

# Article 106(2) or Article 107(3) TFEU? The Compatibility of State Aid for Security of Supply Projects with the EU's *acquis*: A Vision from Energy Community Contracting Party

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## I. Introduction

'Security of supply' has become one of the most important issues in EU energy law and is nowadays an integral part of the strategy of the EU's Energy Union.<sup>1</sup> In many cases, it also used to be an important argument for derogations from the EU's rules on competition on the internal market. Moreover, both Directive 2009/73/EC<sup>2</sup> (hereinafter the 'Gas Market Directive') and Directive 2009/72/EC<sup>3</sup> (hereinafter the 'Electricity Market Directive') recognise security of supply as a basis for the imposition of public service obligations (PSOs) on undertakings operating on these markets. Despite this, EU legislation does not lay down any across-the-board definition of the meaning of security of energy supply. Moreover, there are no explicit criteria that clarify the cases in which a measure of state support to certain undertakings to guarantee security of supply falls within the scope of the derogations provided for in Article 106(2) of the Treaty on the Functioning of the European Union (TFEU) or Article 107(3) TFEU.

In the absence of a single definition of security of supply, one may observe diverging views among EU Member

## Key Points

- There are no explicit criteria by which to clarify the scope of application of Articles 106(2) and 107(3) Treaty on the Functioning of the European Union as legal basis for compatibility of state aid with the EU internal market.
- The issue of security of energy supply in relation to state aid appears extremely complex, since no single definition of the concept of security of energy supply exists under EU law.
- This situation has the potential to give rise to ambiguity in respect of the justification of state aid for security of supply projects and to hinder the development of energy markets.
- Ukraine's state aid for the gas market offers a useful
- case study that illustrates the application of these provisions on example of the Energy Community's Contracting Parties, who are obliged to implement the EU *acquis* in relation to energy and competition.

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1 The EU Energy Union strategy, initially articulated in Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee, the Committee of the Regions and the European Investment Bank, A Framework Strategy for a Resilient Energy Union with a Forward-Looking Climate Change Policy, COM/2015/080 final, has now been enacted in Regulation (EU) 2018/1999 of the European Parliament and of the Council of 11 December 2018 on the Governance of the Energy Union and Climate Action, amending Regulations (EC) No. 663/2009 and (EC) No. 715/2009 of the European Parliament and of the Council, Directives 94/22/EC, 98/70/EC, 2009/31/EC, 2009/73/EC, 2010/31/EU, 2012/27/EU, and 2013/30/EU of the European Parliament and of the Council, Council Directives 2009/119/EC and (EU) 2015/652 and repealing Regulation (EU) No. 525/2013 of the European Parliament and of the Council, OJ L 328, 21.12.2018, pp. 1–77. This regulation recognises energy security, including a security of supply, as constituting one of the five main dimensions of the EU Energy Union.

2 Directive 2009/73/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC (OJ L 211, 14.8.2009, p. 103).

3 Directive 2009/72/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC (OJ L 211, 14.8.2009, p. 64).

States as to the policy required to ensure it.<sup>4</sup> This fact may also complicate the harmonisation of the application of security of supply justifications for derogations from state aid rules. Among other spheres, the hydrocarbons seem to be politically highly contentious and thus problematic in this regard. For instance, controversies may

4 Examples of such different approaches can be found in the drafts of the integrated NECPs 2030, submitted to the Commission, in which Member States, among other objectives, express their energy security aims. For instance, Poland provided a detailed plan on diversification of supply and development of domestic energy production in many spheres (Ministerstwo energii, *Krajowy plan na rzecz energii i klimatu na lata 2021–2030 Założenia i cele oraz polityki i działania*, pp. 26–33). On the other hand, Sweden, for example, limited its planned policies in respect of energy security to the general requirements laid down in EU legislation (Ministry of the Environment and Energy, *Sweden's draft integrated national energy and climate plan*, pp. 12–13). The Member States' drafts of NECPs are available at <https://ec.europa.eu/energy/en/topics/energy-strategy-and-energy-union/governance-energy-union/national-energy-climate-plans>

arise in relation to diversification of the sources of the supply of natural gas in the context of geopolitical threats associated with Russia. At present, derogations from the state aid requirements are usually permitted in respect of large infrastructure projects at midstream level (i.e., large pipeline projects). However, some new problems might arise in the event that these derogations are applied at the upstream level of energy production, especially where justification of state aid for national energy-producing companies is involved.

Therefore, Ukraine—the only large natural gas producer among the Energy Community's Contracting Parties—and its PSO scheme, which is also related to national gas production, offers a useful case study through which to clarify the application of state aid provisions in the context of the EU's *acquis*. It is worth noting that the points that emerge from this case study may also be relevant to analyses of other state aid schemes in the upstream energy markets (not limited to gas production). Such an analysis may also help clarify the scope of Articles 106(2) and 107(3) TFEU in the present state of evolution of EU competition law, taking into account the consideration that states may apply in using their discretion to decide on national services of general economic interests (SGEIs) objectives or the need for investment aid.

These aspects seem to be extremely important for the EU with regard to the development of the internal market and the impact of national support measures in the energy sector on this process. The analysis of state aid cases that involve security of energy supply projects set out in this article demonstrates that some disproportionate measures have been adopted within the EU and that a risk of hindrance of market development may exist across the EU Member States. On the other hand, strategic considerations concerning long-term security of supply in the EU cannot be permitted to result in failure to provide support for those energy sector projects that require it. Thus, this article seeks to contribute to discussion on the proportionality of such support and to achieve clarity as to the limits of the legal bases for its justification under the TFEU.

This article discusses the overall scope of Articles 106(2) and 107(3) TFEU as grounds for derogation from state aid requirements, together with EU case law and Commission practice regarding state aid in relation to security of energy supply. It also provides suggestions as to how EU law might develop in this sphere in terms of the potential to expand the range of support measures that may be adopted in the upstream segment of the energy markets. The Energy Community Contracting Party perspective is provided to demonstrate the complexity of state aid derogations in the upstream segment. This

may be especially relevant for certain EU Member States that regard the diversification of supply through the development of indigenous sources as one of their main strategic priorities in the energy sector.

