to the transmission grid were required by the law to pay the levy directly to the Baltpool-administered fund. Customers connected to the distribution grid were required by the law to pay the levy to the distribution system operator which in turn was required by the law to transfer the levy to Baltpool. The illustration of the PSO levy collection is provided below.
25. The final amount of the compensation was determined by the NRA. Baltpool paid this amount to the beneficiary – Lietuvos Energija.

2.2. The complaint

26. In their submissions of 2 March 2016 and 3 March 2017, the complainants made the following claims in relation to the security of supply services:

a. During the period 2013-2018 LPP received State aid from the Lithuanian government for providing the security of supply services defined in points 7.3 and 7.4 of Resolution 916.

b. The measure constituted State aid that was never notified to the European Commission;

c. The measure could not be found compatible based on the Commission Decision on the application of Article 106(2) TFEU (SGEI Decision)\(^5\). Contrary to the requirement of the Decision there was no entrustment act that makes reference to the Decision, and Lithuanian legislation did not provide any reference to the duration of the PSO. Lithuania’s report on the application of the SGEI Decision did not contain any PSO in the Lithuanian electricity market.\(^6\)

d. The measure could not be justified based on the European Union framework for State aid in the form of public service compensation (SGEI Framework) as it did not fulfil SGEI Framework conditions.\(^7\) PSO compensation was granted selectively each year without a clear definition of what services it involved, and the Lithuanian authorities never explained why PSOs are necessary and why undertakings could not provide these services satisfactorily under the normal market conditions. Finally, Lithuania awarded the PSO services in breach of the Public Procurement Directive as no tenders were organised and services

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\(^6\) The Member States’ reports can be found at http://ec.europa.eu/competition/state_aid/overview/public_services_en.html#reports.

\(^7\) The SGEI framework can be found at https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX:52012XC0111(03).
were entrusted on a discretionary basis without respecting transparency requirements.

e. The PSOs would not meet requirements established in the Electricity Directive\(^8\) for electricity PSOs (PSOs had to have been clearly defined, transparent and non-discriminatory, and guarantee equality of access for electricity undertakings of the Community to national consumers).

f. The measure could not be justified based on the EEAG. The aid would not fulfil the EEAG compatibility criteria. The Lithuanian authorities did not allocate the aid through competitive bidding processes and therefore did not ensure that proportionality criteria were met. The Lithuanian authorities did not seem to have considered the requirement to phase out environmentally harmful subsidies. Moreover, Lithuania did not demonstrate that the existence of a market failure to justify the need for State intervention. Finally, the support to LPP did not comply with transparency requirements.

27. The complaint covers the period starting on 7 February 2012 when the Lithuanian Government introduced amendments to the Law on Electricity No VIII-1881 of 20 July 2000.

2.3. Lithuania’s views

28. In their submissions of 2 March 2016, 22 July 2016 and 27 April 2017 and Lithuanian authorities argued that:

a. The measure should be assessed not based on the SGEI Decision but the SGEI Framework. PSO services were defined in Resolution 916 and were allocated by the Lithuanian government on a yearly basis therefore the duration of the PSO was clearly defined. The Public Procurement Directive does not apply to the specific electricity production and reserve services;

b. PSO services funding complied with the requirements of the Electricity Directive. It is clearly defined in the legislation, it is transparent and non-discriminatory. The PSO list was approved by law and enacted following complex procedures, assessments and approvals involving different institutions.

c. The measure complied with the EEAG. It has clear objective of common interest – security of supply; moreover, there was no overcompensation national regulator ensured that the amount of compensation was proportionate.

29. Moreover, in the documents submitted on 2 March 2016 Lithuania explained that the measure was necessary and justifiable under Protocol No 4 to Lithuania’s Treaty of Accession\(^9\).

30. Ignalina nuclear power plant (INPP) was the major source of electricity generation in Lithuania. Due to the plant’s similarities to the failed Chernobyl Nuclear Power Plant, Lithuania agreed to close the plant as part of its accession agreement to the European

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Union (Unit 1 closed in December 2004 and Unit 2 closed in December 2009). European electricity markets were generally liberalised in situations of excess capacity whereas the Baltic States started liberalisation facing a lack of capacity in view of INPP’s closure. Since 2010 Lithuania has been dependent on imports.\(^{10}\)

31. Recognising the particular situation, Protocol No 4 to Lithuania's EU accession treaty dealt specifically with the closure of INPP and included provisions relating to security of supply issues (refurbishing and building new capacities to replace the INPP with EU assistance). The conditions were detailed in Article 2 of the protocol:

\textit{Article 2}\(^{11}\)

8. Public aid from national, Community and international sources:

- for the environmental upgrading in line with the acquis and modernisation measures of the Lithuanian Thermal Power Plant in Elektrenai [the Lithuania National Power Plant] as the key replacement for the production capacity of the two Ignalina Nuclear Power Plant reactors; and

- for the decommissioning of the Ignalina Nuclear Power Plant shall be compatible with the internal market as defined in the EC Treaty.

9. Public aid from national, Community and international sources in support of Lithuania's efforts to address the consequences of the closure and of the decommissioning of the Ignalina Nuclear Power Plant may, on a case by case basis, be considered to be compatible - under the EC Treaty - with the internal market, in particular public aid provided for enhancing the security of energy supply.

32. Lithuania has explained that, as a result of the closure of Ignalina, it was essential to ensure the ongoing operation of the LPP, and that no other plant could have provided this service and guaranteed secure electricity supplies in Lithuania. Lithuania has also explained that, in its view, Article 2 paragraph 9 of the protocol provides an additional basis for finding such aid compatible.

