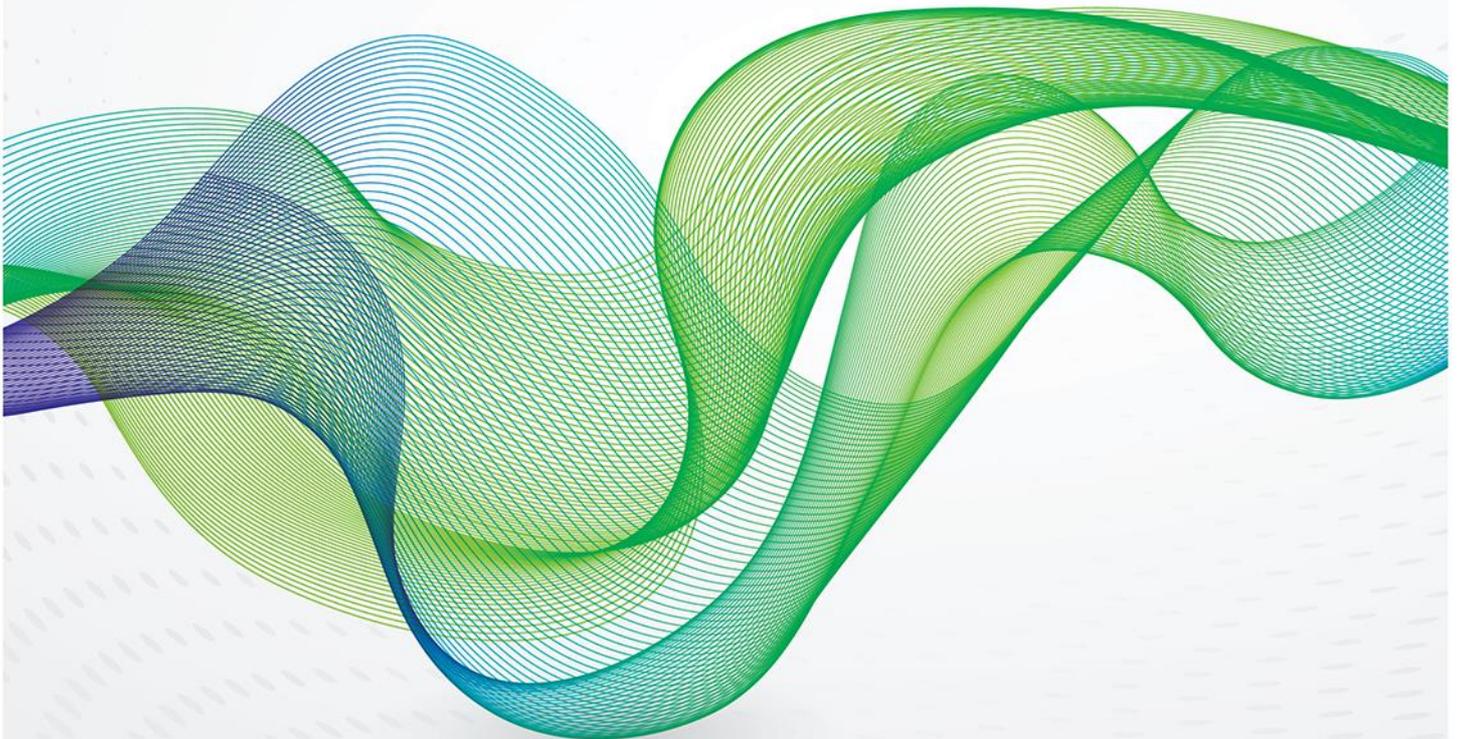
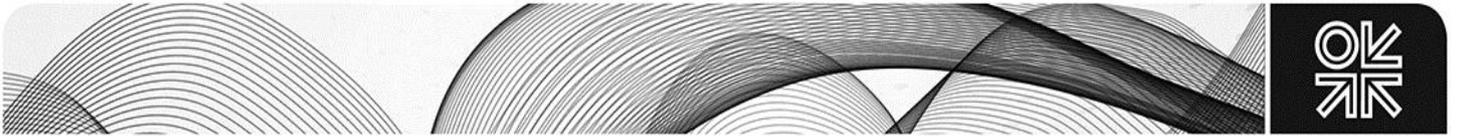


August 2014

National support for renewable electricity and the single market in Europe:

the Ålands Vindkraft case





Introduction – the *Ålands Vindkraft* case

The case was referred by the Swedish courts to the European Court of Justice for a preliminary ruling on the interpretation of Directive 2009/28/EC on the promotion of the use of energy from renewable sources (the Renewables Directive), and of Article 34 of the Treaty on the Functioning of the European Union (TFEU), prohibiting import restrictions and measures having an equivalent effect.

