

# State Aid Assessment of Complex Settlement Agreements:

## The European Commission's Opening Decision in the German Lignite Phase-Out Case

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*The European Green Deal envisages a clean and decarbonised energy sector with net-zero greenhouse gas emissions by 2050. These ambitious objectives entrust the Member States with enormous tasks in connection with the transformation process, which must always be designed in a proportionate manner. For this purpose, compensation measures are regularly part of decarbonisation strategies. In the context of the German lignite phase-out, new legal challenges arise due to State aid law. In particular, the present case poses the question of how elements of settlement agreements are to be assessed under State aid law. This field currently seems to be almost unexplored, as the Commission's notice on the notion of State aid only refers to settlement agreements in connection with tax law. However, settlement agreements contain some important elements that should be properly taken into account by the Commission in its State aid assessment. The fact that settlement agreements serve to avoid legal and factual uncertainties, especially in the context of highly complex decarbonisation strategies, must play a decisive role in an all-embracing economic analysis.*

### I. Introduction

In a decision of 2 March 2021 (C(2021) 1342 final – SA.53625)<sup>1</sup> the European Commission (Commission) decided to initiate the procedure laid down in Article 108(2) TFEU, based on an examination of the information supplied by the German authorities (and by some third parties) regarding the lignite phase-out. Compared to the phase-out of hard coal in Germany, which was supported by the Commission's decision not to raise objections on 25 November 2020,<sup>2</sup> the lignite phase-out has triggered a number of critical comments by the Commission when initiating the formal investigation procedure. The core subject of the investigation is the compensation of €4.35 billion to be granted to the operators for the early closure of the lignite-fired power plants. The approval of the measure by the Commission is of crucial importance here, as the entire construction of the lignite phase-out is subject to the State aid clearance.<sup>3</sup> Is Germany's lignite phase-out strategy, which is a fundamental part of the process of decarbonisation on the way to reach the EU's ambitious climate goals, actually compatible with EU State aid law?

### II. The Commission's Opening Decision

Following pre-notification contacts in December 2020, Germany notified to the Commission, pursuant to Article 108(3) TFEU, compensatory measures to be provided to Lausitz Energie Kraftwerke AG (LEAG) as well as to RWE Power AG (RWE) for the phase-out of lignite powered electricity generation.

The Commission's formal investigation concerns the compensation scheme under public-law contract

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- 1 <[https://ec.europa.eu/competition/elojade/isef/case\\_details.cfm?proc\\_code=3\\_SA\\_53625](https://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=3_SA_53625)> all links in this opinion were last accessed 16 December 2021.
- 2 European Commission, Decision of 25 November 2020 – C(2020) 8065 final – SA.58181.
- 3 The Public-law contract on the reduction and termination of lignite-fired electricity generation in Germany, which forms the decisive legal basis for the lignite phase-out, in s 25 contains a clause making its entry into force subject to the State aid clearance.

terms for the closure of the lignite installations of LEAG and RWE. The legal basis for such compensation is the German Act on the reduction and termination of coal-fired power generation (*Kohleenergieerzeugungsgesetz*, Closure Law) of 8 August 2020, as amended by Articles 22 and 23 of the Act amending the Renewable Energy Act and other energy acts, published on 21 December 2020. The Closure Law envisages the phase-out of coal-fired power generation by 2038 at the latest.

The German government is authorised, by virtue of section 49 of the Closure Law, to conclude a public-law contract with the lignite operators in order to regulate the terms and conditions of the reduction, and ultimately the termination, of lignite-fired power generation. On this basis, Germany and the lignite operators elaborated terms and conditions included in the Public-law contract on the reduction and termination of lignite-fired electricity generation in Germany (contract or public-law contract), which was approved by the German Parliament on 13 January 2021.<sup>4</sup> This contract establishes the operators' legal obligation to close 30 lignite installations. In this regard, section 40 of the Closure Law contains a table that indicates the final closure dates between 2020 and 2038. However, the operators may temporarily or definitely close the installations before the final closure date envisaged in the Closure Law. Therefore, the lignite phase-out follows a negotiated procedure between the German government and the operators.

Section 44 of the Closure Law foresees a compensation of €2.6 billion to RWE for the closure of the lignite installations in Rhineland and €1.75 billion to LEAG for the closure of the installations in Lusatia (Lausitz) by the end of 2029. According to section 45 of the Closure Law, the agreed compensation will be paid in 15 equal annual instalments on 31 December of each year, starting from the year in which the first installation of the operator closes or is transferred to

the deferred closure mechanism (*zeitlich gestreckte Stilllegung*). Based on the public-law contract, the compensation is to be used to cover the rehabilitation costs for the opencast mines in a timely manner (sections 14 et seq of the public-law contract). Accordingly, the modalities of compensation are subject to mutually agreed terms set out in the public-law contract.

From the Commission's point of view, the compensation contains two main elements: First, the operators' foregone profits,<sup>5</sup> because the Closure Law requires them to close down earlier than they would have done otherwise. Second, the additional mine rehabilitation costs that RWE and LEAG face following the requirement to cease their activities earlier than envisaged.<sup>6</sup>

In its preliminary assessment, the Commission considers the compensation measure to constitute State aid within the meaning of Article 107(1) TFEU.<sup>7</sup> The Commission finds that the cumulative criteria for the existence of State aid are likely to be met. Based on these criteria the financial support must:

- be granted by the State or through State resources,
- favour certain undertakings or the production of certain goods with an economic advantage,
- distort or threaten to distort competition, and
- affect trade between Member States.