3. ASSESSMENT OF THE AID

3.1. Existence of aid

33. Article 107 (1) TFEU provides that “any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods, shall, in so far as it affects trade between Member States, be incompatible with the common market”.

3.1.1. Existence of State resources

34. According to established case law, only advantages which are granted directly or indirectly through State resources are to be regarded as aid within the meaning of

\(^{10}\) Lithuania went from exporting 30% of its electricity production in 2009 to importing 60% of its electricity demand in 2010 once Ignalina Unit 2 closed.


Note: The Lithuanian National Power Plant, mentioned in Article 2.8, received direct support for the construction on 455 MW new gas-fired capacity. No aid has so far been found compatible under Article 2.9.
Article 107(1) TFEU. The distinction between aid granted by the State and aid granted through State resources serves to bring within the definition of aid not only aid granted directly by the State, but also aid granted by public or private bodies designated or established by the State. Thus, resources do not need to transit through the State budget to be considered as State resources. It is sufficient that they remain under public control.

35. As established in the case law, the proceeds of levies imposed by the State through legislation, which are managed and apportioned in accordance with the provisions of legislation, constitute State resources within the meaning of Article 107(1) TFEU even if they are managed by public or private entities separate from the public authorities.

36. As explained in section 2.1.3, the Lithuanian State adopted Resolution 916 which obliged all electricity consumers to pay the PSO levy to a fund. Through Resolution 1338 the Lithuanian State appointed Baltpool as the fund administrator. Baltpool was fully controlled by the Lithuanian State. The Lithuanian State also established in Resolution 1157 clear instructions to Baltpool for how the fund must be administered, which means that the fund was established by, and remained under the control of, the State.

37. In its judgement of 15 May 2019, the ECJ concluded that: ‘the funds earmarked for financing a public interest service scheme, such as the PIS, constitute State resources…’ The funds assessed in that judgement had similar characteristics to the funds financing the present production and reserve services. On that basis, the Commission concludes that the compensation provided for production and reserve services is financed from State resources.

3.1.2. Imputability of the measure to the State

39. The establishment of the production and reserve services and their compensation are imputable to the Lithuanian state. These services were established in the Electricity Law and Resolution 916 and allocated to the beneficiary on a yearly basis by separate government resolutions (see section 2.1.1).

3.1.3. Selective advantage

40. The Lithuanian government adopted yearly resolutions by which the compensation was granted to one particular company, Lietuvos Energija, in respect of one particular power plant (LPP). No other companies were able to receive that compensation. Lietuvos Energija could not obtain similar compensation on the electricity market. The Commission therefore considers that the measure provides a selective advantage to Lietuvos Energija.

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13 Case C-482/99 France v Commission, EU:C:2002:294, paragraph 37

14 Case C-262/12, Vent de Colère, ECLI:EU:C:2013:851, paragraph 25

15 Case C-706/17 Achema and Others, ECLI:EU:C:2019:407, paragraph 72.

16 See also Case C-706/17 Achema and Others, ECLI:EU:C:2019:407, paragraph 49.
41. For the period 2013-2015, when the measure involved compensation per MWh for the production of a quota of electricity, the Commission considers that the advantage would comprise the difference between the average wholesale market price each year and the compensation paid per MWh for fulfilling the production quota, multiplied by the amount of generation required under the quota. For the period 2016-2018, the Commission considers that the advantage comprises the entire compensation since no other competitor could receive payments per MW for making capacity available.

3.1.4. Distortion of competition and effect on trade

42. By 2013 when the measure was implemented, the Lithuanian electricity market was open to competition and electricity producers competed to sell their electricity to suppliers on the market. Moreover, in 2013 the Lithuanian electricity system was already connected to the systems of other Member States such as Latvia and from December 2015 also Sweden and Poland.

43. In its 15 May 2019 judgement, the ECJ found that when aid granted by a Member State strengthens the position of one undertaking (Lietuvos Energija) in comparison with other undertakings competing in intra-community trade, the latter must be regarded as affected by that aid. It is not necessary that recipient of aid is involved in intra-community trade. Where a Member State grants aid to undertakings, internal activity may as a result be maintained or increased, reducing the opportunities for undertakings established in other Member States to enter the market may be reduced.

44. Based on the above, the Commission concludes that the measure had the potential to distort competition and was liable to affect trade between Member States.

3.1.5. Conclusion on existence of aid

45. On the basis of the analysis above, the Commission concludes that the notified measure constitutes State aid within the meaning of Article 107(1) TFEU.

3.2. Legality of aid

46. The measure subject to this decision entered into force in 2013 and was in place until the end of 2018. By implementing the measure in advance of a Commission decision in its compatibility, Lithuania has breached the standstill obligation set out in Article 108(3) TFEU and the measure therefore constitutes unlawful aid.

3.3. Compatibility assessment

3.3.1. Applicable rules

3.3.1.1. Service of general economic interest (SGEI)

47. The compensation to Lietuvos Energija could be considered as compatible with Article 106(2) TFUE provided that it does not affect the development of trade to such an extent as would be contrary to the interests of the Union. This is the case if the conditions set

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17 In 2012 Lithuania joined the Nordpool energy trading exchange: https://www.nordpoolgroup.com/About-us/History/
18 Case C-706/17 Achema and Others, ECLI:EU:C:2019:407, paragraphs 91-93.
out in 2.2 - 2.10 of the Communication from the Commission on SGEI compensation\(^{19}\) are met.

48. In this Communication SGEIs are defined as 'services which, if it were considering its own commercial interest, an undertaking would not assume or would not assume to the same extent or under the same conditions'. The Communication therefore considers that 'it would not be appropriate to attach specific public service obligations to an activity which is already provided or can be provided satisfactorily and under conditions, such as price, objective quality characteristics, continuity and access to the service, consistent with the public interest, as defined by the State, by undertakings operating under normal market conditions'.