This request related to proceedings between the Swedish Energy Agency and *Ålands Vindkraft*, a Finnish energy company, following the agency's refusal to authorize the grant of renewable certificates to a wind farm located in the Åland archipelago in Finland, and operated by *Ålands Vindkraft*. The Åland archipelago is a Swedish-speaking semi-autonomous part of Finland and has a grid connection to Sweden but not to Finland. However, Sweden declined to offer support for a wind farm in Åland – on the grounds that it would be unfair to expect Swedish consumers to pay for meeting Finland's wind power target. This raised the question of whether national support schemes can discriminate against producers from other Member States and whether that is an unjustifiable barrier to the free movement of goods.¹ In the main case on the issue, the *PreussenElektra* case of 2001, a German feed-in tariff was not regarded as a trade barrier 'in the current state of Community law concerning the electricity market'.² However, some of the details of the *Ålands Vindkraft* case are different and, in any event, it is arguable that things have moved on significantly since 2001, with the move towards a single EU market in electricity.

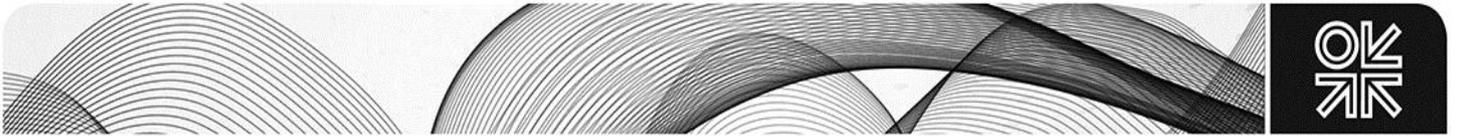
The general background is that EU Member States have established national support systems for renewables in order to fulfil national targets consistent with the overall target set by the second Renewables Directive (2009), of reaching 20 per cent of renewable energy in European gross consumption in 2020. To achieve its national goal, Sweden opted for a renewable certificate system for electricity, rather than a feed-in tariff. Under this scheme, the Swedish Energy Agency awards approved producers an electricity certificate for each megawatt-hour of green electricity produced. Swedish law then imposes an obligation on electricity suppliers and certain users to hold, and to surrender to the State each year, a certain number of certificates corresponding to a proportion of the total quantity of electricity supplied or consumed during the preceding year. Those certificates can be purchased on an open competitive market where price is defined by the interplay of supply and demand.

Article 5 of Sweden's 2011 Electricity Certificates Act, referred to in the ECJ ruling as the 'Swedish Law of 2011', provides that 'electricity certificates which have been awarded for the production of renewable electricity in another State may be used to fulfil a quota obligation under the present Law, provided that the Swedish electricity certificate scheme has been coordinated with the electricity certificate scheme of that other State by an international agreement'. However, although there is no express mention of any domestic criterion in the wording of the Swedish law, it is in practice interpreted by Swedish authorities as reserving the system to green electricity production installations located in Sweden, in the absence of international agreements. As the referring court pointed out, 'the approval of installations located outside Sweden is...impossible' (para. 12) without an international agreement between Sweden and the State in which the green electricity is produced.³ Since no such agreement exists between Sweden and Finland, it was impossible for *Ålands Vindkraft* to be awarded electricity certificates.

¹ In the context of internal taxation, the earlier case of *Outokumpu* (1998) showed that discrimination against a significant category of electricity imports would indeed be caught by EU law.

² Discussed in Johnston & Block, *EU Energy Law* (2012), paras. 12.151–12.172.

³ Such an agreement now exists between Sweden and Norway (concluded after the facts at issue in the *Ålands Vindkraft* case under discussion here, and in any case not covering Finland).



