

# Consultation on Environmental and Energy Aid Guidelines 2014-2020

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A EURELECTRIC response paper



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▶ Commitment, innovation, pro-activeness

Social Responsibility

▶ Transparency, ethics, accountability

# Consultation on Environmental and Energy Aid Guidelines 2014-2020

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## EXECUTIVE SUMMARY

The current process to review the state aid rules is an important opportunity to safeguard the functioning of the EU electricity market. Particularly in the current economic climate it is essential to ensure that the EU has a sound state aid framework that contributes to Europe's competitiveness and advances a cost-effective transition to a low-carbon economy.

The revision of the *Environmental and Energy Aid Guidelines* is only one part of the state aid modernisation. The *Environmental and Energy Aid Guidelines* constitute together with *Regional Aid Guidelines*, *General Block Exemption Regulation (GBER)* and *State Aid Framework for Research, Development and Innovation* a framework for providing state aid to the electricity sector. The revision of these guidelines and the GBER should be treated as a package, since the different instruments need to complete each other.

The Commission's goal to "ensure that state aid control is a tool promoting sound use of public resources and limiting competition distortions" is a sound basis for reviewing the state aid framework that applies to the electricity sector. **EURELECTRIC encourages the Commission to use state aid control, and other available tools to facilitate integration of electricity market, minimise market distortions caused by ill-designed support measures and provide an effective RD&D framework for the energy sector.** The tools used by the European Commission should be consistent and contribute to the advancement of Europe's key policy goals.

**The state aid framework for low carbon technologies should take into account:**

- **Maturity of technology:** Progressive phase-out of subsidies for all technologies should follow when technologies reach market competitiveness and broad deployment. Subsidies should be focused on fostering RD&D of new technologies. The state aid framework should facilitate RD&D support for technologies throughout the entire innovation cycle.
- **Technology neutrality:** As a technology neutral and European-wide policy instrument, the EU Emissions Trading market is suitable for driving investments in mature low carbon technologies. There is a need to ensure that policy instruments – like the ETS and support schemes or energy efficiency support are not conflicting. A reformed ETS should be the main driver for the low carbon transition.
- **Market exposure and integration of supported technologies:** Support schemes should expose electricity generation to market dynamics (e.g. competition between technologies and exposure to wholesale prices). All technologies should be responsible for scheduling and operation, and have equivalent obligations regarding grid connection, balancing and grid charges.

The guidelines should cover all relevant areas where state aid is provided for the power sector.

Investments in the **transmission network** should be financed via the tariff mechanism. Only grid projects with a positive cost–benefit analysis should be executed. State aid for **distribution networks** should focus on RD&D, and regulation should ensure that rates of return are adequate for companies to be able to finance investments through grid tariffs.

Policy makers should prioritise measures to remove market distortions, integrate electricity markets, incorporate RES generation in the market and develop demand-side response in improving **generation adequacy**. In markets where generation adequacy is already endangered, capacity remuneration mechanisms should be considered to ensure that enough capacity is available through a coordinated regional approach. If introduced, CRM should be market-based technology neutral. They should ensure equal treatment of existing/new units, generation/storage/demand, be open to all market participants and take into account interconnectors and be compatible with the internal energy market.

The Commission should take the opportunity to simplify and streamline the operation of state aid rules. Lengthy notification processes add to the uncertainty of investing into low carbon resources and can delay improvements in national support mechanisms. EURELECTRIC would therefore welcome the development of time limits.

The review of state aid guidelines needs to be done in a way that is conducive to investor confidence; this includes retroactive changes to be avoided.

# INTRODUCTION

## RATIONALE AND MAIN OBJECTIVES OF THE REVISION

The Commission has launched a comprehensive state aid modernisation process. The objective of the process is to establish state aid rules that 1) facilitate growth in a strengthened, dynamic and competitive internal market 2) focus enforcement on cases with the biggest impact on the internal market and 3) are streamlined and lead to faster decisions. Given the changed technological and economic landscape, EURELECTRIC finds it essential that state aid rules and processes are updated if Europe is to meet its energy and climate policy goals.

In the current economic and regulatory environment, it is more important than ever to limit the competition distortions caused by aid measures and ensure consistency of markets between Member States. The guidelines should cover all relevant areas where state aid is provided for the power sector.