The Commission notably assumes the existence of an *advantage* due to the high amount of the compensation,<sup>8</sup> going beyond a compensation of unamortised investment costs and including foregone profits that, from the Commission's point of view, cannot be granted as compensation even under German law. Therefore, the Commission concludes that RWE and LEAG are granted an advantage they would not have been able to attain through a compensation claim at a national court or under normal market conditions. The Commission's main argument is that the compensation might constitute disproportionate overcompensation, even taking into account the *Asteris*<sup>9</sup> judgment of the Court of Justice of the European Union (ECJ):

(107) In addition, the *compensation amounts* that Germany grants to LEAG and RWE in the context of the current measure *seem to go beyond a compensation of unamortised investment costs*. The compensation amounts were justified as compensating the operators' foregone profits until 2040 for LEAG and 2051 for RWE. Given that there is

4 'Öffentlich-rechtlicher Vertrag zur Reduzierung und Beendigung der Braunkohleenergieerzeugung in Deutschland' <<https://bit.ly/3CQrS2l>>.

5 European Commission, Decision of 2 March 2021 – C(2021) 1342 final – SA.53625, 8.

6 *ibid.*, 12.

7 *ibid.*, 20.

8 *ibid.*, 20.

9 Joined Cases C-106 to C-120/87 *Asteris* [1988] ECLI:EU:C:1988:457.

no right under German law to be shielded from legal changes – not even until investment costs have been amortised – and that the protection of property rights does not cover turnover and profitability prospects, the Commission also considers it very likely that the compensation granted by Germany goes beyond appropriate expropriation compensation that could be justified under the applicable national law.

(108) On a preliminary basis, the Commission therefore concludes that RWE and LEAG are *granted an advantage* they would not have been able to attain through a compensation claim at a national court or under normal market conditions.<sup>10</sup>

The Commission also concludes that the compensatory measure might cause a *negative impact on competition*, due to the fact that the German electricity market is part of a liberalised market:

(111) In view of the fact that the *German electricity market is part of a liberalised market* which is connected and coupled with the bidding areas of neighbouring countries, the operators of the lignite-fired power plants are in direct competition with other power generators.

(112) In addition, the phase-out of lignite fired electricity generation means that the electricity that would have been produced by these installations will now have to be produced by other generators, which is likely to affect the merit order and hence the electricity wholesale price.

(113) The Commission therefore considers, at this stage of the procedure and on preliminary basis, that *the measure impacts competition* and trade between Member States.<sup>11</sup>

After all, the Commission's assessment of the measure under State aid law appears to be based on a mere formalised approach with focus on the amount of compensation granted. However, the Commission omits to consider the specific nature of the compensation scheme in the context of the measure. Moreover, the Commission's examination fails to address the significance and function of the compensation against the background of the legal and factual uncertainties associated with the lignite phase-out. Consequently, the Commission seems to adopt a too limited view without considering the lignite phase-out as an overall measure.

### III. Assessment of the Measure

Although the Commission sets out a number of reasons in the decision to open the formal investigation procedure, not all relevant aspects that are decisive for assessing the existence of State aid within the meaning of Article 107(1) TFEU are taken into account. First, when considering all elements appropriately, the compensation for the lignite phase-out might not grant an advantage to the operators (1.). Second, the measure is unlikely to cause a negative impact on competition, taking into account the reduced market position of LEAG after the lignite phase-out (2.).

#### 1. Doubts Regarding the Existence of an Advantage

In the present case, there are several doubts as regards the presence of an advantage on the basis of the compensation scheme. In course of the State aid assessment, the Commission has to carry out an all-embracing economic analysis of the measure according to the specifications in the Commission's notice on the notion of State aid (State aid notice)<sup>12</sup> in light of the 'more economic approach' (a.). In this context, it is necessary to consider the specific nature of the compensation, which is to establish a security deposit for corresponding public purposes and obligations (b.). Moreover, the compensation scheme serves to avoid legal and factual uncertainties connected to the lignite phase-out and thus contains components of a settlement agreement that might justify the amount of compensation (c.). With due consideration of all essential elements, the compensation scheme as a whole appears to be a proportionate and fully balanced comprehensive settlement that meets the standards of the MEOT (d.).

##### a. Specifications in the State Aid Notice

According to the criterion of an advantage within the meaning of Article 107(1) TFEU as defined in the

<sup>10</sup> European Commission, Decision of 2 March 2021 – C(2021) 1342 final – SA.53625, 22.

<sup>11</sup> *ibid.*, 23.

<sup>12</sup> European Commission, Notice of 19 July 2016 – 2016/C 262/01.

