State aid to electricity capacity mechanisms: From an uncoordinated patchwork to a harmonised approach?

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1. The evening of 4 November 2006, a power shortage affected more than 15 million customers throughout Europe. The disturbance had its starting point in Germany but subsequently large parts of the interconnected European power system suffered from it, i.e. some customers did not have access to electricity for up to approximately 1.5 hours. That kind of incident—extremely rare in Europe—illustrates the importance of maintaining a constant balance between supply and demand on the electrical system.

2. In certain periods of high consumption, i.e. “peak periods,” such balance may be hard to secure. A number of Member States have therefore devised electricity “capacity mechanisms,” which aim at ensuring the adequacy between generation capacity and consumption at all times and remunerating capacity providers for having sufficient capacity available. At first glance, such mechanisms look like reasonable solutions to prevent the occurrence of a blackout like the one described above. That is, however, only one side of the coin.

3. The other side of the coin emerges from the European Commission’s Interim Report, published on 13 April 2016, regarding the preliminary results of its State aid sector inquiry on electricity capacity mechanisms. This inquiry had been opened in May 2014, following the disturbance in Germany but subsequently large parts of the interconnected European power system suffered from it. The disturbance had its starting point in Germany but subsequently large parts of the interconnected European power system suffered from it, i.e. some customers did not have access to electricity for up to approximately 1.5 hours. That kind of incident—extremely rare in Europe—illustrates the importance of maintaining a constant balance between supply and demand on the electrical system.

Against the background of a changing landscape of electricity markets, a number of EU Member States have devised capacity mechanisms in order to address perceived threats to their national security of supply. However, such mechanisms may raise competition concerns, which the European Commission intends to tackle from the angle of State aid law. In that regard, it stems from the ongoing State aid sector inquiry that while certain capacity mechanisms may be necessary, Member States should improve specific design features and facilitate coordination among their respective national mechanisms. The Commission is now expected to intensify its State aid enforcement action in future years, based on the stringent criteria laid down in the Energy and Environmental Aid Guidelines. The Commission should also to push for further harmonisation of capacity mechanisms in the EU through legislative proposals by the end of 2016.


I. The sector inquiry: Better understanding capacity mechanisms and exploring potential concerns under State aid rules

7. Capacity mechanisms, while offering a response to the changing landscape of electricity markets, can also create competition concerns, which the Commission intends to investigate through the ongoing State aid sector inquiry (1.).

As a first step, the Commission used the inquiry to classify the variety of current or anticipated capacity mechanisms into a workable categorisation (2.). Following such “static” overview, the Commission pointed to specific challenges raised by capacity mechanisms, in terms of assessing their necessity and improving their design features (3.). Building on that analysis, the Commission gave preliminary guidance as to the most problematic types of mechanisms under State aid rules (4.).

1. Capacity mechanisms: A response to the changing landscape of electricity markets as well as a source of competition concerns

8. The European electricity markets have faced profound and unprecedented changes. In order to ensure national security of supply in that context, a number of Member States have devised electricity capacity mechanisms (1.1). Such mechanisms, however, may raise competition concerns, which led the Commission to open a State aid sector inquiry (1.2).

1.1 Capacity mechanisms to ensure security of supply following deep changes in the electricity markets

9. Over the past ten to fifteen years, profound and unprecedented changes took place in the electricity sector. In particular, the share of energy produced through renewable sources (mainly solar and wind energy) has steadily risen, resulting in a significant increase of total installed capacity. However, while the rise of renewables should be encouraged, it also had significant side-effects: in particular, because of their lower operating costs, renewables contributed to a drop in wholesale electricity prices. This prompted some producers to close down their most expensive but least profitable power plants, i.e. usually gas-fired plants. In addition, a number of plants were ageing and required new investment, which producers may find more difficult to fund.
10. As a consequence, concerns emerged that in certain Member States the total capacity available may prove insufficient to meet demand in peak time, thereby placing a threat on their security of supply in the short, medium or long term. Indeed, although renewable energy generation units are environmentally friendly, they only provide “intermittent” capacity; in cases of demand peaks, renewables will not necessarily be available for production, since in essence their operation depends on favourable weather conditions, which are by nature unpredictable.

11. In a so-called “energy-only” market, operators are theoretically remunerated solely by the sale of electricity and base investment decisions on expectations of the profitability of generation activities. In principle, wholesale electricity markets should provide the appropriate price signals to trigger the necessary investments to meet demand, if the level of wholesale prices allows fixed costs to be recovered. However, in practice, price signals may be affected by a number of market failures, including low price caps, public support for renewables, the fact that scarcity periods are unpredictable, and the lack of active participation of demand-side response (“DSR”) operators. This results in particular in the “missing money” problem, meaning that the market may not be able to sufficiently incentivise investment in adequate generation capacity, because investors fear that future revenues may not cover their fixed costs and will not remunerate their investment.

