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Ukraine: AMC Sector Inquiry Gives Guidance on State Support Measures in Energy Sector

Sergiy Glushchenko (Asters) · Wednesday, April 26th, 2017

On 30 December 2016, the Antimonopoly Committee of Ukraine (AMC) published a report on its inquiry into State support measures in the energy sector. With a 2 August 2017 deadline just around the corner, the report provides timely information on possible State aid issues in the Ukrainian coal and related energy sectors.

In particular, while currently the Ukrainian authorities are free to assist the energy sector in any way, from 2 August 2017 onwards the Ukrainian State aid rules will be applicable in line with the general approach of the relevant EU rules. Thus, the Ukrainian authorities should take careful account of the highly restrictive State aid rules that apply in this sector, as many of the measures awarded by them in this sector will not be allowed after 2 August 2017.

In this respect, the results of the inquiry show that almost half of the measures studied by the AMC may be qualified as State aid under the EU rules (let alone contravene these rules). The report also points out that the AMC was unable to adequately assess nearly a third of the measures covered by the inquiry because of complex over-regulated nature of the sector and lack of cooperation from certain state authorities. Unless these measures have expired or are repealed before August 2017, they will have to be notified to the AMC for closer assessment.

Background

On 1 February 2011, Ukraine became a member of the Energy Community Treaty agreeing that any public aid which distorts or threatens to distort competition by favouring certain companies or certain energy resources is prohibited and shall be assessed on the basis of criteria arising from the application of the EU State aid rules.

In April 2014, the Secretariat of the Ministerial Council of the Energy Community initiated Case ECS-8/14 against Ukraine because it had failed to fulfil its obligations under the Energy Community Treaty by not adopting and implementing legislation prohibiting State aid. To settle the dispute, with the assistance of an EU-funded project, the AMC initiated a pilot State aid inventory on energy.

In particular, the inquiry focused on laws and regulations in force in 2014-2015 which envisaged State support measures to undertakings active in the Ukrainian energy sector. The AMC discovered 26 State support measures in coal, electricity and gas industries, which are discussed below in turn.

1. Coal

Out of 6 state support measures analyzed by the AMC in coal industry, 4 were found to have characteristics of State aid under the EU rules, including

(i) financial support for the liquidation of State-owned coal mines,
(ii) partial coverage of the cost of production of clean products by coal and peat-mining companies,
(iii) improvement of health protection and labour safety standards in coal-mining companies, in particular, through installation of modern air control and de-gassing devices in mines, and
(iv) assistance to coal and peat-mining companies in construction of additional production capacities.

On 1(i) above, the essential concern of the AMC is that the Ukrainian laws do not perfectly mirror those in the EU. Namely, in Ukraine, financial support for the liquidation of State-owned coal mines is not necessarily subject to definitive closure of the mines and may be granted even without the proper 'closure plan'.

On 1(ii)-1(iv), these measures are generally directed towards supporting the profitability and operational needs, while in the EU this is not allowed in the coal mining context.

The AMC insisted that the above measures are repealed or re-designed to meet the EU requirements.

2. Electricity

Out of 15 state support measures analyzed by the AMC in electricity sector, 6 were found to have characteristics of State aid under the EU rules, including

(i) the programme for energy efficiency and development of energy production from renewable energy sources and alternative fuels,
(ii) the programme promoting energy saving through making loans more affordable,
(iii) compensation for losses generated from supplies of electricity to preferential customers at a regulated tariff,
(iv) the preferential tariffs on supply of electricity for production needs of certain electro-metallurgical companies,
(v) the regulated retail tariff for supply of electricity to selected mining companies,
(vi) payments to certain electricity generating companies for implementation of laws and decisions of the Cabinet of Ministers of Ukraine, bad debt repayment.

The AMC has concluded that measures (iii) and (iv) contravene the EU rules and have to be either repealed or re-designed. Namely, aid to electro-metallurgical companies is an operating scheme and was not developed to create jobs, protect environment or promote commercial research and innovation. Same with (iv) – the AMC reiterated that this measure was granted neither for closing uncompetitive mines nor for 'horizontal' development purposes.

As far as (iii) is concerned, the AMC clarifies that this measure may constitute State aid. However, reasonable compensation for losses generated from electricity supplies to preferential customers at a regulated tariff will not amount to State aid if such supplies qualify as services of general economic interest (something which is still to be done by the Cabinet of Ministers of Ukraine).

Finally, the AMC has concluded that measures (i)-(ii) and (vi) above may also be considered State aid, as they have an element of discretion by the awarding authorities, which may result in certain companies benefiting more than others. Still, due to lack of information, the AMC refrained from finding these measures incompatible with the EU rules and encouraged their providers to notify them after 2 August 2017 for more thorough analysis.

6 out of 15 measures were allocated by the AMC to so called 'grey zone', as complex nature of over-regulated energy sector proved it hard to conclude whether such measures constitute State aid at all. These include various measures from cross-subsidisation in energy generation & modernization of the energy fleet to tax benefits & state guarantees. For example, the AMC has found that one of the measures provides for 80% tax relief for income derived from sale of certain renewable energy-related goods. The AMC further suggested that there may be some element of selectivity in the process of qualifying for this support. 'Grey zone' measures will also be notified to the AM? after 2 August 2017 for an extra assessment.

3. Gas

Out of 5 State support measures analyzed by the AMC in gas sector, one can be treated as State aid in the EU, the AMC believes. This measure relates to the decision of the Cabinet of Ministers of Ukraine to create stabilizing reserve of gas in Ukraine, where certain amount of its capacity is held outside the market to be called upon when needed. For this purpose, EBRD provided a USD 300 million loan to National Joint Stock Company "Naftogaz of Ukraine" secured by 100% state guarantee.

Here, the AMC explains that the benefit of a State guarantee is that the risk associated with the guarantee is carried by the State. Such risk-carrying by the State should normally be remunerated by an appropriate premium. In the current case, however, the State forgoes such a premium and there is both a benefit for the undertaking and a drain on the resources of the State, which means that such guarantee amounts to State aid to NJSC "Naftogaz of Ukraine". This measure will have to be notified to the AM? after 2 August 2017 to assess whether it is compatible with the EU rules.

Conclusion

With the 2 August deadline fast approaching, it was timely for the AMC to increase 'State aid awareness' in relation to the most 'sensitive' sector of Ukraine's economy.

In this respect, the report serves its purpose and demonstrates risks for coal and electro-metallurgical investments in Ukraine due to forthcoming state aid rules. Namely, in accordance with the report, many measures in the Ukraine energy sector that do not comply with the EU State aid rules and have to be either repealed or re-designed in the foreseeable future. These include measures supporting the closure of uncompetitive mines and certain operating aid in coal and electricity sectors.

Based on the report, we can also forecast many notifications of various State support measures to the AMC after 2 August 2017. In particular, the authority was unable to conclude whether some of the measures covered by the inquiry constitute State aid, and if so, whether such an aid is incompatible with the EU rules. Consequently, unless these measures have expired or are repealed before August 2017, they will have to be notified to the AMC to face further scrutiny.

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