49. Security of supply in general may give rise to SGEIs. However, to determine whether the PSO established by Lithuania relates to a genuine SGEI, Lithuania should therefore demonstrate that a security of supply problem exists, which cannot be solved by undertakings operating under normal market conditions, including where suitable reforms are made to address regulatory failures and improve market functioning.\(^{20}\) Lithuania has not demonstrated this so far.

50. It must be verified that PSOs established for delivering security of supply fulfil the conditions established in the Electricity Directive, ie. that they are 'clearly defined, transparent, non-discriminatory, and verifiable’ and guarantee equality of access for electricity undertakings of the Community to national consumers’.\(^{21}\) In this regard, Lithuania's measure has simply been conferred upon the State owned incumbent each year, without clear justification and without other potential providers of the services being able to express an interest in providing the required services. Moreover, the services could have been provided by other technologies, including other types of generation.\(^{22}\) By limiting the PSO to the energy incumbent, without demonstrating that they checked and excluded the existence of other available technologies and/or of alternative providers that might have provided the service, Lithuania appears to have failed to respect these obligations for PSOs in the sector. The definition of the PSO by the Lithuanian authorities appears to be non-transparent and discriminatory and therefore vitiated by a manifest error.\(^{23}\)

51. Moreover, PSOs must comply with the condition of proportionality. In the *Federutility* judgement the Court concluded that: 'It follows from the very wording of Article 106 TFEU that the public service obligations which Article 3(2) of Directive 2003/55 allows to be imposed on undertakings must comply with the principle of proportionality\(^{19}\)\(^{20}\)\(^{21}\)\(^{22}\)\(^{23}\).

\(^{19}\) 2012/C 8/03, Section 3.2. point 13, also see 2012/C 8/02 point 46.

\(^{20}\) See in this respect the analysis in cases SA.40454 (French tender for capacity in Brittany), in particular recitals 143-150, and SA.45852 (German capacity reserve).


\(^{22}\) In a letter of 4 April 2017, the Lithuanian Competition Council concluded that Lithuanian government by its resolution No 1083 of 7 October 2015 entrusting only LLP to provide security of supply services discriminates other economic entities as it does not provide them with the possibility to compete for the same services with LPP' See: https://kt.gov.lt/lt/naujienos/konkurencijos-teryba-siulo-nbsp-keisti-elektros-energetikos-sistemos-rezervo-uztikrinimo-paslaugas-reglamentuojancius-teises-aktus.

\(^{23}\) AG Wathelet summarized the limits to the prerogative of the Member States when designating a service of general economic interest in his opinion in cases C-66/16 P to C-69/16 P, paragraphs106 to 109 (http://curia.europa.eu/juris/document/document.jsf?text=&docid=194114&pageIndex=0&doclang=EN&mode=lst&dir=&occ=first&part=1&cid=381898).
and that, therefore, after 1 July 2007, those obligations may compromise the freedom to determine the price for the supply of natural gas only in so far as is necessary to achieve the objective in the general economic interest which they pursue and, consequently, for a period that is necessarily limited in time.24 The Federutility judgement refers to the gas market and Directive 2003/55 is known as the ‘Gas Directive’. The Gas Directive serves a broadly similar function for the gas market as the Electricity Directive serves for the electricity market. Both directives include provisions identifying possible PSOs in the respective markets and defining a list of conditions that any such PSOs must respect.

52. In this case, from 1 January 2013 until 31 December 2015 the support concerned the generation of electricity and not simply the holding of capacity in reserve. Lietuvos Energija received subsidy for services provided by LPP, but nevertheless from 1 January 2013 until 31 December 2015 LPP continued to participate in the market and supply quotas of electricity to the TSO. The compensation meant that LPP existed in the market and was able to offer its output at a price that did not cover the full cost of keeping the plant operational. To ensure the achievement of the quotas, the plant may in fact have needed to offer its output at a lower price than required to cover its full costs.

53. From 1 January 2016 until 31 December 2018, the capacity was notionally held in reserve, and the compensation was for the holding of capacity in reserve rather than the fulfilment of generation quotas. However, in practice the supported capacity was required to bid into the market at a price corresponding to its operating costs (and was free to bid into the market with capacity even beyond the amount supported). This meant that the supported capacity even after 1 January 2016 was not held outside the market.

54. For its entire duration therefore the plant was present in the market and required/able to offer its output on the market at a price level too low to enable the full recovery of the costs associated with keeping the plant operational. These costs were covered by aid not available to competitors. The measure thereby effectively capped the market price and foreclosed the market to any other capacity – including imports and demand response – with costs higher than the running costs of the supported plant (which had a competitive advantage because it was paid separately for its capacity in addition to potential market revenue).25 This dampening impact on market price formation could be expected to deter other investors from investing in new generation while the measure was in force. This is because the existence of the measure reduced electricity prices and therefore the revenues potential investors could expect to earn from operating a new power plant or demand response company. In this way, the disproportionate design of the Lithuanian services undermined achievement of the security of electricity supply objective.

55. For the entire 2013-2018 period therefore, due to the significant distortive effect of the measure on market functioning and price formation, the Commission doubts that the proportionality principle as assessed in the Federutility judgement is fulfilled. It

24 C-265/08 - Federutility and Others, paragraph 33. Please note Directive 2003/55 is the ‘Gas Directive’, which is very similar to the Electricity Directive and includes a similar list of potential PSOs in its Art 3(2).