## II. The scope of Articles 106(2) and 107(3) TFEU as justification for state aid

The need to clarify the application of the legal bases for such derogations can be also explained by reference to the assessment of the state aid measures where these apparently fail the test laid down in the case of *Altmark*.<sup>5</sup> In the view of Klasse, despite the Commission's tendency to find violations of the *Altmark* requirements, state support measures can usually be declared compatible with the internal market pursuant to these derogations.<sup>6</sup> The issue of ambiguity in the application of these legal bases seems to be a feature not only of state aid in the energy sector but also in many other spheres in which state intervention has traditionally been significant.<sup>7</sup> Certain important aspects are still lacking despite the clarifications concerning the utilisation of such derogations contained in EU secondary law and in the Commission's guidance documents. These include the SGEI Framework, the General Block Exemption Regulation (the GBER), the Guidelines on State aid for environmental protection and energy 2014–2020 (EEAG), etc.<sup>8</sup> For instance, the EEAG does not cover certain spheres of the energy sector (i.e., the upstream hydrocarbon sphere). Establishing that SGEIs in the energy sphere are proportionate may also prove problematic.

Thus, despite the recognition of a number of security of supply issues (regularity, quality, and price of supplies, etc.) as grounds for PSOs in EU law, numerous controversies may arise in respect of the establishment of various

5 Judgment of 24 July 2003, *Altmark Trans and Regierungspräsidium Magdeburg*, C-280/00, ECLI: EU: C:2003:415.

6 M Klasse, 'The Impact of *Altmark*: The European Commission Case Responses', in E Szyszczak and JW van de Gronden (eds), *Financing Services of General Economic Interest Reform and Modernization* (Springer 2012) 50.

7 For instance, state aid may be held compatible with the internal market in public broadcasting pursuant to these two legal bases. However, research indicates that this usually involves reference only to Article 106(2) TFEU. See Ramona Ianus and Massimo Orzan, 'Aid Subject to a Discretionary Assessment under Article 107(3) TFEU' in H Hoffman and C Micheau (eds), *State Aid Law of the European Union* (Oxford University Press 2016) 304.

8 Communication from the Commission—European Union framework for State aid in the form of public service compensation (2011) (OJ C 8, 11.1.2012, pp. 15–22); Commission Regulation (EU) No. 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty (OJ L 187 26.6.2014, pp. 1–78); Communication from the Commission—Guidelines on State aid for environmental protection and energy 2014–2020 (OJ C 200, 28.6.2014, pp. 1–55).

schemes in the EU Member States. This relates to general debates over state discretion in respect of the provision of SGEIs. Settled practice<sup>9</sup> indicates that the Commission may question an SGEI's purpose only if it contains a *manifest error*, meaning that such error in defining the SGEIs and entrusting undertakings with related PSOs must be indisputable. Moreover, the purpose of the SGEI must be clearly defined when certain PSOs are imposed by governments, and a proper procedure under which certain undertakings are entrusted with the carrying out of these obligations must be established.<sup>10</sup> The EU's practice indicates that the availability of the same services or goods on the markets cannot serve as a proof of *manifest error*.<sup>11</sup> Although this in itself offers states more scope to establish security of supply SGEIs, the issue of proportionality remains highly contentious: the question arises as to whether the SGEIs are limited to preventing market failure, and there are further questions concerning the admissibility of state interference in the market in certain situations. These issues are extremely important, since the rationale of SGEIs in respect of security of supply often relates to non-market factors. These include the desire to diversify the sources of energy supply and to reduce dependency on unreliable supplier states even if suppliers from these states offer better price and delivery options.

Legal scholars often support significantly different positions in this regard. For instance, Burke, who developed the paradigm of *governmental failure* (as opposed to *market failure*) in the event of excessive governmental intervention under Article 106(2) TFEU, points, *inter alia*, to political factors as being among the principal issues that lead to such failures.<sup>12</sup> In particular, this may relate not only to the pursuit of the government's political goals but also to the great political influence enjoyed by the providers of SGEIs, which are, in many states, also strategically important undertakings. Sauter takes the view that the linkage of SGEIs to the prevention of market failure is the most important aspect of the proportionality of such measures. Accordingly, a Member State may impose these obligations in situations where the market is unlikely to provide a necessary public

good without state intervention.<sup>13</sup> On the other hand, some groups of scholars consider SGEIs' objectives to be wider than simply the prevention of market failure and the pursuit of economic goals. For instance, some research on the application of Article 106(2) TFEU in respect of the building of new infrastructure points to Member States having broad scope to include such projects within the ambit of SGEIs. The reason for this is that, even in controversial situations, the individual arguments put forward by states are still of importance in relation to the Commission's market tests.<sup>14</sup> These arguments are also important in the context of security of supply SGEIs that may include large infrastructure construction tasks. Maziarz argues that states may also justify the introduction of different types of SGEIs by means of PSOs. This is an extremely broad concept that covers issues of numerous dimensions,<sup>15</sup> chief among which are various public security concerns.<sup>16</sup>

Therefore, academic opinion in relation to these issues includes both criticism of and support for the idea of wide opportunities for states to establish SGEIs. In her analysis of numerous views on this issue,<sup>17</sup> Wehlander opines that the proportionality of state measures to fulfil the SGEI criteria may be assessed in a 'milder' or a 'stricter' way, depending on the degree of harmonisation of these issues under EU secondary law. Assessment is carried out in a stricter way in spheres where 'EU public service objectives and missions have been formulated and/or the economic approach to fulfil them has been harmonized, at least partly'<sup>18</sup> and, thus, there are fewer possibilities for Member States to demonstrate that a wider scope for such SGEIs and PSOs remains. This conclusion appears quite reasonable and strikes a balance between the different positions that exist as to the potential for Member States to interfere in the markets on the basis of Article 106(2) TFEU.

At the same time, the application of Article 107(3) TFEU seems to be more harmonised at EU level than

9 E.g., judgment of 15 June 2005, *Olsen v Commission*, T-17/02, ECLI:EU:T:2005:218, paragraph 216; judgment of 12 February 2008, *BUPA and Others v Commission*, T-289/03, ECLI:EU:T:2008:29, paragraph 220.

10 M Wolf, 'Services of general economic interest. B. Application of Article 107 TFEU to compensation granted for the provision of SGEI', in FJ Sacker and F Montag (eds), *European State Aid Law: A Commentary* (Hart Publishing 2016) 312.

11 Judgment of 15 June 2005, *Olsen v Commission*, T-17/02, ECLI:EU:T:2005:218, paragraphs 216 and 225.

12 JM Burke, *A Critical Account of Article 106(2) TFEU: Government Failure in Public Service Provision* (Hart Publishing 2018) 32.

13 W Sauter, 'Services of General Economic Interest and Universal Service in EU Law' (2008), TILEC Discussion Paper No. 2008-017, *European Law Review*, No. 2, 17–9.

