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Austria and Luxembourg Will Challenge Hinkley Point C State Aid

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Following an 11-month investigation into UK support for the Hinkley Point C nuclear project, the European Commission (the “Commission”) approved a modified UK support package on 8 October 2014.

Austria announced this Tuesday that it will launch its appeal on Monday 29 June challenging the Commission’s clearance decision before the General Court of the European Union. Luxembourg has stated that it will join Austria’s appeal. Germany has announced that, following a thorough analysis of the Commission’s State aid decision, it will not join the appeal.

State aid appeals can last six years or more. During this period the Commission’s decision would be presumed to be lawful. At this stage the appeal appears unlikely to succeed. Even if the appeal is successful, the Commission could conduct another investigation (lasting at least six months) and reach a substantively identical decision. In the unlikely event that the Commission, after an appeal and second investigation, concludes that the aid is illegal, the relevant aid would need to be returned to the UK Government with significant ramifications for investors and financiers of Hinkley Point C.

Background and the Hinkley Point C Decision

In December 2013, following notification by the UK Government of its proposed support to the Hinkley Point C project, the European Commission decided to initiate an investigation under the EU’s State aid rules. EU State aid rules essentially prohibit

EU Member States from using public money to benefit individual businesses or sectors, absent advance approval by the Commission.

During its 11-month investigation the Commission expressed “serious doubts” that the Hinkley Point C project needed government support at all, and even if it did, the Commission considered the strike price overly generous.

In response, the UK government agreed to modify its planned support by:

- raising its guarantee fee significantly, reducing the subsidy by more than £1 billion (€ 1.3 billion); and
- requiring that profits exceeding set thresholds be shared with the granting UK public entity. The UK Government extended the term of this profit sharing mechanism to the entire 60 year lifetime of the project rather than just 35 years as initially envisaged.

Despite these modifications, the fundamental elements of the UK financing support package (the credit guarantee, the proposed strike price(s) and the 35-year period of the Contract for Difference) have remained intact, allowing EDF (the parent company) to demonstrate reliable revenues for a sufficiently long period to support debt financing.

Granting approval on 8 October 2014, the Commission stated that with these modifications the UK authorities have reduced the UK financial contribution to the project while demonstrating that the State aid would address a genuine market failure. This market failure is caused by the need for replacement low carbon generation capacity and the unprecedented nature and scale of the Hinkley Point C project, which would otherwise be unable to obtain financing. The Commission also noted that the State aid provided was proportionate to the objective pursued and avoids any undue distortions of competition in the EU internal market. Importantly, the Commission also reaffirmed the Treaty right of the EU Member States to determine their own energy mix.

The Appeal

Austria and Luxembourg announced separately that they will appeal the Commission’s clearance decision to the General Court of the European Union. The UK Government reacted robustly to this – threatening to retaliate against Austria by challenging Austrian rules regarding electricity source labeling, by pushing for Austria to bear a greater burden in the EU’s transition to a low carbon economy and by considering whether Austria’s appeal constitutes a breach of the Euratom treaty on nuclear power. Although the German Government has decided against joining the appeal, the opposition parties Bündnis90/Die Grünen and Die Linke have petitioned the German Government to join the appeal of Austria and Luxembourg. It is unlikely that the German Government will now join the appeal.

Litigation before the General Court is a drawn-out process: the average duration of State aid cases completed in the General Court in 2014 was approximately 32 months. Cases can and do last much longer (the average length of cases completed in 2013 was 48 months). An appeal of a ruling by the General Court to the Court of Justice (the EU’s highest court) would add at least 14-24 months to the proceedings. There is no requirement to be granted leave in order to appeal to the Court of Justice.

The Appeal is Unlikely to be Successful

The Commission will be the defendant in the appeal, and will be obliged to defend its clearance decision. The Commission has a very good track record of successfully defending State aid decisions in the Courts – particularly those such as Hinkley Point C that have gone through the full investigation procedure. While the UK Government will not have a formal role in the proceedings, it will be entitled to apply to the Court to intervene in the proceedings in favor of the Commission, and we assume that it would do so.

There are few public details of how Austria and Luxembourg will frame their case. The appeal may challenge whether there is a genuine market failure in nuclear power, which is a mature technology, or whether details of the reasoning

are irrational or unsupported by the evidence. The appeal may also question whether the aid constitutes illegal operating aid, whether it distorts competition and whether it is compatible with the internal market. The Austrian Government states that the appeal is an opportunity for a more intense discussion in the EU of the costs of nuclear energy and is also a sign of support to those countries that have exited nuclear power. Even once filed, Austria's and Luxembourg's pleadings will be confidential (unless they choose to publish them).

Austria's and Luxembourg's challenge faces a number of very material difficulties:

- Austria's opposition to nuclear power and belief that State aid should not be available for it is a political choice it is entitled to make for its own territory, but it is not legally relevant in the context of Hinkley Point C. Compatibility of State aid is a judgment for the Commission exclusively.
- The Commission conducted a full investigation using established procedures lasting almost a year, during which Austria and Luxembourg were able to voice their objections. The Court very rarely accepts procedural complaints following such a full and thorough investigation and there do not appear to be material procedural criticisms Austria or Luxembourg could make.
- There is no applicable guidance on State aid for nuclear power (mostly as a direct result of opposition from Member States, including Austria). As a result, there are no specific substantive assessment criteria against which the Commission's analysis can be accused of having fallen short. This gives the Commission even greater discretion in making its substantive assessment. The Court would need to determine that the Commission committed manifest errors of assessment. Privately we understand both UK Government and Commission officials consider the prospects of the appeal by Luxembourg and Austria to be low.

Impact of a Successful Appeal

While the prospect of success is low, even a small chance of success creates additional risk for project financiers. If the challenge is successful, following a possible appeal to the Court of Justice to the European Union, the Court would annul the Commission's decision and refer the matter back to the Commission for reconsideration.

The Commission would be required to conduct a second full investigation taking into account the Court judgment. While there is no time limit for the Commission to conduct its investigation, a second investigation would last at least six months. During this period, the Commission in theory could (although in practice is unlikely to) suspend aid implementation and require that aid already granted be transferred by the beneficiary into escrow.

In a worst-case scenario, where the Commission makes an adverse decision, the UK Government's support scheme – including the strike price and guarantee – would be ruled unlawful and unenforceable, with any aid already received having to be repaid. A competitor or other party with standing could apply to the UK national court to enforce this.

While this outcome is the least likely, it may have a severely adverse impact on investors in the Hinkley Point C project. Investors would have to carefully analyse and predict the potential for State aid enforcement (also called recovery). There are many hurdles to enforcement, and for it to actually occur would require the cooperation of the Commission, the UK Government and the UK Courts. This is a complex area where investors would need a detailed understanding of their options in such a scenario.

As a general matter, however, investors may find insuring themselves contractually (e.g., via indemnities or similar means) difficult. Any provision seeking protection from the UK Government for such an eventuality could itself risk being struck down as unlawful State aid. Either way it is clear that other nuclear project sponsors and investors face a number of complex State aid issues in progressing projects in the EU which can have major implications for project economics. Planning for how to handle these State aid issues should be at the heart of subsequent projects.

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This memorandum is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

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