25 The analysis in the Commission decision on the Belgian strategic reserve case (SA.48648), paragraph 152 and ff. also describes the significant distortive effect that a ‘reserve’ measure can have on market price formation.
therefore does not seem possible to consider the services identified by Lithuania in this case to be genuine SGEIs.

56. The Commission therefore has strong doubts that the services for security of supply defined by Lithuania constitute an SGEI compatible with Article 106 paragraph 2 TFUE.

3.3.1.2. Assessment under Article 107(3) c TFUE

57. Lithuania has also explained that the measure complied with the EEAG. In this regard the Commission must verify whether the compensation for generation and reserve services paid to Lietuvos Energija could be considered compatible with the internal market on the basis of TFEU Article 107(3)(c).

58. The measure aims to ensure generation adequacy and security of electricity supply and therefore falls within the scope of Section 3.9 EEAG, setting out the conditions under which aid for generation adequacy may be considered compatible with the internal market on the basis of TFEU Article 107(3)(c).

59. The EEAG were adopted on 28 June 2014 and entered into force on 1 July 2014. EEAG point 248 explains that unlawful environmental aid or energy aid will be assessed in accordance with the rules in force on the date on which the aid was granted. The first aid granted in the measure under assessment after the EEAG came into force was the aid granted for the period 1 January 2015 – 31 December 2015. This was granted through Government Resolution No 1091 adopted on 14 October 2014, which specified that LPP would be remunerated for the production of 1,100 GWh electricity in 2015, and NRA Resolution No O3-840 of 17 October 2014 which specified the amount of compensation to be paid. The EEAG and in particular Section 3.9 therefore apply to this measure from 1 January 2015.

60. Prior to this, there were no specific guidelines for generation adequacy measures. For the period 1 January 2013 to 31 December 2014, the measure therefore needs to be assessed directly under TFEU Article 107(3)(c) which states that ‘...aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest...’ may be considered to be compatible with the internal market. In order to be compatible under TFEU Article 107(3)(c), an aid measure must be necessary to pursue an objective of common interest. It must be an appropriate instrument, must provide an incentive effect, and must be proportionate.

3.3.2. Objective of common interest

3.3.2.1. Assessment for the period 2013-2014 under TFEU

61. According to Article 194 TFEU, the Union policy on energy shall aim inter alia to ensure security of energy supply in the Union. The Court has also confirmed that security of energy supply is an objective in the public interest.26

62. The Commission therefore considers security of electricity supply to be an objective of common interest for the period 2013-2014.

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26 Judgment of the Court of 22 October 2013 in Joined Cases C-105/12 to C-107/12, Staat der Nederlanden v Essent and Others, paragraph 59 and case-law cited.
3.3.2.2. Assessment for the period 2015-2018 under EEAG

63. Following the logic of the TFEU and subsequent case practice, EEAG point 30 explains that the primary objective of aid in the energy sector is to ensure a competitive, sustainable and secure energy system in a well-functioning Union energy market. EEAG points 219 to 221 provide additional rules for common objectives for generation adequacy.

64. EEAG point 219 explains that measures for generation adequacy can be designed in a variety of ways including involving both investment aid and operating aid but in principle only involving aid for the commitment to be available. This measure involves aid for keeping capacity in reserve but also involves aid for producing quotas of electricity. This aspect is assessed below in Section 3.3.4 on appropriateness.

65. EEAG point 220 explains that aid for generation adequacy may contradict the objective of phasing out environmentally harmful subsidies including for fossil fuels, and that Member States should therefore consider alternative measures to ensure generation adequacy before resorting to aid for generation adequacy, such as facilitating demand response or increasing interconnection.

66. Lithuania has made significant investments in interconnection in recent years, with the construction of new links to Sweden and Poland coming online in December 2015, which combined with existing links to Russia, Belarus and Latvia mean Lithuania imports around 70% of all electricity consumed. Although Lithuania has not made any significant progress developing the potential for demand response participation in the market, it has supported significant investments in renewable generation capacity in recent years.

67. The Commission takes the view that the existence of a measure for security of supply does not in itself contradict the objective of phasing out environmentally harmful subsidies including for fossil fuels. As explained above, Lithuania has also supported renewable generation and invested in significant new interconnection.

68. EEAG point 221 explains that the precise objective at which the measure is aimed should be clearly defined. Lithuania has explained that the analysis by the TSO targets the achievement of a reliability standard equivalent to zero hours’ loss of load expectation (LOLE). In other words, Lithuania aims to use the measure to ensure that no consumer should ever experience any disconnection due to a lack of installed capacity in Lithuania.

69. The Commission concludes that security of supply is an objective of common interest.

3.3.3. Need for State aid

3.3.3.1. Assessment for the period 2013-2014 under TFEU

70. Lithuania has had electricity interconnectors with Russia (680 MW), Belarus (1 800 MW) and Latvia (1 200 MW) since before 2013. Lithuania currently has a peak demand of around 1 800 MW in the winter. In 2012, Lithuania had 3 905 MW net generating capacity.27

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71. As explained in Section 2.3, Lithuania argues that the closure of Ignalina meant special measures for security of supply were required in Lithuania. The Commission agrees that the closure of Ignalina represented a particular challenge for the Baltic States and in particular Lithuania. This is clearly recognised in the protocol to the Treaty of Accession. The Commission also recognised a security of supply risk in the region in its 2009 decision on State aid case 675/2009 – Tender for Aid for New Electricity Generation Capacity in Latvia.  