14 M Gayger, 'Infrastructure Funding at the Interface between the EU State Aid Rules and Member States' General Economic Policy' (2016), *European State Aid Law Quarterly* No. 4, 550; similar points are also made in C Koenig and S Kiefer, 'Public Funding of Infrastructure Projects under EC-State Aid Law' (2005), *European State Aid Law Quarterly* No. 3, 421.

15 A Maziarz, 'Services of General Economic Interest: Towards Common Values' (2016), *European State Aid Law Quarterly* No. 1, 19.

16 *Ibid.*, p. 25.

17 K Lenaerts, 'Defining the concept of "Services of General Interest" in Light of the "Checks and Balances" set out in the EU treaties' (2012), *Jurisprudencija/Jurisprudence* 19(4), 1259; W Sauter, 'Services of General Economic Interests and Universal Service in EU Law' (2008), TILEC Discussion Paper No. 2008-017, *European Law Review* No. 2, 26 et al.

18 C Wehlander, *Services of General Economic Interest as a Constitutional Concept of EU Law* (T.M.C. Asser Press, 2016), 129.

is true in respect of the application of Article 106(2). There is clarity as to some general and substantive issues concerning its utilisation. For instance, the majority of scholars agree that operating aid does not generally apply in relation to derogations under Article 107(3) TFEU,<sup>19</sup> since it distorts competition to a greater extent than investment aid and does not directly lead to the achievement of the objectives of Article 107(3) TFEU. Moreover, such an approach is reflected in the decisions of the General Court,<sup>20</sup> and in the consequent impact on the Commission's decisions. However, it is worth noting that in some circumstances, operating aid is possible under Article 107(3) TFEU. These circumstances are mainly covered in the Commission's guidance documents (i.e., operating aid for the production of electricity from renewable energy sources).

Problems may, however, arise in relation to the direct application of Article 107(3) TFEU in circumstances where the measures adopted go beyond the scope of the Commission's guidance. It is generally recognised that assessment of state aid must take into account the common interests of the EU.<sup>21</sup> Bouchagiar argues that although the Commission's guidance does not bind the Member States, direct application of Article 107(3) TFEU is possible only if a state is able to demonstrate that certain aid constitutes a special circumstance, which is an exception to the general rule and is not covered by the guidance.<sup>22</sup> Kühling and Ruechardt highlight the absence of consensus over the provision of state aid for certain types of energy production and technologies in respect of which no Commission guidance exists, and point to nuclear energy as an example in this regard. They argue that the Member States and the Commission should enter into discussions with a view to elaborating new approaches to the reconciliation of such aid with the integration of the EU energy market.<sup>23</sup> Recent state aid cases considered under Article 107(3) TFEU by the Commission, as discussed in the next chapter, are indicative of the fact that the absence of such

consensus may lead to further confusion in relation to the assessment of the admissibility of such measures.

Therefore, despite numerous elaborations on the nature of compatibility of energy security measures with EU state aid rules in the EU *acquis*, there is still no definitive clarity as to the boundaries of justification of state aid measures under Articles 106(2) and 107(3) TFEU. In particular, some extremely problematic issues—that is, consideration of operating aid in certain untypical state aid schemes and the proportionality of certain SGEIs—may have a significant adverse impact on clarity as to permissible justifications for state aid. The analyses of state aid measures in the sphere of security of energy supply set out below demonstrate that the complexity of this issue is attributable to a large extent to the lack of single definition of the concept of 'security of supply' in EU law.

The hypothesis of this article is that both the legal bases discussed herein justify state aid in security of energy supply projects. Moreover, the article contends that there is wide scope for the utilisation of Article 106(2) TFEU. However, it is also suggested that further harmonisation of security of energy supply SGEIs based on their objectives should be possible. This consideration applies to strategic continuous SGEIs, which involve the development of new infrastructure, and operational SGEIs, which relate to undertakings' daily activity. On the other hand, one can agree with suggestions previously made to the effect that Article 107(3) TFEU cannot in general cover operating aid, and that, as a result, attempting to use this provision as a basis for the provision of continuous aid to certain undertakings is problematic. Thus, there is a need for clarity on the issue of operational aid, particularly in respect of upstream security of supply projects (mainly in the sphere of hydrocarbons), and their further coverage in the Commission's guidance documents is to be recommended. The provision of clarification on the utilisation of both articles would greatly contribute to the avoidance of situations in which derogations from state aid rules in the energy sphere act as a significant hindrance to the development of the markets. EU practice in relation to the consideration of the compatibility of state aid for energy projects under Articles 106(2) and 107(3) TFEU demonstrates that a number of controversies and even threats to the further development of certain energy markets occur due to ambiguity in the application of these derogations.

### III. State aid in security of energy supply in EU case law and Commission's practice

The Commission's assessment of admissibility of state aid in relation to SGEIs demonstrates that national

19 A Bates, 'Compatibility of Aid: General Principles' in K Bacon QC (ed.), *European Union Law of State Aid* (3rd edn Oxford University Press, 2017), 101; and J Nowag, *Environmental Integration in Competition and Free-Movement Laws* (Oxford Studies in European Law, 2016), 197.

20 For instance, Judgment of 1 June 1995, *Siemens SA v Commission of the European Communities*, T-459/93, ECLI:EU:C:1995:160, paragraph 48; Judgments of 5 October 2000, *Germany v Commission*, C-288/96, EU:C:2000:537, paragraph 90 et al.

21 E Stuart and I Roginska-Green, *Sixty Years of EU State Aid Law and Policy Analysis and Assessment* (Wolters Kluwer, 2016), 74.

22 A Bouchagiar, 'The Binding Effects of Guidelines on the Compatibility of State Aid: How Hard is the Commission's Soft Law?' (2017) 8:3 Journal of European Competition Law & Practice, 163.

23 J Kühling and C Ruechardt, 'Nuclear Energy Reloaded—New State Aid for an Old Industry' (2017) 8:9 Journal of European Competition Law & Practice, 572.



reasoning as to the necessity of measures is taken into account only when the special SGEIs and sectorial requirements of the EU law are met. Thus, in Commission Decision 2009/609/EC,<sup>24</sup> the Commission dismissed Hungary's argument that the State aid that it had awarded through power purchase agreements (PPAs) entailed the fulfilment of PSOs on the basis that it was not in line with provisions of the Electricity Market Directive concerning Member States' ability to lay impose an obligation to utilise indigenous primary fuel for electricity generation to an extent not exceeding 15 per cent of the overall primary energy necessary to produce the electricity consumed in the Member State concerned. In particular, only a few of the generation installations involved in PPAs could fulfil this criterion and the Hungarian government had not imposed a clearly defined obligation or adopted any instrument through which a particular generator was entrusted with the task of providing the SGEI. This case clearly follows the logic of the limited powers of the state to establish particular PSOs in the spheres, where such rules are to some extent harmonised within the EU.