State aid notice, the measure in question has to cause an economic benefit in favour of the undertaking that could not have been obtained under normal market conditions:

An advantage, within the meaning of Article 107(1) of the Treaty, is any *economic benefit* which an undertaking could not have obtained under normal market conditions, that is to say in the absence of State intervention. Section 4.2 of this Communication provides detailed guidance on the question whether a benefit can be considered to be obtained under normal market conditions.<sup>13</sup>

The economic benefit is further specified as an improvement of the financial situation of the undertaking following the State intervention:

Only the effect of the measure on the undertaking is relevant, and not the cause or the objective of the State intervention. Whenever *the financial situation of an undertaking is improved* as a result of State intervention on terms differing from normal market conditions, an advantage is present. To assess this, *the financial situation of the undertaking following the measure should be compared with its financial situation if the measure had not been taken*. Since only the effect of the measure on the undertaking matters, it is irrelevant whether the advantage is compulsory for the undertaking in that it could not avoid or refuse it.<sup>14</sup>

According to these specifications in the State aid notice, an advantage within the meaning of Article 107(1) TFEU exists if the financial situation of an undertaking improves as a result of a State measure under terms which differ from normal market conditions. In the assessment of market analogy, the State aid notice strictly adheres to the market economy operator test (MEOT):

The purpose of the MEO test is to assess whether the State has granted an advantage to an under-

taking by not *acting like a market economy operator with regard to a certain transaction*. In that respect, it is not relevant whether the intervention constitutes a rational means for the public bodies to pursue public policy (for example employment) considerations. Similarly, the profitability or unprofitability of the beneficiary is not in itself a decisive indicator for establishing whether or not the economic transaction in question is in line with market conditions. The decisive element is *whether the public bodies acted as a market economy operator would have done in a similar situation*.<sup>15</sup>

To carry out the MEOT appropriately it is important to assess whether, in similar circumstances, a private investor of a comparable size operating under normal market economy conditions could have been prompted to make the investment in question. This approach follows the settled case law of the ECJ:

In order to determine whether such measures are in the nature of State aid, it is necessary to consider whether in *similar circumstances a private investor* of a size comparable to that of the bodies administering the public sector *might have provided capital of such an amount*.<sup>16</sup>

In this context, the MEOT takes into account not only the short-term perspective of a private MEO but also the estimations of a long-term investor.<sup>17</sup> Hence, long-term investment strategies and evaluations must be considered when carrying out the MEOT:

It should be added that although the conduct of a private investor with which the intervention of the public investor pursuing economic policy aims must be compared *need not be the conduct of an ordinary investor laying out capital with a view to realizing a profit in the relatively short term*, it must at least be the conduct of a private holding company or a private group of undertakings pursuing a structural policy – whether general or sectorial – and *guided by prospects of profitability in the longer term*.<sup>18</sup>

In line with this long-term perspective, the consideration of the measure under the MEOT must also evaluate whether legal and factual uncertainties that may lead to judicial defeat risks can be avoided.<sup>19</sup> In this context, judicial defeat risks are to be assessed *ex ante*, preferably by virtue of a reliable independent

13 *ibid.*, para 66.

14 *ibid.*, para 67.

15 *ibid.*, para 76.

16 Case C-305/89 *Alfa Romeo* [1991] ECLI:EU:C:1991:142, para 19.

17 A Haratsch, C Koenig and M Pechstein, *Europarecht* (12<sup>th</sup> edn, CH Beck 2020), para 1273.

18 C-305/89 *Alfa Romeo*, para 20.

19 See Koenig and Hellstern, RIW 5/2011, 287.

legal opinion balancing judicial defeat risks and winning/defence chances. In fact, from a long-term perspective, the elimination of existing litigation risks (for example by a waiver of legal remedies or an agreement on the settlement of all potential claims) has a significant economic value for investors. Hence, the avoidance of legal and factual uncertainties must be priced into the scope of compensation as an essential component to the extent that judicial defeat risks would result from these uncertainties.

Therefore, an all-embracing comparative analysis of the financial status *quo ante* of the undertaking and its financial situation after the State intervention is of crucial importance. In this regard, the 'more economic approach'<sup>20</sup> of the Commission applies when it comes to the question whether the financial situation of an undertaking is improved as a result of State intervention on terms differing from normal market conditions. The consequence of the 'more economic approach' has been a comprehensive change in State aid law from a highly formalised control to an impact-based assessment. Thus, the Commission must consider the economic impact of all relevant aspects.<sup>21</sup> State aid law is not geared towards a general prohibition of State measures on the basis of a formalised approach. In the light of a functional understanding, not only the amount of the measure matters, but rather the nature of the measure must likewise be fully considered. In addition, it is important to note the legally relevant positions that the undertaking loses or gives up in course of the measure as well as legal obligations resulting from it. Consequently, the Commission's assessment should provide a detailed economic analysis of the measure in question. Only if under all relevant circumstances an economic benefit remains with the undertaking will there be an advantage within the meaning of Article 107(1) TFEU.

In the case at hand, it is necessary to understand the lignite phase-out as a broad and highly complex measure, in the context of which the compensation is an indispensable element in striking a proportionate balance in view of the early closure of the lignite-fired power plants. Compensation can therefore neither be considered detached from the concrete decommissioning obligations, nor on the mere basis of the abstract concepts of German State liability law, which the Commission particularly emphasises in its decision and thereby deviates from its usual 'more economic approach'.<sup>22</sup> The Commission must per-

form due diligence, *inter alia*, in the economic assessment of the agreement under a concrete longer-term risk management, and not simply focus on the foregone profits and the additional mine rehabilitation costs.

#### b. Compensation for LEAG Is Primarily a Security Deposit

Considering the security deposit nature of the compensation payments, it appears rather unlikely that LEAG gains an advantageous economic position under MEOT terms. In order to apply a market analogous assessment, it is crucial to understand the security mechanisms of the compensation scheme. The entire compensation is granted by payments to special-purpose vehicles (*Zweckgesellschaften*, SPVs) and is thus withdrawn from LEAG's direct disposability. Instead, the entire compensation is channelled and filtered as a security deposit through the special-purpose vehicles that manage the financial resources within strict public law constraints in order to secure the rehabilitation obligations under mining law and any other after-care obligations.