72. Lithuania has explained that the TSO determined the required amount of each service required each year as part of its role developing ten year network development plans for the region. From the information provided by Lithuania, it appears that these assessments were deterministic assessments that assumed imports were unavailable except from Latvia, and which did not take account of renewables development or demand response. However, before the EEAG entered into force there was no requirement for a more sophisticated probabilistic adequacy assessment, taking into account for example variations in the output of renewable energy generation and demand linked to weather, to justify the necessity of a generation adequacy measure. This is reflected in the Commission’s pre-EEAG case practice.

73. In 2013 and 2014, cheap and abundant electricity imports from Russia and Belarus would have undermined the potential for profitable new investment in Lithuania. In addition, plans for the construction of a new nuclear power plant, along with plans to construct a new link to Sweden where electricity prices are generally low could have acted as a deterrent for new investments or an incentive to mothball or close existing capacity in Lithuania. While the imports from Russia were generally reliable, supply disruptions were possible.

74. For 2013 and 2014, we therefore consider that a measure addressing generation adequacy may have been necessary due to insufficient market-based investment in new capacity combined with Lithuania’s high dependence and the risk of disruptions to imports.

75. For 2013 and 2014 therefore, the Commission therefore arrives at the preliminary conclusion that the measure was necessary.

3.3.3.2. Assessment for the period 2015-2018 under EEAG

76. EEAG points 222 to 224 define specific criteria for how Member States should demonstrate the need for State intervention. Point 222 requires a proper analysis and quantification of the generation adequacy problem. Point 223 requires a demonstration of the reasons why the market cannot be expected to deliver adequate capacity. Point 224 requires the Commission, based on information submitted by the Member State, to take account of assessments on the ability of the existing generation fleet and the grid to address situations of high demand.

77. Lithuania’s practice in making adequacy assessments to determine the necessity of the security of supply measure did not change over time. As recently as for the reserve in

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29 See the analysis in case 675/2009 for example.

30 Lithuania was for many years considering a new nuclear power plant at Visaginas near the site of INPP. See: [https://enmin.lrv.lt/en/strategic-projects/electricity-sector/visaginas-nuclear-power-plant](https://enmin.lrv.lt/en/strategic-projects/electricity-sector/visaginas-nuclear-power-plant)
2018 the assessment was deterministic and not probabilistic. As with earlier assessments, it assumed no imports other than from Latvia, and assumed no contribution from demand response nor installed renewables.

78. In 2017 Lithuania had 3 663 MW installed capacity\(^{31}\) (825 MW RES) and peak demand of around 1 800 MW in the winter. ENTSO-E identified no capacity adequacy problems in 2020 nor 2025, but also noted that ‘available generation is usually not competitive in the wholesale market’ and a ‘large amount of Lithuanian power system demand is covered by imported electricity’. In other words, while there appeared to be no adequacy problem in Lithuania (sufficient supply to meet demand), the national generation is not competitive and hence large amounts of electricity are imported.

79. Since December 2015, Lithuania has also benefitted from interconnections to Poland (500 MW) and Sweden (700 MW). Lithuania argued in its 2 March 2016 submission to the Commission that: ‘Once the conditions for the competitive market are created by completing interconnectors which open the Lithuanian market to diversified sources of electricity supply, Lithuanian authorities are abolishing this measure as no longer necessary.’ Lithuania has however also explained that the connections to Poland and Sweden were unreliable because: i) Poland prevents exports to Lithuania at certain times; and ii) there were technical problems with the line with Sweden (the line was available 78% of the time in 2016, and 89% of the time in 2017).\(^{32}\) Lithuania has therefore argued that domestic measures to ensure security of electricity supply were needed.

80. The amount of installed renewable energy generation capacity also continued to increase over time and in 2018 Lithuania had 833 MW of installed renewable capacity (excluding the 900 MW Kruonio pumped storage hydro plant). Lithuania explained that in the 100 hours of highest Lithuanian demand over the previous few years renewable capacity delivered an average of 233 MW output, and the trend is for a higher and higher output from RES as more RES capacity is installed (eg. in 2013 the installed capacity was 127 MW and in 2017, 331 MW). The Commission would therefore expect some account to be taken of the contribution of renewables to security of supply when planning for a generation adequacy measure, yet no account seems to have been taken of the contribution of renewable generation.

81. In terms of EEAG point 223, Lithuania did not identify any particular reasons why the market could not have been expected to deliver adequate capacity. However, the Commission notes the following:

82. In a 24 July 2018 submission, Lithuania identified 189 MW technical demand response potential in Lithuania, but explained that consistently available demand response does not exceed 50 MW. Lithuania also explained in discussions that, with appropriate price signals, a greater amount of demand response capacity could potentially be enabled including 86 MW of industrial sites have generation that could potentially be interested in diverting electricity to the market rather than consuming energy in high price hours. These sites already have the requisite meters, but the price signals in Lithuania’s market are not expected to provide adequate signals for demand response at present.


\(^{32}\) The line to Sweden was upgraded in summer 2018 and is expected to be more reliable after these repairs.
83. In the 24 July 2018 submission, Lithuania explained that the value of lost load (VOLL), which is the amount an average Lithuanian consumer is willing to pay to avoid having their electricity supply disconnected, is estimated to be around 5,320 EUR / MWh. However, Lithuania explained that prices in the Lithuanian market have not been enabled to rise at times when electricity is scarce, and in fact were effectively capped for the duration of the measure at the level of the variable costs of the LPP (between 60 and 90 EUR / MWh depending on the specific generation unit). This means that the electricity market failed to send the signals needed to ensure security of supply. For example:

   a. Higher prices may have encouraged more consumers to disconnect voluntarily when prices rose, unlocking greater demand response and reducing the need for generation; and

   b. Potential higher prices may have encouraged greater investment in generation that could have been reliably available at times of scarcity since it would have profited from these high prices. This may have reduced the need for out of market subsidies to support generation.