EURELECTRIC's comments to paragraphs 1-6:

The review of the Environmental Aid provides an opportunity for the Commission to safeguard the operation of the internal electricity market. We are only one year away from 2014, the target year for completion of the internal market, and the electricity market is at a turning point. Unless the EU rapidly changes course and ensures greater coherence between EU and national policies, we will very soon witness a deterioration of the internal electricity market. In addition to the electricity market, also the carbon market is at stake.

RES technologies are an important and promising asset within a diversified power generation portfolio. It adds to security of supply and facilitates the low carbon transition. To reach the EU's 20% RES target by 2020, about one third of the EU's electricity will need to be generated from renewable energy sources. RES represents a key investment opportunity for the power sector, and its increase is a positive development. RES is not an objective in itself, and making the most of the opportunities for RES development as a part of the power system, will require the right framework for RES growth, both before and after 2020.

As the Commission points out, various RES technologies are becoming mainstream due to large scale deployment of especially wind and PV, and their costs have decreased. In recent times, most investments in power generation in Europe have been based on national support schemes rather than on market signals. RES electricity is not yet integrated in the wholesale market and the overall costs of support<sup>1</sup>, other market

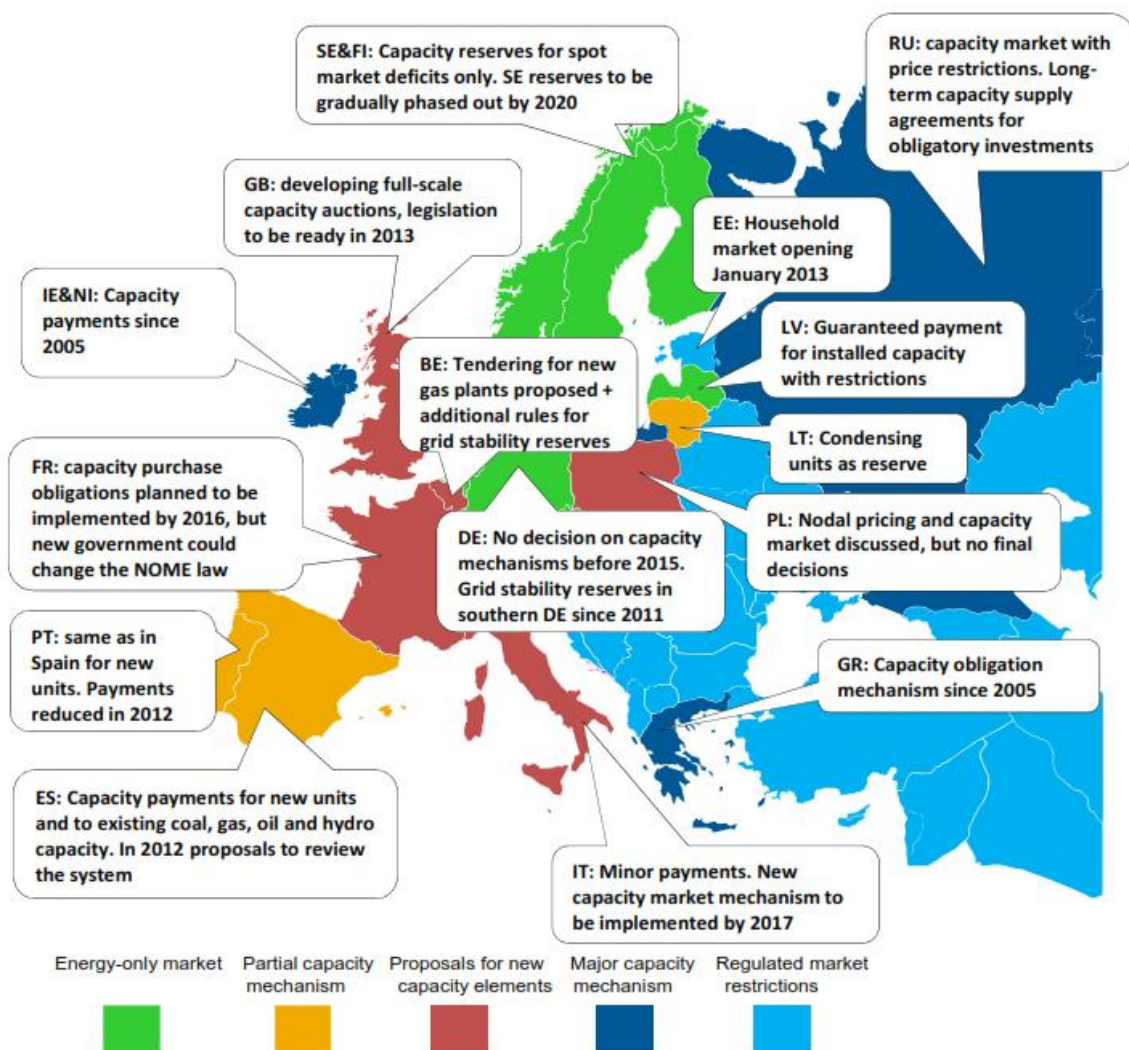
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<sup>1</sup> The costs of support schemes amounted to 38 billion euros in 2012 (CERA). The Consultation paper mentions 12 billion euros in 2011, which does not cover the full RES Support (paragraph 8), because all support schemes do not constitute state aid