The strict earmarking procedure regarding the use of public funds correlates with the tightening legal and economic conditions for LEAG in recent years. The mining authorities of Saxony and Brandenburg demanded for collaterals under German mining law for the rehabilitation of the opencast mines (section 56(2) of the German Federal Mining Act – *Bundesberggesetz*, BBergG). Instead of claiming mining law security payments, the authorities agreed with LEAG on the establishment of SPVs for the purpose of saving special assets until the closure of the opencast mines in order to secure LEAG's obligations to rehabilitate the opencast mines (section 55(1) BBergG). In this context, corresponding precautionary agreements were concluded with Saxony and Brandenburg covering the details, especially LEAG's obligation to pledge all shares in the SPVs to the Federal States. Under these precautionary agreements, the SPVs pledged to the Federal States save sufficient special assets, and, therefore, serve as a security in-

20 Haratsch, Koenig and Pechstein (n 17) para 1167.

21 See R Wish and D Bailey, *Competition Law* (8th edn, OUP 2015), 2.

22 European Commission, Decision of 2 March 2021 – C(2021) 1342 final – SA.53625, 21, 22, para 100 seq.

strument replacing any security that might otherwise be required under German mining law.

The German Government recognised this precautionary legal construction in the negotiations on the lignite phase-out and synchronised it within the compensation scheme. Consequently, LEAG's entire compensation flows into the two SPVs in Brandenburg and Saxony (section 10(2) of the contract):

The claim of LEAG KW is covered by *payments of compensation (i) to the special purpose vehicle Brandenburg and the special purpose vehicle Saxony and (ii) insofar as the federal states of Brandenburg and/or Saxony demand it, in accordance with sec. 16(5) into trustee accounts, whereby the receipt of payment by the special purpose vehicles shall be recorded as a capital contribution respectively.*<sup>23</sup>

Following this security deposit nature of the compensation scheme, sufficient funds must always be available for the corresponding public purposes and obligations in order to cover the post-mining costs (section 14 the contract):

There is an agreement between the contracting parties that the compensation will be used to *cover the post-mining costs in due time*. The opencast mine operators as well as the special purpose vehicles will therefore *ensure that sufficient funds are available at the time when the post-mining costs are due to be paid in order to cover these costs*.

Pursuant to section 16 of the contract, the SPVs are obliged to use the compensation for the mining law rehabilitation and for the fulfilment of other after-care obligations. However, subject to certain exceptions, among others for the energetic use of lignite, the special assets can be made available for investments and management measures of SPVs. The relevant requirements are specified in detail in investment guidelines according to section 16(1) of the contract:

LEAG and the special-purpose companies are *obliged to ensure*, by means of appropriate measures and in consultation with the responsible

mining authorities, that *the assets of the special-purpose companies and the income from their investment assets are only used to fulfil their obligations under mining law for the rehabilitation and any after-care obligations, unless there is an opportunity to use the assets in accordance with the investment guidelines of the respective precautionary agreement to increase assets*.

Nevertheless, it must always be ensured that the assets of the SPVs remain sufficient to fulfil the primary obligations. This also becomes clear when considering that investments according to section 16(1) must always serve to increase assets of the SPVs.

The Commission should therefore consider the nature of the compensation payments comprehensive when it comes to the assessment of an advantage. The limited economic disposability of the compensation funds for investment and management purposes and the restrictions imposed on the funds managed exclusively by SPVs, while serving as a primary security deposit to cover the follow-up costs associated with the lignite phase-out must play a decisive role in an all-embracing economic analysis of the financial situation after the state intervention. Even if the financial resources can be used for certain purposes under the conditions of the investment guidelines, the security deposit nature of the compensation at least mitigates the economic impact the measure causes on the financial position of LEAG.

### c. Compensation Amounts Based on a MEO Settlement Agreement

Another essential component of the compensation covering the full scope of any damages caused to the operators affected by the early closure is the avoidance of legal and factual uncertainties as well as any connected litigation risks. Within the framework of the overall agreement with the German Government, RWE and LEAG have given up their favourable legal positions, in particular under mining property law (section 9(1) BBergG). Their mining property is in fact devalued as a result of the early closure. All these devaluations, damages and costs together might even exceed the agreed compensation amounts.

The compensation serves, in particular, to avoid legal and factual uncertainties, which must be priced into the scope of compensation. Especially against the background of the German nuclear phase-out,<sup>24</sup>

23 Any passages of the public-law contract are translated by the authors. The public-law contract is only available in German <<https://bit.ly/3dVVIOr>>.

24 For further information see <<https://www.reuters.com/article/us-germany-nuclear-compensation-idUSKBN2AW2FI>>.



the consequences of the lignite phase-out would also have been fraught with legal uncertainties. These have however been avoided through the waiver of legal remedies that is part of the public-law contract (sections 23 and 24) as well as the agreement on the settlement of all potential claims (section 22). Accordingly, the compensation contains, to a large extent, elements of a settlement agreement, especially due to the fact that RWE and LEAG waived their right to sue Germany for damages. This is relevant in light of the decision by the German Federal Constitutional Court<sup>25</sup> which ruled the nuclear Closure Law to be partially unconstitutional for lack of adequate compensation. The operators' forbearance to sue Germany for damages implies, on the other side, a significant financial value for the German State under MEOT terms.