84. EEAG point 224 requires the Commission to take account of, among other things, ‘measures to encourage demand side management’ and regulatory or market failures, including for example caps on wholesale prices’. Lithuania explained in the 24 July 2018 submission that a new regulatory environment would be created to support demand response but has not identified specific aspects of the market requiring attention, nor any measures other than the installation of new metering equipment required to encourage demand response. The Commission therefore invites views on potential market improvements.

85. Lithuania has explained that it targeted a reliability standard equivalent to zero hours’ LOLE due to insufficient generation capacity. This is significantly more stringent than the reliability standards adopted in other Member States, where the most stringent standard so far encountered is 3 hours’ LOLE e.g. in France and the UK. A more stringent standard reduces the cost associated with security of supply interruptions, but increases the costs associated with constructing or maintaining electricity capacity. As the Commission noted in the conclusions to the sector inquiry on capacity mechanisms, ‘an economically efficient reliability standard is based on the value that electricity consumers place on security of supply. In other words, Member States should carry out a cost-benefit analysis to determine the extent to which it is useful to give incentives to market players to achieve a particular reliability standard’.³³ If VOLL in Lithuania is around 5,320 EUR / MWh, following the logic described in the sector inquiry final report would imply that the economically optimal reliability standard in Lithuania might be around 11.5 hours’ LOLE.³⁴ This would imply that the measure adopted by Lithuania, targeting a standard of zero hours, were significantly oversized.

86. In its case practice on strategic reserves, the Commission has however considered that the necessity of a reserve can be demonstrated based on a reasonable worst-case scenario.³⁵ This implies that a strategic reserve could be justified to ensure a higher level of security of supply than might generally be considered to be optimal based on a cost-benefit analysis. As in the German case, a cap on the maximum price to be paid

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³⁴ Cost of new capacity (approx. EUR 60,000 / MW / year) divided by VOLL.
³⁵ See for example the analysis in case SA.45852 (2017/C), recital 110.
for the capacity to be held in reserve may need to be applied to ensure that the cost of purchasing the insurance in the form of the reserve does not exceed the cost of unmet demand if in fact the worst case scenario did materialise in a single year.

87. Based on this analysis, the Commission considers that the necessity of the measure has not at this stage been demonstrated for the years 2015-2018. However, the necessity of a security of supply measure might be demonstrated on the basis of analysis based on a reasonable worst case scenario, particularly for the year 2015 before the new interconnectors to Poland and Sweden became operational. Such analysis would also need to compare the anticipated benefits of the reserve were the worst-case scenario to arise, and the costs of procuring the reserve. The Commission invites views on these points.

3.3.4. Appropriate instrument

3.3.4.1. Assessment for the period 2013-2014 under TFEU

88. Directive 2003/54/EC provided two options to ensure security of supply in the case of a market failure: first Member States should consider whether energy efficiency and demand response can solve the problem. Only if they cannot, Member States could turn to supply-side measures in the form of a 'tendering procedure or any procedure equivalent in terms of transparency and non-discrimination, on the basis of published criteria.'36

89. As explained above, Lithuania has identified a potential contribution of demand response but also explained that its active participation in the market requires further investments in metering and possibly amendments to market rules.

90. Rather than pursuing a non-discriminative procedure to fill the identified capacity gap, however, Lithuania unilaterally selected the LPP each year to provide the required generation service. There was no tender or other call for interest to establish whether alternative suppliers of capacity might have been able to provide the required service on more advantageous terms, thereby reducing the aid necessary to finance the measure. Lithuania has explained that it was not possible to open the measure to a competitive process involving other potential service providers because:

a. Generation quotas were necessary to ‘ensure 330 kV grid voltage regulation’, which required the LPP to generate a quota of electricity production;

b. The operation of LPP units was necessary ‘to ensure the dynamic stability of the electricity system in the event of a three-phase shortage’;

c. Without the LPP, it would be impossible to restart the power system after a crisis (ie. the LPP was required to provide black start services); and

d. The LPP was required because of the ‘possibility of overloads at BRELL system points’.

91. Lithuania has not however explained why the need for various ancillary services and the need to ensure against different security of supply problems could solely be

provided by the LPP, nor why other market participants (including complainants and potential new entrants) were incapable of providing all or part of the required services.

92. The production service required by the measure in 2013 and 2014 also meant that the beneficiary was obliged to generate a certain quantity of electricity each year. This subsidised electricity may have increased supply in the market beyond what the LPP would have produced anyway, thus displacing other sources of capacity not benefitting from the advantages of this measure. This may also have reduced market prices in Lithuania to the extent the subsidies led to excess electricity on the market and to the maintenance of the LPP in the market when it might otherwise have been mothballed or closed. The effect of this may have undermined the achievement of the common objective, since a reduction in market prices and the displacement of other capacity may have reduced incentives for investors in the market to maintain, reliably operate and build capacity that could contribute to security of electricity supply.

93. Based on the analysis above, the Commission has doubts on the design of the measure as distorting market price formation and that a more open and competitive alternative should have been considered in view of the requirements in relevant sectoral legislation. The Commission therefore has doubts about the appropriateness of the measure for the period 2013-2014.

3.3.4.2. Assessment for the period 2015-2018 under EEAG

94. EEAG Point 225 requires generation adequacy measures to solely remunerate availability (MWs), and not delivery (MWhs). This is to reduce the potential market-distortion of operating aid payments.

95. Until 31 December 2015 the measure involved payments per MWh for the established electricity generation quotas. From 1 January 2016 the payments per MWh were abolished and the measure evolved into a reserve involving payments for capacity (payments per MW/year).