A different situation can be observed in the case of *Castelnou Energía*,<sup>25</sup> which concerned the Commission's approval of a Spanish PSO scheme aimed at securing a domestic electricity supply. The scheme obliged several electricity generation companies to use indigenous coal, since this was in line with the Electricity Market Directive's requirements and satisfied other necessary conditions.<sup>26</sup> *Castelnou Energía* is important in the context of this article, also because it also addressed the arguments of Spain's foreign dependency on supply. The General Court recognised the Member State's discretion to define the SGEI and the possibility of adopting a wider interpretation of the concept of security of supply. In analysing the purpose of SGEIs, the General Court also considered other secondary EU legislation, including the provisions of Directive 2005/89/EC<sup>27</sup> and all the important factors affecting Spain's electricity market (its interconnectivity, dependence on foreign supply, share and role of coal generation, etc.). The General Court ultimately ruled that Spain had not made a *manifest error* in defining SGEIs

and that it had followed the necessary requirements for the entrusting of undertakings with PSOs.<sup>28</sup>

Hence, Member States seem to be free to determine aims (unless they constitute a *manifest error*) in defining SGEIs and entrusting undertakings with the performance of PSOs. The issue of the proportionality of such measures is trickier and, among other things, limited by the harmonised provisions of EU law. In the context of the subject-matter of this article, the issue of *overcompensation* is no less an important aspect of the compatibility of SGEIs with EU law, and this is highlighted in the framework for assessing large compensation for state aid in the form of public service compensation.<sup>29</sup> Despite the vagueness of the concept of overcompensation (in respect of reasonable profit and some derogations)<sup>30</sup> and the possibility of covering investment costs, this may raise some additional difficulties for large investment projects in the energy sector. For instance, difficulties that are associated with the long period of return on investment in this sphere and the high probability of additional expenses arising. On the other hand, the long period of execution of such projects may deteriorate some other aspects of the proportionality of SGEI measures, that is, the existence of some of the exclusive rights for an SGEI-providing undertaking may negatively affect the development of the market in the relevant sector.

Moreover, the entrustment of an SGEI-providing undertaking with the task of fulfilling several related PSOs may give rise to additional challenges in the assessment of overcompensation<sup>31</sup> (i.e., when an undertaking has been entrusted with PSOs in respect of both production and supply of certain goods or services). The Commission's practice may also demonstrate that state aid in some large investment projects related to the building of new capacities and infrastructure and involving the assumption of obligations in a few segments of the market by the same undertaking (or group of undertakings) can be brought under the SGEI umbrella. For instance, this was the case in respect of the Delimara Gas and Power Energy Project.<sup>32</sup> In this case, Malta had provided state

24 Commission Decision 2009/609/EC of 4 June 2008 on the State aid C 41/05 awarded by Hungary through Power Purchase Agreements (OJ L 225, 27.8.2009, p. 84).

25 Judgment of 3 December 2014, *Castelnou Energía v Commission*, T-57/11, ECLI:EU:T:2014:1021.

26 See N178/10 in Authorisation for State aid pursuant to Articles 107 and 108 of the TFEU—Cases where the Commission raises no objections (OJ C 312, 17.11.2010, pp. 5–8), p. 6.

27 Directive 2005/89/EC of the European Parliament and of the Council of 18 January 2006 concerning measures to safeguard security of electricity supply and infrastructure investment (OJ L 33, 4.2.2006, pp. 22–27).

28 Judgment of 3 December 2014, *Castelnou Energía v Commission*, T-57/11, ECLI:EU:T:2014:1021, paragraph 104.

29 Communication from the Commission—European Union framework for State aid in the form of public service compensation (2011) (OJ C 8, 11.1.2012, p. 20), paragraphs 47–50.

30 Ibid.

31 M Wolf, 'Services of general economic interest. B. Application of Article 107 TFEU to compensation granted for the provision of SGEI', in FJ Sacker and F Montag (eds), *European State Aid Law: A Commentary* (Hart Publishing, 2016), 351.

32 See SA.45779 Delimara Gas and Power Energy Project in Authorisation for State aid pursuant to Articles 107 and 108 of the TFEU—Cases where the Commission raises no objections (OJ C 51, 17.2.2017, pp. 1–9).

aid in the form of a number of long-term contractual obligations to fix the price of electricity and gas in order to ensure investment in the Project. The Commission held that this was compatible with the internal market under Article 106(2) TFEU.

It is worth noting that there is no electricity market in Malta (the country also has a derogation from the application of the Electricity Market Directive) and the SGEI-providing undertaking (EGM) was not involved in any additional activity, which also removed the issues involved in finding cross-subsidies. The problem of overcompensation was avoided by means of an *ex ante* calculation of the necessary price for supply (in the long-term agreements mentioned above) in this case, since it was based on the calculation formulas, which took into account the undertaking's costs in terms of investment and operation. However, more challenges may arise in the event of future energy market opening in Malta, which may occur if, for example, the derogations laid down in the Electricity Market Directive are repealed. In such a situation, potential competitors may face significant barriers to entering the market if a certain supplier has already been provided with guarantees and fixed prices. This might be an example of the issue that arises when the use of SGEIs in a few segments of the value chain of a particular market results in the formation of a closed system that enables the undertaking engaged in providing the relevant services to maintain its dominant market position for a long period. Due to the potential of simultaneous justification of both investment and operating costs pursuant to Article 106(2) TFEU and utilisation of arguments of security and/or future advantages of the Project to development of internal energy market, it is perfectly possible for this outcome of a derogation from state aid rules to be found admissible. This might be the case, even if the proportionality of such measures would be still controversial.

In contrast, the application of Article 107(3) TFEU seems to be more focused on derogations associated with investment aid and excludes the continuous aid required to allow an undertaking in receipt of state aid to continue to function (i.e., operating aid). Nevertheless, recent developments in EU case law may cast doubt on this assumption. Thus, in assessing the compatibility of state aid granted under Article 107(3)(c) TFEU in respect of Hinkley Point C nuclear power station in the United Kingdom (UK), the Commission reaffirmed the general rule as to the inadmissibility of operating aid within the framework of Article 107(3)(c) TFEU. Accordingly, it recognised that aid that resulted from a contract for difference signed by the UK government does not constitute

operating aid but is equivalent to investment aid.<sup>33</sup> As a result, the state aid was considered compatible with the internal market under Article 107(3)(c) TFEU.