Ålands Vindkraft argued that the Swedish law constituted an infringement of Article 34 TFEU, because it has the effect that a significant proportion of the Swedish electricity market is reserved for national green electricity producers. More specifically, even though the Swedish law does not link the sale of electricity certificates to any physical transfer of electricity, the system indirectly encourages the production of domestic electricity, because suppliers have an additional incentive to acquire electricity from Swedish producers, given that the latter are able to provide them with the corresponding certificates. *Ålands Vindkraft* argued that this barrier to trade could not be justified on the grounds of environmental protection, since the consumption of green energy in Sweden would be promoted just as effectively through the award of electricity certificates for green electricity *consumed* in Sweden but *produced* somewhere else.

The Swedish authorities countered that their approach was covered by the Renewables Directive (specifically point (k) of the second paragraph of Article 2 of Directive 2009/28/EC and Article 3(3), reinforced by recital 25⁴). Before considering the Article 34 TFEU point, the ECJ had, therefore, to determine whether the Swedish law was justified by the wording of the directive.

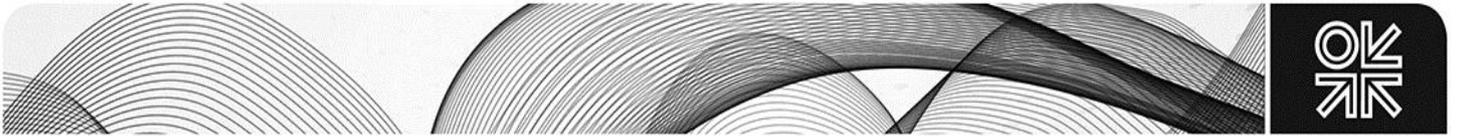
The Renewables Directive and the Swedish mechanism

Both the advocate general and the ECJ largely upheld the position of the Swedish authorities in this respect. The ECJ noted that the Renewables Directive allows Member States to create support schemes such as the Swedish mechanism and that it assumes that most support schemes apply only to domestic electricity production. Article 3 of the directive, for example, provides Member States with the right to decide ‘to which extent they will support energy from renewable sources that is produced in another Member State’. However, the advocate general went on to conclude that the relevant provisions of the Renewables Directive – which had been relied upon to justify the discriminatory national measure – were themselves an unjustifiable restriction upon free movement of goods and thus should be invalidated as contrary to Article 34 TFEU. The ECJ declined to reach such a conclusion, as discussed further below.

In short, the implication is that the Renewables Directive does not enforce a Europe-wide system. It permits, but does not require, the possibility of extending national support systems beyond national borders. Only via an international agreement, in the form of a cooperation mechanism provided for under the directive, could a Member State recognize green energy produced in another Member State.

There is a paradox here: the Renewables Directive allows Member States to establish discriminatory support schemes for renewable energy, but this is inconsistent with the wider principle of the free movement of goods, as protected by Articles 34 and 35 TFEU. Normal practice is that the primary (treaty-based) principle would prevail (in that the treaty overrides a directive) and on this basis Advocate General Yves Bot argued for the invalidation of Article 3 of the Renewables Directive.

⁴ Which reads, insofar as material: ‘[i]n order to ensure the effectiveness of both measures of target compliance, i.e. national support schemes and cooperation mechanisms, it is essential that Member States are able to determine if and to what extent their national support schemes apply to energy from renewable sources produced in other Member States and to agree on this by applying the cooperation mechanisms provided for in this Directive.’



A restriction on the free movement of electricity

However, the ECJ did not follow this reasoning, despite accepting that the provisions concerned amounted to a restriction on trade - Articles 34 and 35 TFEU prohibit all kinds of import or export restrictions and measures having an equivalent effect. Since electricity has been recognized as a good within the meaning of Articles 34 and 35 TFEU, it should also circulate freely in the market. Incentives to consume domestic rather than imported goods are regarded as import restrictions. The ECJ therefore considered that the Swedish mechanism did constitute a measure having an equivalent effect to quantitative restrictions on imports, and thus required justification under EU law.