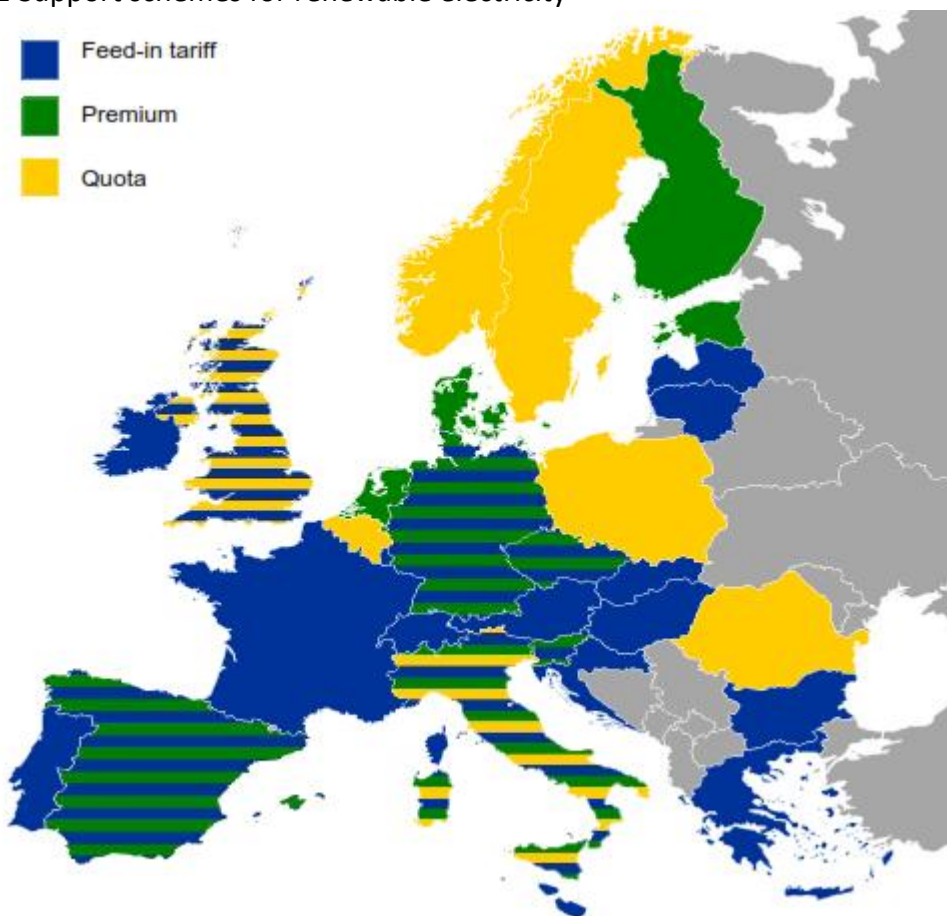
interventions and distorting effects of ill-designed support schemes that hinder market integration of RES electricity have grown and even escalated.

The following graphs on the renewable support schemes and capacity remuneration mechanisms (CRM) set up on national levels illustrate a trend to fragmentation of the electricity market. This goes against the objective of the integrated European energy market, foreseen for 2014. And there is a risk for a similar pattern for CO<sub>2</sub> measures to follow, if the ETS reform fails.