#### *i. Litigation Risks Connected to the Lignite Phase-Out*

The Commission's abstract assumptions on rather negligible litigation risks under German State liability law<sup>26</sup> therefore lack a profound analysis in light of the jurisprudence on the German nuclear phase-out. It is true that the lignite phase-out measures might not amount to expropriations within the meaning of Article 14(3) of the German Constitution (*Grundgesetz*). However, in order to balance proportionality of property rights and public interest limitations under Article 14(1) and (2) *Grundgesetz*, a financial compensation is also required if the limitations restrict the exercise of property rights to a critical extent.<sup>27</sup>

In the present case, the lignite phase-out causes a particularly severe restriction of the companies' property rights, with regard to both the power plants and the mining property. The final closure of the power plants almost completely devaluates these property positions, as no reasonable or legally permissible ways of using them exist anymore. Even if the restriction is imposed for reasons of public welfare, it can only be justified under proportionality considerations of German constitutional law if its intensity is mitigated by compensation. Such mitigating compensation (*Entschädigung*) to balance the proportionality of property rights and social limitations under Article 14(1) and (2) *Grundgesetz* is not subject to typical calculation methods for damages (*Schadensersatz*), eg of foregone profit or natural restitution.

By contrast to compensation of damages, mitigating compensation rather implies components essen-

tially based on equity principles and, therefore, is more difficult to calculate. Against this background, compensation that exceeds the reimbursement for non-amortised investment costs can be justified and considered appropriate. Compared to typical compensation of damages, which is aimed at foregone profit or natural restitution, mitigating compensation is therefore detached from net present value (NPV) calculations of foregone profits. The Commission addresses the national compensation regime.<sup>28</sup> However, this is done without considering the equity element of *Entschädigung* to balance proportionality of the restriction of property rights. The mere consideration of damages calculations based on NPV and additional costs is insufficient.

#### *ii. Evaluation of Risk Settlements under MEOT Terms*

In particular, for measures that contain elements of risk management through a settlement agreement, the Commission should take into account that the public sector may also take its decisions on the basis of longer-term strategic considerations, which a MEO would also apply to avoid litigation risks from a long-term investor perspective.<sup>29</sup> In view of an uncertain legal and/or factual situation, as well as from the terms of the settlement found between the German Government and the affected companies, the MEOT requires an economic evaluation of the risk costs, in particular opportunity costs, in the absence of the settlement. The negative experience of the German nuclear phase-out weighs heavily in this assessment. Ten years after the entry into force of the nuclear Closure Law, Germany had to agree in March 2021 to grant a compensation of €2.4 billion under State liability law to the operators following the decision of the German Federal Constitutional Court<sup>30</sup> that part-

25 German Federal Constitutional Court, Decision of 6 December 2016 – 1 BvR 2821/11, 1 BvR 321/12, 1 BvR 1456/12 – Nuclear phase-out.

26 European Commission, Decision of 2 March 2021 – C(2021) 1342 final – SA.53625, 22, para 106.

27 German Federal Constitutional Court, Decision of 6 December 2016 – 1 BvR 2821/11, 1 BvR 321/12, 1 BvR 1456/12 – Nuclear phase-out.

28 European Commission, Decision of 2 March 2021 – C(2021) 1342 final – SA.53625, 21, paras 100-106.

29 C-305/89 *Alfa Romeo*, para 20.

30 German Federal Constitutional Court, Decision of 6 December 2016 – 1 BvR 2821/11, 1 BvR 321/12, 1 BvR 1456/12 – Nuclear phase-out.

ly classified the nuclear phase-out law as unconstitutional since no adequate compensation was granted to the operators.<sup>31</sup> However, the Commission's opening decision in the German lignite phase-out case appears to underexpose these negative liability experiences.

Whereas the Commission's State aid notice is silent on public settlement agreements in general, it provides for specific MEOT standards on tax settlements. Tax settlement agreements can be a suitable instrument 'to avoid long-standing legal disputes before national jurisdictions'<sup>32</sup> and related legal or factual uncertainties. In the view of the Commission, such settlement agreements may be considered a selective advantage within the meaning of Article 107(1) TFEU, if the measure meets the following criteria:

In this context, a transaction between the tax administration and a taxpayer may in particular entail a selective advantage where:

- (a) in making *disproportionate concessions* to a taxpayer, the administration applies a more 'favourable' discretionary tax treatment compared to other taxpayers in a similar factual and legal situation;
- (b) the settlement is *contrary to the applicable tax provisions* and has resulted in a lower amount of tax, outside a reasonable range. This might be the case, for example, where established facts should have led to a different assessment of the tax on the basis of the applicable provisions (but the amount of tax due has been unlawfully reduced).<sup>33</sup>

Even if the specifications of the State aid notice only refer to tax settlements, the conclusions can be transposed to the principle that the avoidance of litigation risks through settlements of legal and/or fac-

tual uncertainties can be taken into account to an adequate extent in a State measure without this constituting a selective advantage within the meaning of Article 107(1) TFEU.