The environmental justification for the restriction

Nonetheless, the ECJ considered that the restriction was justified, apparently on environmental grounds – but there is some uncertainty about the exact basis of this reasoning. It is clear that some exemptions from freedom of movement are allowed. Broadly, they fall into two categories: there is a list of ‘public interest grounds’ in Article 36, which includes such goals as the protection of ‘life and health of humans, animals and plants’; and in addition, the ECJ’s case law has added ‘overriding’ or ‘mandatory requirements’ (*Cassis de Dijon*).⁵ These objectives include environmental goals and it has been agreed that ‘the protection of the environment is a mandatory requirement which may limit the application of [current Article 34] of the Treaty’.⁶ Nonetheless, it is the specific list of public interest grounds which is in principle the only way of justifying *discriminatory* barriers to trade.⁷ Mandatory requirements are only a justification for trade barriers when the measure in question applies without distinction to both national and imported products.⁸ Logically, this is because the notion of a mandatory requirement was developed as part of the definition of what amounts to a measure having equivalent effect to a quantitative restriction under Article 34 TFEU, stemming from the judgment in *Cassis de Dijon* and its limitation of the use of such mandatory requirements to ‘indistinctly applicable’ (that is only indirectly or non-discriminatory) national rules. Otherwise, the ECJ would face the criticism that it was unilaterally making amendments to the treaty by adding extra express grounds of justification to the list contained in Article 36 TFEU.⁹

This is why it would be helpful to clarify how the ECJ viewed the restriction in the *Ålands Vindkraft* case. In practice, its judgment was in broad terms. On the one hand, it pointed to mandatory requirements such as the Swedish mechanism’s contribution to the protection of the environment ‘inasmuch as it contributes to the reduction of greenhouse gas emissions’ (para. 78), its compliance with the implementation of the international conventions to which the Community is party (such as the Kyoto Protocol: para. 79), and its contribution to EU energy policy (para. 81). But it also referred to the ‘public interest grounds’ including, perhaps surprisingly, the effect in protecting the health and life of humans, animals, and plants. But the ECJ did not indicate which of those reasons amounted to the justification for the discriminatory measures at issue, nor if there is any hierarchy between them.

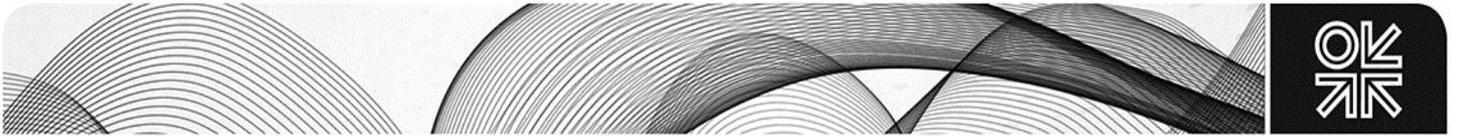
⁵ Case 120/78 *Rewe-Zentral AG* (*‘Cassis de Dijon’*) [1979] ECR 649.

⁶ Case 302/86 *Commission v. Denmark* [1988] ECR 4607, para. 9.

⁷ See Case C-353/89 *Commission v. Netherlands* [1991] ECR I-4069, para 15: discriminatory measures “are compatible with Community law only if they can be brought within the scope of an express exemption”.

⁸ See Joined Cases C-1/90 and C-176/90 *Aragonesa de Publicidad Exterior SA* [1991] ECR I-4151.

⁹ For discussion, see Johnston *et al*, ‘The Proposed New EU Renewables Directive: Interpretation, Problems and Prospects’ (2008) 17(3) *EEELRev* 126, 131-137.



This uncertain reasoning has appeared in previous decisions, such as the *PreussenElektra* case, and has led to criticism that the ECJ has created ‘confusion and legal uncertainty for economic operators and national courts’ as well as raising a number of questions, such as: ‘to what extent can discriminatory measures be justified on grounds not contained in Article 36?’¹⁰

Proportionality

Last but not least, the ECJ had to determine whether the restriction to trade in question was proportionate – i.e. was it appropriate for ensuring attainment of the objective pursued and did it go beyond what was necessary to attain that objective? Advocate General Bot had argued that the discriminatory condition that the Swedish legislation is based upon should lead the ECJ to perform a particularly rigorous proportionality test.¹¹

In this respect, the ECJ introduced its analysis by mentioning the review of proportionality that it undertook in the *PreussenElektra* case. This was somewhat surprising, given that in that case the ECJ qualified its judgment by reference to the circumstances of the time, concluding that ‘in the current state of Community law concerning the electricity market, legislation such as [the German Law] is not incompatible with [what is now Article 34] of the Treaty’.¹² It is therefore a little odd that the approach in *PreussenElektra* was not reconsidered in the light of the development of the single market for electricity.