12. Against that background, a number of Member States seek to guarantee their national security of supply by introducing (or planning to introduce) capacity mechanisms designed to ensure an adequate generation capacity in particular through supporting investment in capacity. In essence, those mechanisms imply that electricity producers receive remuneration for providing capacity to the market, either by maintaining existing capacity, or by adding new capacity. Capacity mechanisms may provide support not only to power generation capacity, but also to DSR measures, such as incentives to reduce electricity consumption during peak periods.

13. Capacity mechanisms undoubtedly entail fundamental changes in electricity markets: indeed, instead of being paid only for the electricity that they generate, generators and other capacity providers are (also) paid for keeping capacity available.

1.2 Capacity mechanisms as a source of competition concerns prompting the first State aid sector inquiry

14. The setting up of a capacity mechanism inevitably involves some kind of intervention by the State, potentially resulting in State aid within the meaning of Article 107 of the Treaty on the Functioning of the European Union (“TFEU”). State support in the form of capacity mechanisms will have to be notified to the Commission prior to implementation if it constitutes State aid within the meaning of Article 107 (1) TFEU, i.e. (i) it is imputable to the State or a body under State control, (ii) it is financed, directly or indirectly, through State resources, (iii) it grants a selective advantage to its beneficiary, and (iv) it actually or potentially impacts competition and trade between Member States.

15. Where a measure is characterised as State aid, its compatibility with the internal market is assessed on the basis of Article 107(2) and (3) TFEU and associated notices and guidelines published by the Commission. In that regard, the Commission issued guidance in the Energy and Environmental Aid Guidelines (“EEAG”) adopted in 2014, which provide specific criteria to assess capacity mechanisms, referred to as “generation adequacy measures.” Those guidelines contain significant amendments to the 2008 Guidelines on Environmental aid, which did not cover capacity mechanisms.

16. At the time of launching the sector inquiry, the Commission had already applied the EEAG compatibility criteria to capacity mechanisms only in relation to the Great Britain “Capacity Market” (the “GB Capacity Market”), which was found in July 2014 to constitute State aid compatible with the internal market (see Section II infra). Another case, relating to a Greek “interruptibility scheme,” did not involve State aid and therefore no compatibility assessment was made.

17. In that context of limited enforcement, the Commission opened its sector inquiry on 29 April 2015. The Commission expects this inquiry to provide a better understanding of the existence and functioning of capacity mechanisms and to shed light on the various types of capacity mechanisms that exist or are planned. Upon reading the Staff Working Document published on 13 April 2016, it appears that the sector inquiry was also meant to “draw tentative conclusions which will help with the application of the EEAG,” in the context of potential follow-up enforcement cases.

18. In addition, the information collected in the context of the State aid sector inquiry is expected to feed into the wider “Energy Union” strategy. In February 2015, the Communication on the EU Energy Union already warned against the potentially adverse effects of capacity mechanisms on the internal energy market and announced plans for legislation on electricity market design and security of electricity supply.

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10 SWD, p. 5.
19. In view of those ambitious goals, it is no surprise that the sector inquiry has wide coverage: the Commission sent more than 200 questionnaires to public authorities and market participants in 11 Member States (Belgium, Croatia, Denmark, France, Germany, Ireland, Italy, Poland, Portugal, Spain and Sweden). The Commission says it selected those Member States because they have either introduced or are considering introducing one or more capacity mechanisms.12 The UK was not part of the list, presumably because the Commission had already cleared the GB Capacity Market in 2014. Interestingly, France is part of the sector inquiry but the Commission took enforcement action without even waiting for the end of the sector inquiry, as it opened in November 2015 formal State aid procedures in relation to two French capacity mechanisms, namely a country-wide market-based mechanism13 (the “French Mechanism”) and a local tender for new capacity in Brittany14 (the “Brittany Tender”). At the time of writing, the Commission had not yet issued a final decision in relation to either of the two French cases.