Subsequently, Austria and the Grand Duchy of Luxembourg contested this Commission decision in the General Court, arguing that the state aid granted for Hinkley Point C was incompatible with the internal market. In its judgment on the case, the General Court took an interesting position regarding the existence of operating aid. It noted that where operating aid maintains the status quo but does not facilitate development, it may still be considered compatible with the internal market if it meets certain requirements. In particular, the General Court pointed to the pursuit of a 'public interest objective' that does not have an adverse effect on trading conditions to an extent contrary to the common interest.<sup>34</sup> The General Court considered the development of the nuclear power plant as one possible public interest objective. It concluded that in such cases, state aid may be regarded as compatible with the internal market under Article 107(3)(c) TFEU.

This position seems somewhat controversial in the light of the stance taken in previous cases in which state aid was assessed pursuant to Article 107(3) TFEU. Even if the argument as to the admissibility of operating aid in situations when it does not affect trading conditions may be regarded as being in line with similar derogations laid down in the Commission guidance documents, it still seems unusual to consider a 'public interest objective' as being one of the main elements justifying derogation under Article 107(3). The employment of such an argument would appear more suitable if the state aid measures utilised were assessed under Article 106(2) TFEU, which provides that nationally defined objectives of a general economic interest serve as a ground for state intervention and aid. Most of the earlier cases in which the Commission assessed state aid under Article 107(3) TFEU indicate that the main factor the Commission took into account was EU-wide interests rather than a public interest objective based on the situation in a particular Member State.

Many of these cases concern infrastructure-related state aid schemes in numerous Member States, which were approved by the Commission and did not face further objections. For instance, in assessing the state aid granted in the course of the construction of a regasification LNG terminal in Świnoujście, Poland, the

33 SA.34947 Support to Hinkley Point C Nuclear Power Station, paragraphs 344–347 (OJ L 109, 28.4.2015).

34 Judgment of 12 July 2018, *Austria v Commission*, T-365/15, ECLI:EU:T:2018:439, paragraph 583.

Commission assessed measures that aimed to achieve a well-defined objective of common interest of the EU and whether the negative effect on competition could be balanced by positive achievements.<sup>35</sup> Very similar tests were utilised in respect of the upgrading of a liquefied natural gas (LNG) terminal in Revithoussa, Greece,<sup>36</sup> a tender for aid for new electricity generation capacity in the form of a solid fuel/LNG thermal power plant in Latvia,<sup>37</sup> aid granted to the Klaipėdos Nafta LNG terminal in Lithuania,<sup>38</sup> etc. In most of these cases, the Commission relied on the common interests test laid down in *Kronoply v Commission*.<sup>39</sup> Therefore, it could be concluded that focusing on the EU's common interests in justifying such derogations under Article 107(3) TFEU used to be one of the distinctive elements the presence of which rendered state aid admissible. However, the General Court's recent judgment regarding Hinkley Point C indicates that the grounds for derogation under Article 107(3) TFEU are broader than was previously thought.

It should be noted that a dual legal basis for derogation from state aid requirements in energy security of supply cases may still be possible. This conclusion arises from the Commission's assessment of the state aid granted to Klaipėdos Nafta in respect of the construction of an LNG terminal on the Baltic coastline in Lithuania in order to reduce dependency on a single supplier (Gazprom). In this case, the Commission found that measures of state aid were compatible with the internal market simultaneously pursuant to Article 106(2) TFEU as regards the operating aid and Article 107(3)(c) TFEU as regards the investment aid.<sup>40</sup> Surprisingly, this aspect of the case has not received significant attention among researchers and commentators, with the exception of some rather informal analyses.<sup>41</sup> The Commission's decisions on this case recognised state guarantees for credits in respect of the construction of the LNG terminal and a so-called 'LNG

supplement' (an additional levy on transmission system users to cover the costs incurred by LITGAS, which was subject to a PSO under which it was required to purchase certain amounts of liquefied gas to ensure the supply to the LNG terminal) as investment costs covered by Article 107(3)(c). The inclusion of the LNG supplement in the investment costs and in the context of the justification under Article 107(3) TFEU seems confusing, since this forms part of the financing of the regular operation of the PSO provider, which is covered by the provisions of Article 106(2).

Therefore, it seems that assessment of state aid measures and the ability to justify them by reference to certain legal bases greatly depends on the particular situation at hand. Moreover, this is an extremely dynamic field where no single approach exists, which is also reflected in situations where the Commission has modified legal bases for derogation or where similar components of state aid have been considered under different legal bases. This also leads to a confusion as to the original ideas behind different grounds for the justification of state aid: some projects, which factually aim at facilitating the development of particular spheres of energy markets can be interpreted as SGEIs, while some state aid measures for operating aid may be included in the scope of Article 107(3) TFEU. For instance, a broad possibility to include different types of investment projects within the scope of Article 106(2) TFEU by creating a number of PSOs, which carries a risk of creating a status quo situation on the market, may limit other undertakings' prospects of entering the market or even create a closed system for newcomers for a long period. On the other hand, the justification of state aid that includes operating aid under Article 107(3) may lead to a similar lasting distortion of competition and neglect of the development of the market by favouring certain undertakings.

One of the reasons for the aggravation of this problem in the energy sphere is the fact that 'security of supply' seems to be a very heterogeneous notion that has numerous possible dimensions, which must be taken into account when analysing the possible grounds for derogations.

#### IV. Heterogeneity of security of supply as a basis for derogation from state aid requirements

The overall investigation of possible derogations from state aid rules in EU law and practice demonstrates that security of energy supply arguments may be covered by the provisions of either Article 106(2) or Article 107(3)

35 SA.31953 Construction of a LNG Terminal in Swinoujsci, Brussels, paragraph 48 (OJ C 361, 10.12.2011).

36 SA.35165 1st upgrade LNG Terminal at Revithoussa (OJ C 117, 16.4.2014).

37 N675/2009 Tender for Aid for New Electricity Generation Capacity (LV) (OJ C 213, 6.8.2010).

38 SA.36740 Court Case concerning LNG terminal in Lithuania (OJ C 161, 4.5.2016).

39 Judgment of 14 January 2009, *Kronoply v Commission*, T-162/06, ECLI:EU:T:2009:2, paragraphs 65 and 66.

40 SA.36740 Court Case concerning LNG terminal in Lithuania (OJ C 161, 4.5.2016). Later the Commission excluded Article 107(3) TFEU as the source of the derogation, leaving only Article 106(2) as the basis for the justification of state aid.