According to the specifications on tax settlements in the State aid notice and the decision-making practice of the Commission, it is furthermore important that the settlement agreement is part of a 'normal practice'<sup>34</sup> of the State authorities and thus provided for by national law. The Commission concludes the scope of the assessment of (tax) settlement agreements under State aid law as follows:

It is necessary, first of all, to check whether the measure grants the beneficiary any advantage that provides relief from charges normally borne by its budget. In the case under consideration, this involves determining *whether the disputed settlement was concluded illegally or on the basis of disproportionate concessions made by the tax authorities*.<sup>35</sup>

Section 55 of the German Administrative Procedures Act (*Verwaltungsverfahrensgesetz*) provides explicitly for such a settlement agreement as a public-law contract to eliminate legal or factual uncertainties:

#### 55. Compromise agreements

The authority may conclude an agreement under public law within the meaning of section 54, second sentence, which *eliminates an uncertainty existing even after due consideration of the facts of the case or of the legal situation* by mutual yielding (compromise) if the authority considers the conclusion of such a compromise agreement advisable in order to eliminate the uncertainty.<sup>36</sup>

Consequently, German law explicitly allows the conclusion of a settlement agreement, as long as an existing legal and/or factual uncertainty is eliminated by a mutual concession of all parties. Therefore, the present settlement agreement regarding the lignite phase-out is part of the 'normal administrative practice' of the German authorities.

According to the ECJ, the burden of proof to establish the actual advantage lies upon the Commission, and the Member States may even submit ex-post evaluations as counter-evidence on the lack of an advantage.<sup>37</sup> Therefore, the Commission would be well advised to conduct the MEOT evaluation of any risk settlement in a diligent manner by proceeding in the following manner:

31 For further information see Reuters (n 24).

32 European Commission, Notice of 19 July 2016 – 2016/C 262/01, para 175.

33 *ibid*, para 176.

34 European Commission, Decision of 26 May 2010 – State aid C 76/03 (ex NN69/03), *Umicore SA* – 2011/276/EU, paras 153-160.

35 *ibid*, para 157.

36 Official English translation of para 55 of the German Administrative Procedures Act, Federal Ministry of the Interior, Building and Community <<https://bit.ly/30zfZhq>>.

37 C Dekker, 'Annotation on Case C-148/19P BTB' (2020) ESIAL 346.



- in a first step, the settlement pre-conditions, ie an uncertain legal and/or factual situation, are to be established, assessed and quantified in stochastic (if available: statistical) probabilities from an *ex-ante* perspective. In the absence of substantial, quantifiable uncertainty, a MEO would refrain from a costly and superfluous settlement of controllable minor risks. Instead, in case of minor factual risks, a MEO would rely on means of judicial evidence;
- in a second step, the judicial defeat risks are to be assessed *ex-ante*, preferably by virtue of a reliable independent legal opinion balancing judicial defeat risks and winning/defence chances;
- in a third step, on the basis of the aforementioned steps, it has to be assessed under terms of best business practices whether a hypothetical private party to a dispute would have entered into a corresponding settlement on terms of mutual forbearance, respectively to sue and defend, preferably by virtue of a reliable opinion by a certified public accountant with resilient experiences regarding accounting provisions/reserves for legal risks.<sup>38</sup>

These basic requirements of an appropriate MEOT evaluation of risk settlements should be taken into account more thoroughly by the Commission for the assessment of the public-law contract and the compensation granted to RWE and LEAG for devaluations, damages and extra charges resulting from the early closure of the lignite-fired power plants.

Certainly, if an action for annulment under Article 263(4) TFEU was filed, the General Court of the European Union (GC) would scrutinise the Commission's assessment of any proportionate/disproportionate elements of the settlement terms within an all-embracing approach on a long-term-scale (see d. below).

#### d. Essential Elements of the Compensation within an All-Embracing Settlement

It appears that the Commission's opening decision might have neglected an all-embracing comparative analysis of RWE's and LEAG's financial status *quo ante* and their financial situation after the State intervention to achieve the lignite phase-out. Even a deterioration of the financial situation may occur, if all devaluations, damages and extra charges from the

early closure of the lignite-fired power plants are fully balanced against the compensation. In particular LEAG's case raises questions of under-compensation since its compensation funds (that are managed exclusively by SPVs, as described above) serve as a primary security deposit to cover the follow-up costs associated with the lignite phase-out.

The first element of the Commission's focus on compensation is the foregone profit, which is considered and assessed in great detail.<sup>39</sup> This focus is reflected in particular in the detailed data presented in the relevant calculations. These foregone profits are obviously one of the decisive reasons for the Commission's qualification of the measure as an advantage within the meaning of Article 107(1) TFEU.<sup>40</sup> The measure indeed contains aspects of foregone profit, which could, however, also be compensated under German law if the prospects of profit have become sufficiently plausible.<sup>41</sup>

However, the loss of profit is, *inter alia*, only a first component within an all-embracing and rather complex compensation scheme. The Commission's second focus lies on the compensation of the operators' subsequent damages and costs. Especially against the background that the additional costs for the rehabilitation of the mines are not sufficiently taken into account by the Commission,<sup>42</sup> this aspect should certainly be expanded. Nevertheless, even these aspects are not the only essential positions of relevant devaluations, damages and costs.