As to proportionality overall, as the advocate general pointed out: ‘whilst it is easy to accept that green certificate schemes contribute to environmental protection by stimulating the production of green energy, it would appear somewhat paradoxical to assert that the importation of green energy from other Member States might undermine environmental protection’¹³.

This argument was not accepted by the ECJ, which confirmed its *PreussenElektra* reasoning that, ‘as EU law currently stands, such a territorial limitation may in itself be regarded as necessary in order to attain the legitimate objective pursued in the circumstances, which is to promote increased use of renewable energy sources in the production of electricity’ (para. 92). It also argued that ‘it is primarily at the production stage that the environmental objectives in terms of the reduction of greenhouse gases can actually be pursued’ (para. 95), which seems inconsistent both with the overall EU goal (expressed in terms of consumption not production) and with the system of guarantees of origin which allows power to be certified as green across Europe.

Next steps: a European electricity market or 28 national markets?

In short, the ECJ judgment on the *Aländs Vindkraft* case seems to raise more questions than it answers concerning the place of environmental protection within the framework of European energy market law. It also fails to go any way towards resolving, and may even exacerbate, the tensions between the European internal market in electricity and national support schemes. Earlier Comments have drawn attention not just to the tensions themselves but also to the distortions that they introduce in European markets¹⁴ by mixing subsidized and unsubsidized sources in the same market. As the share of renewables in the EU’s energy, and particularly

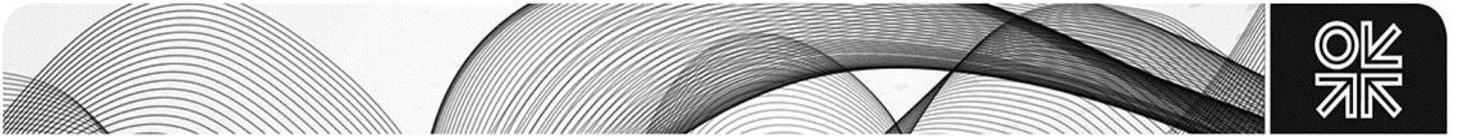
¹⁰ Johnston & Block, *EU Energy Law*, Oxford University Press 2012, p. 344.

¹¹ Opinion of AG Bot, op. cit., para. 79; AG Jacobs had taken a similar approach in his Opinion in *PreussenElektra* some 13 years previously: see the discussion in Johnston *et al*, op. cit..

¹² *PreussenElektra* case, op. cit., para. 81.

¹³ Opinion of AG Bot, op. cit., para. 93.

¹⁴ Malcolm Keay, *The EU Target Model for Electricity Markets*, OIES Energy Comment May 2013



electricity, mix increases, the tensions and distortions can also only increase. With 28 Member States operating 28 different national support schemes, mostly confined to domestic production, it will be increasingly difficult to argue that there is a level playing field for competition across Europe.

Already, there are moves across Europe for the introduction of capacity markets and mechanisms, in practice on a different basis in each country, in the interests of security and reliability in markets with a growing share of renewables. An increasing number of plants are therefore being remunerated not just by revenue from electricity markets but by income from the various different government schemes for rewarding capacity or investment in low-carbon sources. In the UK, for instance, it seems likely that nearly all plants will in future get some or most of their income either from feed-in tariffs or from capacity payments, which have been designed around largely UK rather than EU objectives.