41 This mainly refers to Phedon Nicolaides' analysis in Phedon Nicolaides, 'Combining Infrastructure Aid with SGEI Aid', State Aid Hub.eu (Lexxion), part I (21 June 2016) available at <http://stateaidhub.eu/blogs/stateaiduncovered/post/6517> and part II (5 July 2016) at <http://stateaidhub.eu/blogs/stateaiduncovered/post/6567>.

TFEU, or even by both simultaneously. It is extremely difficult to draw a line between the limits of the scopes of these articles, especially given the present dynamic evolution of EU state aid law. Therefore, some of the possible boundaries between the application of these respective articles are becoming vaguer in terms of interpreting justification of state aid. For instance, *Austria v Commission* rebuts what might be considered a reasonable argument as to the possibility of considering only investment aid projects (unless the Commission's guidance documents provides otherwise) that serve the EU's common interests, pursuant to Article 107(3) TFEU. This situation may result in confusion concerning the original purpose of the derogations from competition rules provided for in the Treaty given their interpretation in practice. Thus, an unreasonable distortion of competition on the internal market might be authorised on the basis of its being 'compatible state aid' in circumstances where the EU's common goals are neglected in practice by favouring certain national undertakings. On the other hand, Member States' undoubted ability to designate SGEIs under Article 106(2) may also improperly implemented in such a way as to obstruct the fulfilment of EU-wide aims in terms of building the common energy market.

Therefore, we can observe one of the lacunae in EU state aid law as applied to the energy sector. In particular, the coincidence of two broad concepts, where a natural need for Member State discretion exists, has resulted in greater ambiguity as to determining the compatibility of state aid with the internal market: SGEIs, which are supposed to be determined at national level; the concept of security of supply, in respect of which both EU-wide and national interpretations are possible.

The perspective of this article is that this problem can be, at least partly, solved by further harmonisation of security of supply rules and by more substantial elaboration of the concept of security of supply in the EU's secondary legislation. Despite the clarification of security of supply measures in the framework of SGEIs under the Electricity Market Directive and the Gas Market Directive and some sector-specific energy security legislation, there is still an element of confusion as to the different aims of security of supply measures, which may be of a technical, financial, environmental, geopolitical (geostrategic), or other nature. The versatility of the concept of security of supply and its components has been mentioned in the Commission's working documents<sup>42</sup> and in academic

research on this topic.<sup>43</sup> Among other views, one can support Stern's suggestion of identifying long-term adequacy of supply and infrastructure, short-term availability of supply, operational and strategic security<sup>44</sup> as distinguishing features of security of supply. This adoption of this paradigm would contribute to better formulation of the specificities of derogations from state aid requirements in measures related to security of supply. It could also be used to identify state support measures that pursue strategic objectives (i.e., diversification of sources of supply) and operational aims (i.e., ensuring availability of supply in particular situation), which can be applied in a different manner in accordance with the relevant time-frame. In this way, some general strategic considerations can be defined at EU level by elaborating the existing secondary law on the basis of one of the need to ensure security of energy supply in the EU, which is laid down in Article 194 TFEU as one of the EU's main energy policy objectives.

At present, the EU's secondary legislation on energy provides certain clarifications on the specific SGEIs, as well as on the strategic priorities in this sphere. For instance, the Gas Market Directive offers broad possibilities for the establishment of SGEIs, which may serve security of supply purposes in terms of the environment, energy efficiency, and the protection of vulnerable customers (which may also include social security objectives). Regulation (EU) 2018/1999,<sup>45</sup> adopted last year, also focuses attention on security of supply issues in strategic planning at Member State and EU level and offers some basic approaches to achieving strategic understanding of the EU's security of supply policy. In particular, it points to the issues of diversification of sources of supply, limiting dependency on third countries and development of domestic energy sources as being the main goals of the security of

42 Green Paper, Towards a European strategy for the security of energy supply (COM/2000/0769 final).

43 B Barton et al. (eds), *Energy Security: Managing Risk in a Dynamic Legal and Regulatory Environment* (Oxford University Press, 2004); G Luft, et al., 'Energy Security and Climate Change: A Tenuous Link', in BK Sovacool (ed), *The Routledge Handbook of Energy Security* (Routledge, 2013); PL Joskow, 'Supply Security in Competitive Electricity and Natural Gas Markets', in C Robinson (ed), *Utility Regulation in Competitive Markets: Problems and Progress* (Edward Elgar Publishing, 2007); J Stern, *Security of European Natural Gas Supplies: The Impact of Import Dependence and Liberalization* (Royal Institute of International Affairs, 2002).

44 J Stern, *Security of European Natural Gas Supplies: The Impact of Import Dependence and Liberalization* (Royal Institute of International Affairs, 2002), 6.

45 Regulation (EU) 2018/1999 of the European Parliament and of the Council on the Governance of the Energy Union and Climate Action, amending Regulations (EC) No. 663/2009 and (EC) No. 715/2009 of the European Parliament and of the Council, Directives 94/22/EC, 98/70/EC, 2009/31/EC, 2009/73/EC, 2010/31/EU, 2012/27/EU and 2013/30/EU of the European Parliament and of the Council, Council Directives 2009/119/EC and (EU) 2015/652 and repealing Regulation (EU) No. 525/2013 of the European Parliament and of the Council (OJ L 328, 21.12.2018, pp. 1–77).



supply dimension to be considered in the context of the integrated national energy and climate plans (NECPs). Moreover, the recitals of Regulation (EU) 2017/1938<sup>46</sup> highlight domestic production as being an important element in respect of diversification of sources of supply.

Nevertheless, more detailed clarification is still possible at the level of secondary legislation and in the Commission's guidance documents, since this would assist in highlighting the EU's strategic objectives and the specificity of SGEIs in relation to security of energy supply. For instance, the Commission has not provided for the possibility of recognising state aid for hydrocarbon production and processing (up to a certain threshold) as being compatible with the internal market in the EEAG. The need to consider this type of aid can be explained by reference to the defined priorities in respect of security of supply and the EU's dependency on an external natural gas supply. There have already been some cases in which state aid in relation to natural gas production has been regarded by the Commission as being compatible with the internal market.<sup>47</sup> However, additional issues may arise in assessing more complicated state aid schemes in this sector, which may include multiple objectives (for instance, the increase of gas production and a guarantee of continuity of supply at an affordable level to protected consumers). Although the absence of hydrocarbon production and processing under the EEAG does not prevent the Commission from considering such aid directly under Article 107(3)(c) TFEU, the involvement of operating aid and other problematic state aid issues in this sector may bring more questions to the fore in the context of such assessments. It would be useful for either secondary legislation or the Commission's documents to provide clarification as to the permissible operative and strategic objectives of security of supply SGEIs in order to contribute to a common understanding of the scope of possible SGEIs and the proportionality of the related PSOs.