In sum, an all-embracing compensation scheme, meeting the MEOT standards, rests on the following principal pillars to settle the early closure of lignite-fired power plants in an appropriate and fully balanced overall assessment:

- compensation of foregone profits;
- compensation of additional mine rehabilitation costs, costs for socially acceptable personnel adjustments under German labour law, additional financing costs resulting from the anticipated use

38 See Koenig and Hellstern (n 19) 287.

39 European Commission, Decision of 2 March 2021 – C(2021) 1342 final – SA.53625, 8, paras 30-54.

40 *ibid.*, 22, para 107.

41 German Federal High Court of Justice, Judgment of 26 June 1972, III ZR 203/68; Judgment of 3 March 1977, III ZR 181/74; see further F Ossenbühl and M Cornils, *Staatshaftungsrecht* (6th edn, CH Beck 2013), 320.

42 European Commission, Decision of 2 March 2021 – C(2021) 1342 final – SA.53625, 12, paras 55-63.

of provisions for the mining costs and additional investment costs, which would not have occurred without the Closure Law, to technically allow the gradual early phase-out of the lignite-fired power plants (decommissioning costs);

- in LEAG's case, the limited economic disposability of the compensation funds for investment and management purposes and the restrictions imposed on the funds managed exclusively by SPVs, while serving as a primary security deposit to cover the follow-up costs associated with the lignite phase-out;
- settlement of an uncertain legal and factual situation, as section 22 of the public-law contract contains an agreement on the settlement of all potential claims and hereby contributes to legal certainty, especially against the background that the mining property-law issues of the decommissioning obligations have not been conclusively clarified;
- elimination of judicial defeat risks of the State, as sections 23 and 24 of the public-law contract contain a waiver of legal remedies, lowering the judicial defeat risk which in light of the decision of the German Federal Constitutional Court on the nuclear phase-out should definitely not be neglected.

## 2. Impact on Competition

Even if LEAG's (limited) possibilities to use the special assets for investments through the SPVs were considered as an advantage, the measure seems unlikely to cause or risk to cause a distortion of competition. In this regard, the Commission's assessment appears to lack a profound analysis of the competitive impact caused by the compensation scheme.

According to the Commission's State aid notice, the measure

is considered to distort or threaten to distort competition when it is liable to *improve the competitive position of the recipient compared to other un-*

*dertakings with which it competes*. For all practical purposes, a distortion of competition within the meaning of Article 107(1) of the Treaty is generally found to exist when the State grants a financial advantage to an undertaking in a liberalised sector where there is, or could be, competition.<sup>43</sup>

In this context, an all-embracing comparative analysis of the competitive status *quo ante* of the undertaking and its competitive situation after the State intervention is of crucial importance.<sup>44</sup> Thus, according to the State aid notice, a measure is considered to distort or threaten to distort competition when the market position of the undertaking improves due to the measure.<sup>45</sup>

In the present case, the Commission sticks to the second part of the specification in the State aid notice and thus concludes that the measure causes a negative impact on competition due to the fact 'that the *German electricity market is part of a liberalised market*'.<sup>46</sup> However, this mere formalised approach appears insufficient to address the unique characteristics of the lignite phase-out as a broad and highly complex measure. Thus, the Commission adopts a too limited view in assessing the measure's impact on competition.

Contrary to the Commission's assumption, the compensation measure does not seem to distort or threaten to distort competition, at least when it comes to LEAG. This results from the restricted terms and conditions of the compensation granted to LEAG (a.). Even if LEAG was to use the funds for a transformation process, the compensation would only preserve LEAG as a small competitor on the remaining relevant markets instead of improving its market position vis-à-vis its competitors (b.).

### a. Restricted Terms and Conditions of the Compensation

A distortion of competition is only to be expected to the extent that the financial resources can be used by the undertaking in competition in a manner that allows it to improve its market position in comparison to its competitors. Therefore, an advantage only threatens to distort competition if it provides the beneficiary a margin that puts it in a position to engage in competitive investment.

At least as far as LEAG is concerned, such a risk of distortion of competition appears rather doubtful

43 European Commission, Notice of 19 July 2016 – 2016/C 262/01, para 187.

44 Haratsch, Koenig and Pechstein (n 17) para 1301.

45 Case C-730/79 *Philip Morris* [1980] ECLI:EU:C:1980:209, para 11.

46 European Commission, Decision of 2 March 2021 – C(2021) 1342 final – SA.53625, 23.

when it comes to the very restricted terms and conditions under which LEAG can use the compensation funds. The entire compensation granted solely to the SPVs is withdrawn from LEAG's direct disposability. Instead, the compensation is channelled and filtered as a primary security deposit through the SPVs that manage the financial resources within strict public law constraints to secure the rehabilitation obligations under mining law and other after-care obligations. As mentioned before, the assets are only available for investment purposes or other management measures in accordance with the investment guidelines as agreed with the Federal States, and to increase assets (section 16(1) of the contract). Under this investment option it must be ensured that the assets of the SPVs always remain sufficient to fulfil the primary obligations (section 14 the contract). Furthermore, the income from the investments based on the assets of the SPVs flows into their special funds and, therefore, again serves the security purpose.

Thus, in view of the specific nature of the compensation scheme, the measure appears to grant no, or very little, margin for LEAG allowing it to engage in competitive investment. This becomes even more clear when LEAG's competitive position is analysed in greater detail and compared to RWE's position. Whereas RWE receives the compensation directly (sections 10(1) and 15 of the contract), LEAG's entire compensation flows into the SPVs and thus serves as a primary security deposit, not allowing LEAG to easily engage in practices to distort or threaten to distort competition.