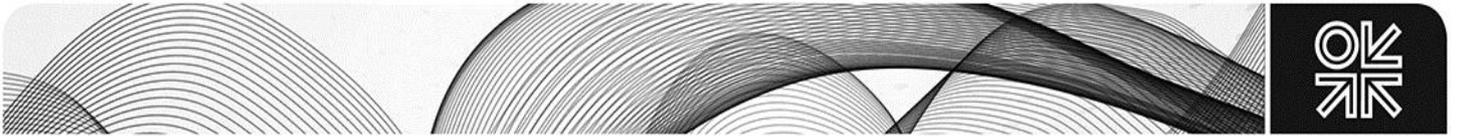
The result is that the energy-only market, which forms the basis of trading within Europe, will increasingly represent only a part (and a different proportion in each country) of the overall revenues received by each plant. Producers in different countries will therefore be in different positions, and responding to different economic signals, leading to behaviour which would not be possible in normal markets. It is already the case, for instance, that in times of surplus generation from German renewable power producers, that power is effectively 'dumped' on adjacent markets. The risk is that the whole European market is turning into little more than a residual mechanism for dealing with intermittent generation, while the driving force is the various government schemes for investment: that is to say the market will in effect become one big dumping ground. As long as different national schemes of support are being offered on a discriminatory basis, it is difficult to see how this outcome can be avoided without major market reform or a change in the basis of investment support.

National governments are prepared to live with this situation, in the short term at any rate. They do not want to subsidize non-national producers and, in most cases, have not woken up to the fact that underlying electricity markets are effectively broken. There is little appetite across Europe to unpick the whole existing system of renewables support, which might have been the consequence of a different outcome to the *Ålands Vindkraft* case. Nonetheless, the current situation appears unsustainable, and it becomes increasingly difficult to believe in a level playing field for competition in the face of both the continuing growth of renewable power, under national support schemes, and the increasing development of capacity mechanisms and other market interventions at national level.

The Commission recognizes the problem and is trying to move renewables targets, and support, on to a more harmonized European basis (whether via positive legislation, such as a third renewables directive, or through exercising its function under EU State aid law), as well as to harmonize the approach to capacity mechanisms. The problem is that its proposals for the overall way forward in this area are unconvincing in themselves, and unlikely to be workable in practice.¹⁵ The *Ålands Vindkraft* judgment risks complicating the process further – if there is uncertainty about how far basic principles of European law like non-discrimination and the free movement of goods apply, it is difficult to see on what basis the Commission can persuade Member States to take a more harmonized approach, especially if it is attempting to use an as yet untried system based essentially on negotiation with individual Member States.

Already Member States have been using the *Ålands Vindkraft* judgment as justification for discriminatory practices. For instance, Germany has been in discussion with the Commission about its new renewable energy law, under which consumers have to pay a surcharge on electricity, both domestic and imported, but revenue from the surcharge is used only to finance domestic renewable electricity producers. The Commission has argued that this means that imported electricity may be disadvantaged and made comparatively more expensive.

¹⁵ David Buchan and Malcolm Keay, *The EU's New Energy and Climate goals for 2030*, OIES Energy Comment January 2014



Both sides have referred to the *Ålands Vindkraft* ruling: for Germany, economy minister Sigmar Gabriel welcomed that ruling, saying it had removed any lingering EU obstacles to Berlin's renewable energy law,¹⁶ while the Commission argues that the Swedish case is distinct from the situation in Germany.

It seems that the judgment in the *Ålands Vindkraft* case has compounded the uncertainties about the balance between environmental imperatives and the free movement of electricity. But since the 'takeaway' message from the ruling is that, in relation to renewable electricity, environmental considerations trump other principles of European law, it is likely to make the Commission's negotiating position more difficult as it tries to develop a more harmonized system of support; and that is before it may be forced to grapple with the uncertainties engendered by the wording of the likely legal basis for such legislation, Article 194 TFEU.¹⁷

A sort of chicken and egg situation seems to have developed whereby 'the current state of [EU] law concerning the electricity market' is used as a justification for retaining the *status quo*, which in effect suggests that the current state of the law justifies the current state of the law. This sets up a sort of impasse making it difficult for the electricity market to develop on the same basis as other markets across the EU, and it seems likely that it will remain something of an anomaly – outside the normal system of barrier-free trade, for reasons which remain obscure. As the market distortions arising from national schemes of support can only increase, the chances of reaching the EU's central goal in this area – a true single market for electricity across Europe – recede.

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¹⁶ Reuters 3 July 2014, <http://www.reuters.com/article/2014/07/03/eu-energy-idUSL6N0PE24C20140703>

¹⁷ On which see Johnston & van der Marel, *Ad lucem?* Interpreting the New EU Energy Provision, and in particular the Meaning of Article 194(2) TFEU, (2013) 22(5) *EEELRev* 181.