Such clarifications may also reduce the risk of confusion as between different objectives in establishing PSOs and improper justification of state aid pursuant to Article 106(2) or Article 107(3). Excessively broad opportunities to bring different types of aid in the energy sector within the scope of Article 106(2) TFEU may be used as a joker card by governments to avoid the

requirements of competition law. Furthermore, lack of clarity as to the inclusion of operational aid within the scope of Article 107(3) TFEU (especially in the light of the judgment in *Austria v Commission* concerning Hinkley Point C) may be also used as a tool to create favourable conditions for particular undertakings rather than certain economic areas. The cases discussed above concerning state aid assessment in numerous EU Member States highlight various issues that are controversial issues in security of supply projects. However, more problems may arise in respect of state aid schemes that concern the sensitive issue of national energy companies' obligations to provide a secure supply. The example of Ukraine and its PSO scheme in respect of the natural gas market illustrates this issue from an Energy Community perspective.

## V. Case study: PSOs in Ukraine's natural gas market

Ukraine is the biggest Contracting Party to the Energy Community, having joined it in 2011. The country has also ratified an association agreement with the EU aiming at building a Deep and Comprehensive Free Trade Area. These frameworks imposed the obligation to implement the EU's energy and competition law *acquis* at national level.<sup>48</sup> In the course of so doing, Ukraine embarked upon a new stage of reform of the natural gas market in 2015 by transposing the Gas Market Directive into national law<sup>49</sup> and beginning the process of laying down conditions for its implementation in practice. As a result of the liberalisation of the natural gas market, the Ukrainian government faced numerous challenges related to security of supply. This led to establishment of a PSO scheme<sup>50</sup> in 2016, which has been replaced and amended several times since. In 2017, the Energy Community found infringements of the Community's *acquis* (which is based on the EU's energy and competition *acquis*) in respect of the provision of SGEIs. In 2018, the Energy Community extended grounds for non-compliance by adding allegations of violation of state aid rules.<sup>51</sup> This appears to be a very untypical approach on the part of the Energy Community, since it would be logical to begin with the allegation concerning illegal state aid, which could then

46 Regulation (EU) 2017/1938 of the European Parliament and of the Council of 25 October 2017 concerning measures to safeguard the security of gas supply and repealing Regulation (EU) No. 994/2010 (OJ L 280, 28.10.2017, pp. 1–56), paragraph 8.

47 SA.48623 Support for marginal off-shore gas fields in the Netherlands (OJ C 360, 5.10.2018).

48 In particular, by means of obligations to implement the energy, environment and competition *acquis* in accordance with the *acquis* of the Energy Community and Annex XXVII (which covers energy) of the Association Agreement with the EU.

49 It was transposed into the Law of Ukraine on the natural gas market (Vidomosti Verkhovnoi Rady, 2015, № 27, ст.234).

50 Cabinet of Ministers of Ukraine (Government) Decree on entrusting of PSOs to natural gas market participants No. 867, 19.11.2018.

51 Energy Community. Case ECS 02/17: Ukraine/gas.

(or otherwise) be justified pursuant to Article 106(2) TFEU. However, the Energy Community's finding of illegal state aid raises an interesting issue in the context of this article, because the Ukrainian PSO scheme simultaneously concerns to several segments of the natural gas market.

The issues of PSO schemes in relation to the natural gas markets of Ukraine and Moldova (another country that has begun reforming its energy markets as a Contracting Party to the Energy Community) have been already addressed in other articles, which analysed the main issues as to the proportionality of current PSO schemes.<sup>52</sup> Some changes were made to the Ukrainian PSOs scheme at the end of 2018. These principally concerned the methodology used for natural gas price formation (both for the retail and wholesale markets) but did not significantly alter the main obligations of the undertakings participating on the market, including those operating in the upstream segment.

Therefore, Ukrainian state-owned natural gas-producing companies<sup>53</sup> have been entrusted with the obligation to sell the gas they produce to the parent company, Naftogaz, at a regulated price in order to create a reserve to meet the needs of household and some other vulnerable consumers (i.e., district heating companies). In turn, Naftogaz is obliged to provide this amount of gas to the retail companies for delivery to final consumers. The current regulated price for natural gas is based on the average wholesale price charged for Naftogaz sales to non-protected consumers ('industrial consumers' under Ukrainian law), which is not regulated.<sup>54</sup> Previously, this price was based on the so-called 'import parity' price, which was based on the average price for the import of natural gas.<sup>55</sup> The governmental decree on the establishment of this PSO scheme mentions a number of its objectives: ensuring the stability, quality, and affordability of the natural gas supply and provision of security of supply to consumers without prejudice to the creation of a liberalised natural gas market.<sup>56</sup> However, the idea behind price regulation on the natural gas markets (laid down in the decree on the PSO scheme) also in fact serves the aim of increasing the production of natural gas in Ukraine,

which can clearly be observed in Naftogaz's reports and in certain government statements.<sup>57</sup> Furthermore, this aim is in line with Ukraine's state Energy Strategy until 2035, which highlights 'energy independence' and full domestic supply of natural gas among midterm priorities.<sup>58</sup>

The reason why such price regulation may bring about the increase of domestic production is that the cost price of Ukrainian gas production is significantly lower than the market price for natural gas (due to a long period of stagnation in national gas production and lack of renovation of the facilities until 2016).<sup>59</sup> Consequently, the Ukrainian government factually pursues two main objectives in regulating natural gas prices: it seeks to increase social protection of vulnerable consumers (since the formula used includes a discount coefficient), and it guarantees a stable profit for the gas-producing companies by obliging other market participants to buy all the natural gas produced and by establishing a price that is significantly higher than the costs incurred by companies in producing the gas. The net result is the creation of a closed system, where natural gas is produced and sold at a price that excludes competitors from this market segment.