Graph 1 Capacity remuneration mechanisms



Graph 2 Support schemes for renewable electricity<sup>2</sup>



EURELECTRIC's comments to paragraphs 21-25:

EURELECTRIC agrees on the need to ensure that state aid control supports the integration of renewable electricity, competitiveness of EU and resource efficiency. Furthermore, we agree on the principle of technology neutrality. In our view the Commission should include the importance of well-functioning, common electricity market among key considerations for the review of the guidelines.

<sup>2</sup> Source: European Commission, Switzerland and Norway added by Eurelectric



# MAIN ISSUES OF THE REVISION OF THE GUIDELINES

## HARMONISATION AND SIMPLIFICATION OF RULES

EURELECTRIC's comments to paragraphs 27-29:

The state aid control should be based on rules that are EU wide, transparent and easy to apply. The new rules should facilitate a harmonised and predictable framework for state aid and ensure that case-by-case approach to aid measures is only used in specific circumstances.

The revision of the framework should also lead to a faster notification of state aid measures. Lengthy notification and investigation processes add to the uncertainty of investing into low carbon resources and can delay improvements in national support mechanisms. Time limits should be applied to ensure shorter notification processes.

EURELECTRIC encourages the Commission to explore the opportunities to harmonise and simplify the state aid rules.

## ENERGY INFRASTRUCTURE

EURELECTRIC's comments to paragraphs 31-38:

Investments in cost-effective interconnections should be facilitated as a matter of priority, because they are a key for a functioning internal energy market and integration of renewable electricity into the electricity market. Merchant interconnection could be considered as an alternative in appropriate cases, and could help solve the problem of TSOs not investing if the benefits accrue to others.

Investments in the **transmission network** should be financed via the tariff mechanism. Only grid projects with a positive cost–benefit analysis should be executed. The new infrastructure package and the coordination through the TYNDP are already good support and should be a sufficient starting point to increase network investments.

Support for demonstration and innovation of storage technologies is welcome, but it must be borne in mind that storage of electricity and gas is a competitive activity and that market distortions should be avoided. The principle of unbundling must be respected.

Investments in distribution networks will represent the major part of overall network investments, and their share of overall network investments will rise. Two thirds of the €200 billion investments that are needed into European networks by 2020 have to be invested into **distribution networks**<sup>3</sup>. This share will rise to almost three quarters of total transmission and distribution investments by 2035, and to four fifths by 2050.

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<sup>3</sup> IEA Energy outlook (€520 billion by 2035)

As the Commission states in the Consultation paper, investments in European electricity networks are a regulated asset for which national regulatory authorities approve tariffs or tariff methodologies. Investments are financed through tariffs and the priority is to ensure that a fair rate of return is allowed in Member States, not to provide funding through state aid measures. If the achievable rate of return is too low or the risk of stranded investments is not adequately considered, strong constraints on investments in distribution network will occur. Regulation should become more flexible and focus more strongly on long-term needs, including investments in smart grids and smart meters, thereby promoting long-term regulatory stability rather than narrow, short-term optimisation. Clear rules for adjusting revenues for lifting investment barriers during the regulation period should be in place.<sup>4</sup>

Nevertheless, the proposal that national infrastructures, such as the extension of local distribution network or the development of smart grids could be assessed with a stricter test, seems too restrictive. Most of RES capacity will be connected to distribution grids<sup>5</sup> and the development of distribution networks and smart grids that will enable flexible solutions including demand response is equally important for their integration as development of transmission networks. In addition, when smart grid projects could be financed by a municipality through public funding, DSO may not be allowed to include the costs arising from its participation in the tariff. Therefore the guidelines should be flexible enough and should not introduce more onerous tests for distribution networks and smart grids than for interconnections.

State aid for the power sector, including distribution of electricity should be focused on RD&D (see page 12-13 for EURELECTRIC's views on state aid for RD&D). In particular, demonstration projects throughout Europe are necessary to test the system integration of the innovative solutions. The DSOs need to develop new solutions for improving power quality to minimise the risks for outages due to the increase of variable renewables in the distribution network.