96. In practice however, because of the dispatch rules meaning that even from 2016 the reserve was dispatched whenever market prices reached 60-80 EUR/MWh, the Lithuanian reserve had the potential to cause significant market distortion by effectively capping market prices. In this way, for its entire duration the measure may have prevented prices rising to the level needed to incentivise new investment in electricity capacity in Lithuania.

97. EEAG point 226 requires generation adequacy measures to be open to new and existing capacity, and to all technologies capable of providing the required service. As explained in Section 3.3.4.1, the measure was not open to any provider other than LPP. Lithuania has suggested that there was no other capacity available that could have delivered the required security of supply. It may also be argued that some other marginal capacity would have been insufficient because in any event the LPP would have been necessary to cover the residual need for the reserve. With the present decision, the Commission seeks clarity regarding these points.

98. Based on the analysis above, the Commission has doubts about the appropriateness of the measure for the period 2015-2018.
3.3.5.  *Incentive effect*

3.3.5.1.  Assessment for the period 2013-2014 under TFEU

99. State aid provides an incentive effect if the aid changes the recipient’s behaviour so that the objective of common interest is achieved. As explained in recital 73, competition from imports means that most of the domestic generation in Lithuania was uncompetitive. Lithuania has also explained that without the obligations on the LPP to meet generation quotas in 2013 and 2014, the plant would not have provided sufficient electricity to ensure various services essential to security of supply were delivered.

100. The Commission therefore concludes that the payments under the measure for generation quotas in 2013 and 2014 had an incentive effect.

3.3.5.2.  Assessment for the period 2015-2018 under EEAG

101. EEAG point 49 explains that the incentive effect occurs if the aid induces the beneficiary to change his behaviour towards reaching the objective of common interest, which it would not do without the aid.

102. Based on the analysis in Section 3.3.2.1, and the fact that from December 2015 the plant faced additional competition from imports from Poland and Sweden, the Commission concludes that for the years 2015-2018 the measure continued to have an incentive effect.

3.3.6.  *Proportionality*

3.3.6.1.  Assessment for the period 2013-2014 under TFEU

103. A State aid measure is proportionate if the aid as such is kept to the minimum required. This can be assured where the beneficiaries are selected in a non-discriminatory, transparent and competitive process. In the present case, the aid was conferred directly on the beneficiary. The level of remuneration was therefore not determined through a competitive process but set administratively. The Commission therefore needs to determine whether the aid was proportionate in the absence of a competitive process.

104. As shown in Figure 1, the amount of aid allocated under the measure varied considerably. In 2013, LPP was paid 136.5 million EUR for fulfilling a 900 GWh generation quota. In 2014, LPP was paid 77.6 million EUR for fulfilling a 900 GWh generation quota. In 2013 the aid amount was 151.67 EUR / MWh, and in 2014 86.22 EUR / MWh (and in 2015 the aid amount for the same service was 46 EUR / MWh). Lithuania has explained that these variations can be explained by the following factors:

a. Variations in gas prices;

b. Adjustments related to other years (ie. the payments in a specific year do not necessarily correspond only to services provided in that year, they could also include adjustments to correct for the recalculation of compensation due in other years);

c. Variations due to which units of LPP were in fact providing the required service each year;
d. Variations due to the size of the production quota (which determines the extent to which fixed costs are spread across the operating hours);

e. Variations due to inspection results of the NRA; and

f. Variations due to ‘different normative profit-setting principles’.

105. Lithuania has explained that the compensation provided to LPP reflects reasonable compensation for its costs but has not provided detailed calculations. Such calculations would for example compare the costs of the plant with its revenues from the electricity and ancillary services markets as well as aid under this measure and any aid from other sources including for example any aid granted to the plant under paragraph 2.8 of the accession treaty protocol mentioned in Section 2.3. Such calculations would be necessary to verify the proportionality of aid and the significant variation in aid levels over the years. On the basis of the information available at this stage, the Commission has doubts about the proportionality of the measure for 2013-2014.

3.3.6.2. Assessment for the period 2015-2018 under EEAG

106. EEAG point 228 requires beneficiaries to earn a reasonable rate of return. Point 229 explains that a competitive bidding process will normally ensure a reasonable rate of return, and point 230 requires that a measure should have built-in mechanisms to ensure windfall profits cannot arise. Finally, point 231 requires the price paid for availability should automatically tend to zero when there is sufficient capacity in the market.

107. In the present case there is no competitive bidding process and the level of aid is set administratively each year. For the period 2016-2018, the level of aid varied significantly, from 45 818 EUR / MW / year in 2016 to 127 358 EUR / MW / year in 2018, with the plant also eligible to receive revenue from the ancillary services and electricity markets. As for 2013 and 2014 (see Section 3.3.6.1), Lithuania has not provided detailed calculations allowing the proportionality of the level of aid granted to LPP for the production service in 2015, nor the reserve service in 2016-2018 to be verified.

108. It would also seem important to verify that the amount of compensation paid to LPP did not exceed the likely costs of installing new capacity in Lithuania (or eg. supporting new demand response capacity), since it would be disproportionate to pay LPP more than the costs of alternative capacity that would have been an alternative way to support the common objective.

109. The Commission therefore has doubts about the proportionality of the measure for 2015-2018 and welcomes views on the level of compensation paid and the estimated cost of new capacity in Lithuania.

3.3.7. Distortion of competition and balancing test

3.3.7.1. Assessment for the period 2013-2014 under TFEU

110. The distortion of competition and trade resulting from the State aid should be limited, so that the overall balance with regard to the objective of common interest is positive.
111. The granting of aid constitutes a financial advantage for the beneficiary compared to its competitors. Such an advantage is particularly distortive where it keeps inefficient firms afloat or where it reinforces existing market power and encourages exclusionary behaviour.