Despite its violation of the state aid rules, which also do not appear to meet the *Altmark*<sup>60</sup> criteria (especially the fourth criterion, since no tender or preliminary assessment was provided for), Ukraine may have an opportunity to justify the state aid granted to Naftogaz Group companies by adding the objective of increasing the production of natural gas to meet the PSOs.<sup>61</sup> Moreover, there may be scope to consider justification under Article 107(3) TFEU. These assumptions are based on the significant discretion afforded to states in determining the objectives of SGEIs in security of supply cases and as a result of the lack of clarity as to how Article 107(3) TFEU should be applied in the non-EEAG cases. This case may resemble certain of the situations analysed above, in which undertakings received lasting guarantees from the

52 M Iakovenko, 'PSOs in the Natural Gas Markets of Ukraine and Moldova: What Needs to be Changed to Enhance Market Liberalization and Compliance with Energy Community Acquis Communautaire?' (2018) 4 OGEL, pp. 9–12.

53 Namely, Ukgazvydobuvannia (UGV) and Chornomornaftogaz.

54 Cabinet of Ministers of Ukraine (Government) Decree on entrusting of PSOs to natural gas market participants No. 867, 19.11.2018.

55 Cabinet of Ministers of Ukraine (Government) Decree on entrusting of PSOs to natural gas market participants No. 187, 22.03.2017 (not in effect).

56 Cabinet of Ministers of Ukraine (Government) Decree on entrusting of PSOs to natural gas market participants No. 867, 19.11.2018.

57 For example: Naftogaz Group Annual Report 2017, p. 11, available at: [http://www.naftogaz.com/files/Zvity/NAK\\_AnRep2017\\_EN.pdf](http://www.naftogaz.com/files/Zvity/NAK_AnRep2017_EN.pdf). Some information on the government's vision is also provided in Ukrainian mass media: 'Shcho bude z cinamy na gaz, abo yak MVF ta Kabmin vyprovovuyut' ody odnoho' ('What will be with the price for gas, or how the IMF and the government are "testing" each other') in *Ekonomichna Pravda*, 31 August 2018, available at: <https://www.epravda.com.ua/publications/2018/07/31/639187/>

58 Energy Strategy of Ukraine until 2035 'Security, energy efficiency, competitiveness', approved by the Government's Order No. 605-p of 18 August 2017.

59 Ibid.

60 See note 5.

61 However, this does not seem to be enough to justify the state aid to other companies that are involved in PSO scheme, including retail companies. For more details, see article mentioned in note 51.

government in return for the imposition of obligations to purchase from other companies. The argument that there is no guarantee that the market can guarantee increases in gas production in the absence of such intervention can be also used to maintain the status quo for a long period.

However, the situation could be clarified by separating operational (a regular supply to consumers) and strategic (an increase of domestic production) objectives in the context of the obligations imposed on these companies. This approach could be a tool by which to prevent the use of cross-subsidies and to enable a clear separation of the investment component in pricing from the other components of the price. Furthermore, the present supply to protected consumers could be organised in a less market-restrictive way, for instance, by direct selling to the market and establishing PSOs for the procuring companies. It could also guarantee the removal of opportunities to preserve the incumbent company's dominant position on the ground that it is the provider of SGEIs. Further separate and shorter programmes aimed at increasing production and involving state guarantees for foreign loans or tenders for grants could then be explicitly covered under the derogation contained in Article 107(3) TFEU.

Therefore, this case study highlights the need to clarify the approach to be taken in providing SGEIs and, perhaps, to revise the EU's secondary legislation and the Commission's guidance documents on state aid derogations concerning the upstream segment of the energy markets, as well as a general need to differentiate the security of supply concept in relation to other energy security aims.

## VI. Conclusions

The issue of the derogations from EU state aid requirements that may be permitted is becoming more complex in the present dynamic process of the development of EU law and its impact on particular spheres such as energy. This has led to greater ambiguity in the search for legal bases for derogation as well as the potential for confusion between the initial aims of the Treaty's provisions and the interpretation of those provisions in particular cases dealing with state aid. For example, assessing the compatibility of state aid in the energy sector in projects that involve large-scale investment in infrastructure and facilities involves examining at least two possible legal bases as source of derogation: Articles 106(2) and 107(3)(c) TFEU. The discussion of cases involving state aid above reveals that certain restrictions as to the application of these provisions were initially observed (i.e., incompatibility of

operating aid in cases to which Article 107(3)(c) TFEU applied, except in some special situations). However, further development of the case law demonstrates that the boundaries between the application of different articles are getting vaguer.

No less important is the fact that Member States have a significant level of discretion in defining their SGEIs and the particular aims pursued by these SGEIs and PSOs in terms of the provision of services. On the other hand, there is no single definition of the concept of security of supply that may be used to inform the purposes of SGEIs, and EU Member States also have wide discretion in defining their understanding of this concept. These factors significantly affect the application of derogations from state aid requirements, making it possible to include almost any kind of state aid within the scope of Article 106(2) TFEU. This risks destruction of the balance between achieving EU-wide objectives and those of individual states in respect of energy and related policies.

The segments of the energy sector, in which the need for large-scale investment in infrastructure is combined with various PSOs, especially in the upstream segment, seem to be one of the most nebulous spheres in respect of state aid, since there is no clarity as to the application of the various derogations. Thus, the upstream segment is almost not covered in the secondary legislation and Commission's guidance documents related to the application of Article 107(3) TFEU. Moreover, the general lack of clarity as to the use of security of supply SGEIs may negatively affect state action under Article 106(2) TFEU in this sphere.

The example of Ukraine as one of the Energy Community's Contracting Parties and as a state that has an association agreement with the EU, and, thus, similar legislation and obligations in the sphere of competition and energy, demonstrates that numerous problematic issues are taken into account in designing SGEIs related to the operational and strategic aims of security of supply. This is especially important in state aid schemes that concern the upstream segment in terms of the proper application of derogations from state aid requirements and the consideration of different sources of aid in relation to strategic and operational security measures.

The present situation as to the provision of state aid for security of energy supply projects across EU Member States has some features in common with that of Ukrainian PSOs on the gas market as discussed above. These common features concern, in particular, simultaneous approval of operational and investment aid, which leads to the provision of a broad swathe of rights and opportunities for certain undertakings over

a long period. Further development of national energy production in EU Member States in the context of security of supply may give rise to additional issues in terms of finding proper justification for such support measures. Therefore, it would be advisable to continue to develop EU secondary law with a view to bringing more clarity to these issues. One option might be to clarify the derogations available under Article 107 regarding the

issue of operational aid in some upstream energy markets. Moreover, further development of energy security legislation by reference to the 'operational' and 'strategic' paradigms to allow for the provision of certain energy security measures may bring further clarity to the notion of security of supply in relation to SGEIs.

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