## **ISSUES OF SYSTEM STABILITY AND GENERATION ADEQUACY**

EURELECTRIC's comments to paragraph 41 and 42:

Ensuring generation adequacy is increasingly challenging in the electricity markets across Europe. This is related to a large extent to the effects of most RES support schemes. Generation adequacy has also deteriorated in some markets due to lack of investments in view of various market distortions like regulated end user prices and price caps in wholesale markets, barriers for generators to enter the market, forced closure due to environmental legislation, regulatory price controls during periods of scarcity and general uncertainty about the stability and evolution of national and/or European energy policies.

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<sup>4</sup> See EURELECTRIC report 'Regulation for Smart Grids', February 2011

<sup>5</sup> For example, recently a German study stated that the modernization of German distribution grids to allow the integration of RES will require investments between 27 and 42 billion Euros. (Source: Expansion and investment needs of the distribution networks in Germany until 2030, DENA German Energy Agency <http://www.dena.de/presse-medien/studien/dena-verteilnetzstudie.html>)

The rapid development of renewable generation in recent years has been a welcome development in terms of placing energy production on a more sustainable basis. However, much of the investment has been undertaken via non-market-based and operational support schemes. This means that an increasing share of capacity is operating outside wholesale markets, reducing market liquidity and undermining the business case for conventional generation, because running hours have been reduced (especially for CCGTs) and average price levels lowered. But at the same time, back up capacity and peak load capacity is still needed and premature decommissioning of conventional power plants for economic reasons puts security of supply and system stability at risk.

As a result of a deteriorated generation adequacy, a number of member states have introduced or are considering introducing capacity remuneration mechanisms to ensure that sufficient capacity is available to ensure an adequate level of back up and meet peak demand.

In our view, policy makers should focus on the following key areas to improve generation adequacy: 1) Remove the various remaining distortions such as end-users' regulated prices 2) step up efforts in integrating electricity markets 3) bring mature RES gradually into the market and make RES producers balancing responsible parties and 4) develop demand response 5) develop grid infrastructure (mainly cross-border interconnections). However, EURELECTRIC observes that in many cases the implementation of these measures is taking place too slowly and many member states therefore rather continue increasing interventions in the market. In those markets where, in particular, generation adequacy is endangered, capacity remuneration mechanisms should be considered to ensure that enough capacity is made available to the market through a coordinated regional approach amongst Member States.

EURELECTRIC's comments to paragraphs 44-47:

Capacity remuneration mechanisms should be carefully designed to avoid distortions. Cross-border effects should be taken into account in order to reduce the risks of competition and market distortions and possible over-capacity. Impacts assessment should be carried out before introduction of CRM, and the impacts to the neighbouring countries taken into account. A common framework is needed to assess generation adequacy while taking into account cross border connections.

In the recent consultation on generation adequacy EURELECTRIC called for a set of coherent EU level compatibility criteria for the use of capacity remuneration mechanism<sup>6</sup>. The primary objective of CRM should be to ensure sufficient capacity to meet peak demand. Other objectives, like promoting flexibility, reducing CO<sub>2</sub> etc. should not be targeted by CRMs as there are other policy instruments for these objectives.

The distortions caused by CRM can be reduced by smart design. If introduced, CRM should be market-based and technology neutral. They should ensure equal treatment of existing/new units, generation/storage/demand, be open to all market participants and take into account interconnectors. Capacity mechanisms should be established as a

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<sup>6</sup> [http://www.eurelectric.org/media/73943/eur\\_response\\_to\\_ec\\_consult\\_on\\_gen\\_adequacy\\_crm\\_final-2013-301-0001-01-e.pdf](http://www.eurelectric.org/media/73943/eur_response_to_ec_consult_on_gen_adequacy_crm_final-2013-301-0001-01-e.pdf)

stable framework, allowing for a self-regulation that will lead to lower capacity prices when there is overcapacity.

Retroactive changes to the CRM should be avoided.

## **SUPPORT TO LOW-CARBON ENERGY SOURCES**

### **Issues of technology neutrality and market failures**

EURELECTRIC's comments to paragraphs 49-53:

Competition between technologies contributes to cost-effectiveness and decision makers should avoid picking winners through policy measures. The optimum route for achieving a low carbon economy involves an integrated, well functioning EU electricity and emissions trading markets. Within this framework, all mature technologies should compete in the market, and RD&D support should be provided for new technologies.