112. In its State aid decision on the Latvian tender for a new power plant the Commission examined the fact that the planned Latvian tender was designed to bring a new market entrant to the system. The decision found that ‘the aid will … bring more competition to the Baltic region, both by supporting a new generator as well as by promoting a new fuel type.’ In contrast, in this case the measure has for its full duration benefited only a single power plant owned by the incumbent electricity generation company in Lithuania. The lack of a competitive process means potential alternative providers of the service may have been excluded from the market.

113. Furthermore, as explained in Section 3.3.4 the design of the measure may have acted as a cap on market prices. In the short term, this may have reduced the market revenues available to other market participants, and foreclosed the market to alternative solutions including imports and demand response that might have provided security of supply instead of or in addition to the LPP. In the long term, this may have undermined investment signals for alternative capacity providers and strengthened the incumbent’s market position.

114. The Commission therefore doubts that the measure may on balance be considered compatible with the internal market despite its contribution to a common interest objective as it created undue distortions to competition and trade.

3.3.7.2. Assessment for the period 2015-2018 under EEAG

115. EEAG points 232 (a) and (b) require generation adequacy measures to allow for the participation of any capacity that can contribute to solving the problem, including demand response, storage, and foreign capacity. EEAG point 232 (c) requires generation adequacy measures to involve sufficient generators to establish a competitive price. This measure has for its entire duration been open only to the LPP. Lithuania has not brought forward arguments to explain why other capacity and other operators were not taken into account to ensure security of supply.

116. EEAG point 232 (d) requires generation adequacy measures to avoid capping wholesale prices. EEAG points 233 (a-c) require generation adequacy measures to maintain incentives to invest in interconnection, to maintain market coupling and not to undermine investment decisions in the market. As explained in Section 3.4, this measure is likely to have acted as a cap on market prices, which potentially undermined investment decisions including in interconnection and in alternative capacity sources. However, Lithuania has supported significant recent investment in interconnection.

117. EEAG point 233 (d) requires generation adequacy measures to not unduly strengthen market dominance. As the beneficiary of the aid was always Lietuvos Energija, the Commission has doubts that this provision is complied with because the measure may have strengthened the dominance (see Section 2.1.2) of Lietuvos Energija.

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37 Commission decision in case 675/2009, recitals 48 and 50.
EEAG point 233 (e) requires generation adequacy measures to give preference to low carbon generators. This measure supported only an oil- and gas- fired plant, and Lithuania has not provided any evidence that preference was given to low carbon generators.

Based on this analysis, the Commission doubts that the measure has been sufficiently well designed to avoid undue negative effects on competition and trade.

3.3.8. Transparency

EEAG Section 3.2.7 requires, from 1 July 2016, the publication of the various information relating to the granting of State aid for environmental protection and energy on a comprehensive State aid website.

Although this information is publicly available by looking at Lithuania’s registries of legislation and NRA decisions, the Commission is not aware of a comprehensive State aid website in Lithuania on which this information is available. The Commission therefore has doubts that this provision has been complied with since 1 July 2016.

4. CONCLUSION

At this stage, the Commission doubts that the Lithuanian PSOs for security of supply can be qualified as an SGEI compatible with Article 106(2) TFEU or is compatible with the internal market on the basis of Article 107(3)(c) TFEU. More specifically, it doubts whether the measure:

a. was necessary for the period 2015-2018, in view of the absence of any analysis justifying the need to achieve a reliability standard of zero hours LOLE, and in view of the lack of a detailed adequacy assessment establishing the size of the problem;

b. was appropriate for the period 2013-2018, in view of its restrictive eligibility requirements, and the way in which the design seems to have distorted market price formation and undermined potential market investment that may have contributed to security of supply;

c. was proportionate for the period 2013-2018, in view of its restrictive eligibility requirements, the lack of a competitive process to establish the aid level, and the lack of calculations justifying the proportionality of the aid level; and

d. sufficiently avoided negative impacts on competition and trade for the period 2013-2018, in view of its restrictive eligibility requirements benefitting only one plant owned by the incumbent generation company, and the way in which the design seems to have distorted market price formation and undermined market investment.

Information on aid granted after 1 July 2016 would also need to be published online.

In the light of the foregoing considerations, the Commission, acting under the procedure laid down in Article 108(2) of the Treaty on the Functioning of the European Union, requests Lithuania to submit its comments and to provide all such information as may help to assess the aid within one month of the date of receipt of this letter.
requests your authorities to forward a copy of this letter to the potential recipient of the aid immediately.

125. The Commission wishes to remind Lithuania that Article 108(3) of the Treaty on the Functioning of the European Union has suspensory effect, and would draw your attention to Article 16 of Council Regulation (EU) 2015/1589, which provides that all unlawful aid may be recovered from the recipient.

126. The Commission warns Lithuania that it will inform interested parties by publishing this letter and a meaningful summary of it in the Official Journal of the European Union. It will also inform interested parties in the EFTA countries which are signatories to the EEA Agreement, by publication of a notice in the EEA Supplement to the Official Journal of the European Union and will inform the EFTA Surveillance Authority by sending a copy of this letter. All such interested parties will be invited to submit their comments within one month of the date of such publication.

If this letter contains confidential information which should not be published, 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 publication of the full text of this letter.

Your request should be sent electronically to the following address:

European Commission,
Directorate-General Competition
State Aid Greffe
B-1049 Brussels
Stateaidgreffe@ec.europa.eu

Yours faithfully
For the Commission

Margrethe VESTAGER
Member of the Commission