However, even if LEAG invests funds through the SPVs in the relevant market transformation process, a distortion of competition is not to be expected, as its market shares and commercial position will become significantly weaker due to the ongoing transformation process of the energy sector in the coming years (see b. below).

#### b. Compensation Preserving LEAG as a Competitor

In the present case, the compensation scheme preserves LEAG as a (small) competitor in the remaining relevant markets for the generation and wholesale of electricity, in particular from renewable sources, instead of improving its competitive position. Only through the filter of SPVs, parts of the compensation could be used by LEAG as a (small) player to counter the growing market power which will be

accumulated and exercised progressively by big international players, not only by traditional incumbent electricity providers like Eon, RWE or Vattenfall, but also by the new leaders of the renewable and hydrogen energy economy, such as Shell or BP. None of these forward-looking aspects appear to be appropriately addressed in the Commission's opening decision in the German lignite phase-out case.

Certainly, LEAG might decide to engage in a transformation process and enter the markets for trading of renewable energies. After its exit from conventional power generation and the wholesale market, LEAG could enter the renewable energy markets as a new player and expand its position there. In this transformation process, however, LEAG will lose significant market power in comparison to its competitive situation before and until the lignite phase-out. In 2019, LEAG was the second largest electricity producer in Germany with a market share of 16%.<sup>47</sup> The lignite-fired power plants represented the majority of LEAG's production capacity. It is obvious that the company will no longer be able to produce electricity in such large quantities after the lignite-fired power plants are shut down. LEAG will almost completely lose its business basis in course of the lignite phase-out. Without compensation that enables a transformation process, LEAG might not even be in a position to engage in other, more future-oriented markets.

Accordingly, even an alleged advantage resulting from the potential use of the compensation would not lead to a distortion or risk of distortion of competition in the sense that LEAG may obtain an advantageous market position as a result of the State measure. Rather, the measure enables LEAG to undergo a transformation process that will allow it to survive the lignite phase-out and to remain a small competitor on the renewables market. Overall, the measure is thus aimed at providing an adequate legal and financial compensation for a public intervention massively reducing LEAG's business activities and competitive position. After the transformation process, it is to be expected that LEAG has a much weaker position on the relevant markets for electricity generation and wholesale of renewable energies than it pre-

<sup>47</sup> See the Monitoring Report 2020 of the Bundesnetzagentur (42) <[https://www.bundesnetzagentur.de/EN/Areas/Energy/Companies/DataCollection\\_Monitoring/DataCollectionMonitoring\\_node.html](https://www.bundesnetzagentur.de/EN/Areas/Energy/Companies/DataCollection_Monitoring/DataCollectionMonitoring_node.html)>.

viously had on the conventional markets. In this regard, it is important to understand that the compensation scheme at hand is the necessary flip side of the early closure of the lignite-fired power plants. Consequently, the existential effects of the early closure on LEAG's market position are mitigated by the compensation scheme in order to balance the reduction in its market shares. This, in turn, does not easily allow the conclusion assumed by the Commission in the opening decision that the compensation will lead to a distortion of competition by LEAG.

#### IV. Conclusions

At least in LEAG's case, the compensation payments to be granted by the German Government for the lignite phase-out do not appear to meet the relevant legal criteria for constituting State aid within the meaning of Article 107(1) TFEU.

First, LEAG might not even gain an advantageous economic position. The entire compensation is granted by payments to the SPVs and is thus withdrawn from LEAG's direct disposability. Instead, the compensation is channelled and filtered as a primary security deposit through the SPVs that manage the financial resources as trustees within severe public law constraints in order to secure the rehabilitation obligations under mining law and any other after-care obligations. Therefore, an all-embracing MEOT assessment should include the following aspects to settle the early closure of lignite-fired power plants, in order to strike an appropriate balance:

- compensation of foregone profits, additional mine rehabilitation costs, costs for socially acceptable personnel adjustments under German labour law, additional financing costs resulting from the anticipated use of provisions for the mining costs and additional investment costs, which would not

have occurred without the Closure Law, to technically allow the gradual phase-out of the lignite-fired power plants (decommissioning costs);

- limited economic disposability of the compensation funds for investments and management purposes and the restrictions imposed on the funds managed exclusively by SPVs with the funds serving as a primary security deposit to cover the follow-up costs associated with the lignite phase-out;
- settlement of an uncertain legal and factual situation especially against the background that the mining property-law issues of the decommissioning obligations have not been conclusively clarified;
- elimination of judicial defeat risks of the State by virtue of a waiver of legal remedies in light of the decision of the German Federal Constitutional Court on the nuclear phase-out.

Second, even if LEAG's (limited) possibilities to use the special assets for investments through the SPVs were considered as an advantage, the compensation appears not to cause or risk to cause distortions of competition. Instead, the compensation preserves LEAG as a (small) competitor in the remaining relevant electricity generation and wholesale markets from renewable sources. Only indirectly, through the filter of SPVs, parts of the compensation can be used by LEAG as a small player to counter growing market powers which will be accumulated and exercised progressively by big international players.

These aspects appear not to be appropriately addressed in an all-embracing manner in the Commission's opening decision. Having regard to the Commission's burden of proof under Article 107(1) TFEU to establish the actual advantage and the risks to cause distortions of competition, DG Competition would be well advised to widen and deepen its analysis and evaluation.