EURELECTRIC welcomes the Commission's statement in paragraph 52 that the EU ETS should remain the key tool for driving low-carbon energy deployment. We consider the EU ETS to be the best pan-European instrument to drive investments in carbon reduction because it is technology neutral. Carbon markets are the cost-effective way to drive investment choice in CO<sub>2</sub> reduction and the EU ETS is fully compatible with the Internal Energy Market.

The credibility of the EU ETS has recently been questioned, given the very low carbon prices at present, which are insufficient to incentivise investment in low-carbon technologies. EURELECTRIC believes that these problems are primarily the result of poor implementation of the Scheme and conflicting policy instruments. As the recent Green paper *A 2030 framework for climate and energy policies* states there is an increasing risk of policy fragmentation threatening the Single Market, with national and sectorial policies undermining the role of the ETS and level playing field it was meant to create. EURELECTRIC sees an urgent need to ensure that support measures do not interfere with the functioning of the carbon market and implement measures to restore the EU ETS<sup>7</sup>. Restored EU ETS would ensure that positive externalities of CO<sub>2</sub> free power generation are rewarded by a market friendly policy instrument.

EURELECTRIC agrees with the principle of technology neutrality. However, in our view it is important to advance less mature technologies which are beyond the stage of research and development but still not commercially viable (e.g. CCS). The solution is RD&D support that is available for technologies throughout the entire innovation cycle- the needed policy change for this is currently under way and very much welcomed by EURELECTRIC (e.g. Energy Technology Communication, Horizon 2020, but also Innovation Action Plan Report EURELECTRIC).

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<sup>7</sup> The Polish Electricity Association supports neither the backloading of emissions allowances nor structural changes to the EU ETS

State aid rules should ensure that innovation in the field of energy contributes effectively to competitiveness, jobs and long-term sustainable growth in Europe. EURELECTRIC finds it particularly important that the state aid guidelines on RD&D are improved in such a way that RDD support for immature technologies from inception to demonstration up to market induction is possible. Promising technologies close to market deployment require support in overcoming the final hurdle before entering the market. The final steps of the innovation cycle are decisive for going ‘from promise to practice’, but are financially risky and have not received the appropriate attention in previous support programmes<sup>8</sup>. The main cost reduction of technologies come through large scale deployment.

The existing State Aid Guidelines on RD&D are complicated, and should be greatly simplified.

Financial support should be phased out as technologies become mature. This needs to be done in a way that is conducive to investor confidence. Retroactive changes<sup>9</sup> must be avoided. In addition, any regulatory changes for new investments should be clearly signalled in advance, because project development is a long process in the energy field. These factors should be taken into account when determining the transitory regime for the new guidelines.

EURELECTRIC’s comments to paragraph 54:

The Commission mentions in the consultation paper the need to phase out subsidies for fossil fuels. EURELECTRIC is not in favour of subsidies to mature power generation technologies. There are no reasons to have subsidies to generation technologies including fossil fuels.

## **Support to renewable energy sources (RES)**

The growth of renewables in Europe is a positive development, which adds additional technologies to the European generation portfolio. EURELECTRIC is committed to achieving a carbon-neutral power supply in Europe by 2050, and renewable energy sources will play a major role in this regard.

EURELECTRIC’s comments to paragraphs 56- 58:

The EU energy policy should ensure least distortive support measures for RES to the benefit of consumers. EURELECTRIC considers the revision of the State Aid Guidelines as an important opportunity in this respect: European citizens and businesses deserve cost-efficient support schemes, even more so in a difficult economic environment.

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<sup>8</sup> EURELECTRIC is currently elaborating an Innovation Action Plan which will be published during a high-level conference on 14 May 2013.

<sup>9</sup> Changes after moment where exposure has started, investment decision has been taken.

EURELECTRIC considers that over compensation, excessive rents<sup>10</sup> should be avoided. . Recent developments show that this leads to “stop and go” policies or bubble types of investments which fundamentally harm the investment climate (as it was the case of solar PV/ CSP in Spain and in PV in the Czech Republic for example). Excessive rents also increase customers’ bills unnecessarily. But indeed the problem is not solved once overcompensation is abolished. The rootcause of the problem is operational support which distorts the market.

Europe must integrate RES technologies into the market at least cost. Like any other generation technology, all RES technologies should be responsible for scheduling and operation, participate in the wholesale markets and be subject to equivalent obligations and rights regarding grid connection, balancing and grid charges. These good practices are already a reality in many European Member States (e.g. onshore wind in Belgium, Nordic countries, Spain). As market integration is rolled out and the commensurate market rules exist to facilitate within day flexibility, these obligations should be extended to all renewable technologies.

Extension of market obligations to all technologies may require an adjustment of support mechanisms to ensure that new costs imposed on RES generation are correctly considered<sup>11</sup> while still providing an incentive to improve forecasts and reduce imbalance.

EURELECTRIC’s comments to paragraph 59 and 60:

EURELECTRIC encourages the Commission to take into account the design of a support scheme while considering compatibility with internal market. Competition between technologies and exposure to wholesale market prices bring competition elements to RES support schemes.

When comparing the varying distortive impacts of investment aid and operating aid, investment aid is usually the preferable option<sup>12</sup> as it is a one time payment and as such is likely to distort market price signals less.

Support mechanisms have different impacts on markets, for example tradable certificates and tendering/auctions are less distortive than feed-in tariff schemes<sup>13</sup>. Among feed-in schemes, feed-in premiums are more market compatible than feed-in tariffs as they expose RES technologies to market dynamics and market discipline, ultimately ensuring a better match between demand and supply. This would therefore encourage the

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<sup>10</sup> Excessive rents have occurred e.g. in cases when FIT schemes have not been modified to accommodate decrease in the costs of technologies.

<sup>11</sup> Example of an adjustment to a support scheme to ensure that new costs on RES generation are considered: In Germany there is a management premium which comes on top of the feed-in premium when an operator decides to switch from the simple feed-in tariff to the feed-in premium regime.

operation of power plants when energy is actually needed. Feed-in tariffs are best suited for technologies at the market induction stage.

In the end, the detailed design of a support scheme determines its impacts on the market, and the state aid review should take this into account.

EURELECTRIC's comments to paragraph 63:

A more European approach is paramount to cost-efficient RES development. Hence, EURELECTRIC welcomes the efforts of the Commission to support initiatives giving a more regional and ultimately European dimension to RES deployment in Europe. The joint certificate scheme recently set up by Norway and Sweden is a good example of this spirit of cooperation. In this regard, we welcome the Commission's intention to encourage the further use of cooperation mechanisms of the RES directive. We look forward to the Commission's upcoming guidance on cooperation mechanisms.

## **EXEMPTIONS FROM ENVIRONMENTAL TAXES OR OTHER CHARGES ON ELECTRICITY CONSUMPTION**

EURELECTRIC's comments to paragraphs 65-72:

EURELECTRIC is concerned about the lack of progress in harmonising energy taxation and we call for the Commission to take measures both through state aid control and other means to ensure a level playing field and stable investment climate for the utilities.

The tax burden on the electricity sector has continuously increased in recent years. Moreover, it is becoming ever more diversified<sup>14</sup>. With market integration as one of our cornerstones, EURELECTRIC regrets that those developments create undue market and competition distortions, thereby leading to severe impediments in the development of electricity markets.

Harmonisation of energy taxation should be based on the following principles:

- a) Taxes or levies on fossil fuels used for power generation or certain power generation technologies should not be applied. They hamper market integration and distort competition. Electricity should be taxed at the point of consumption.
- b) CO<sub>2</sub> based taxation should be applied only for sectors that are not in the scope of EU ETS. The EU ETS already ensures that emissions from the ETS sectors do not exceed a cap, and conflicting policy instruments should be avoided. On the other hand, the introduction of an equivalent CO<sub>2</sub> tax for the non-ETS sectors contributes to a level playing field and to an overall least cost approach to reducing CO<sub>2</sub> emissions.

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<sup>14</sup> See Eurelectric report: Powering Investments: Challenges for the Liberalised Electricity Sector (2012)

In relation to exemptions from taxes and charges, there should be a European approach to avoiding carbon leakage, not national solutions. We suggest the Commission should explore measures which are appropriate for energy intensive customers of the entire European Union.

Energy intensive industries enjoy largely free allocation of CO<sub>2</sub> allowances and have EUA surpluses from the previous trading period. While EURELECTRIC considers that it is important to ensure the competitiveness of European industry, exemptions regarding taxes/levies/CO<sub>2</sub> allowances should be limited to cases where measures are most needed, because their costs are borne by households.





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