20. In parallel to the sector inquiry, the Commission also organized workshops with Member States in order to share experience regarding adequacy assessment methods, design features or cross-border participation in capacity mechanisms.15

21. From the outset—i.e. when opening the sector inquiry—the Commission expressed concern that capacity mechanisms, although they may appear desirable at first sight, may also have a negative impact on trade between Member States and distort competition, either in their design or implementation, in particular as a consequence of uncoordinated approach at the EU level. More specifically, in the Commission’s view, capacity mechanisms may (i) distort price formation and/or (ii) exclude participation from specific technologies or foreign capacity.16

22. Shortly after the launch of the sector inquiry, Commissioner Margrethe Vestager said that capacity mechanisms may be a “quick-fix solution” but should not serve as a substitute for tackling market design failures.17 It is therefore no secret that the Commission has a clear preference for market forces over recourse to capacity mechanisms. In addition, a high-ranking official of DG COMP publicly acknowledged that the inquiry was meant to “pre-empt uncoordinated subsidies for capacity mechanisms” in view of preventing capacity mechanisms from developing in varying forms and directions, which occurred for example in relation to support mechanisms for renewables.18

2. Applying a workable categorisation of the broad variety of capacity mechanisms

23. The Commission received 124 replies, with the highest total number of respondents coming from France, Poland and Spain (15 replies each). The first lesson that can be drawn from that broad consultation is that capacity mechanisms (already in place or currently foreseen) take very diverse forms. In the 11 Member States that were investigated, the Commission identified 28 capacity mechanisms in total, falling in 6 different categories. The following diagram, prepared by the Commission,19 summarises those categories:

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12 SWD, p. 6.
17 Speech delivered by Commissioner Margrethe Vestager in Brussels on 28 September 2015, Securing electricity supply in the EU: How to optimise public support.
18 Mlez, 22 April 2016, EU looks to learn from renewable-energy errors with capacity markets.
19 Interim Report, p. 10; SWD, p. 37.
20 SWD, p. 38.
21 SWD, p. 42.
Member States. In addition, “interruptibility schemes” are a subcategory of strategic reserve, involving DSR capacities, whereby beneficiaries receive a fixed price for each MW of DSR made available and a price for demand reductions actually made.

– Targeted capacity payment (price-based): the price of capacity, which is set by a central body, is then paid to a subset of capacity operating in the market, e.g. a particular technology or capacity providers that meet specific criteria.

25. Market-wide mechanisms, which are in principle open to participation from all categories of capacity providers, can take the form of three models:

– Central buyer (volume-based): a central body sets the total required capacity; capacity providers compete through a central bidding process so that the market determines the price. The GB Capacity Market—which was approved by the Commission in 2014—belongs to this category.

– De-central obligation (volume-based): electricity suppliers are under an obligation to contract with capacity providers to secure the total capacity that they will need in order to meet their consumers’ demand. Here, there is no central bidding process. Instead, the market establishes the price for the required capacity volume. To the Commission’s knowledge, the only example of such a mechanism is the French Mechanism, which is currently the subject of a formal procedure (see Section II infra).

– Market-wide capacity payment (price-based): central estimates are made in order to assess the level of capacity payment needed to bring forward sufficient total capacity. On that basis, the price of capacity is set centrally and then paid to all capacity providers in the market. The only identified mechanism of this kind is in Ireland.

26. The table below, drawn up by the Commission, illustrates how a Member State’s choice of mechanism fits within the above categorisation, even if such categories are not necessarily clear-cut.

Table 1

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<th>Tender for new capacity</th>
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<th>Targeted capacity payment</th>
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<td>Spain (Interruptibility Scheme)</td>
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<td>Central buyer</td>
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<td>Italy *</td>
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* Planned Mechanism (or being implemented)
** Past Mechanism (or never implemented)
*** Multiple capacity mechanisms of the same type

Source: European Commission based on replies to sector inquiry

22 SWD, p. 38.
23 Interim Report, p. 11; SWD, p. 41.
24 SWD, p. 39.
27. One notes that several capacity mechanisms may coexist within a Member State, the extreme case being Spain, with four simultaneous mechanisms. Likewise, France currently has two mechanisms currently undergoing formal State aid investigation: the French Mechanism and the Brittany Tender already described above.

3. Specific challenges raised by capacity mechanisms

28. After setting out the general landscape of capacity mechanisms, the Interim Report emphasises some of the issues identified at this point of the sector inquiry. In a nutshell, the Commission recommends a harmonisation of methods to assess the need for capacity mechanisms (3.1). The Commission also sees some room for improvement in the design of mechanisms (3.2).

3.1 Harmonise methods to assess the need for capacity mechanisms

29. The Commission acknowledges that Member States’ concerns about the reliability of their electrical systems may require the adoption of a capacity mechanism, following an assessment of the adequacy situation. In that regard, the Interim Report, while praising Member States for assessing adequacy requirements “with an increasing degree of sophistication,” regrets that each Member State employs its own methodology with little regard to those applied elsewhere in the EU. For example, national methodologies vary when it comes to taking foreign capacity into account.

30. This leads to a situation where Member States and transmission system operators (“TSOs”) risk assessing capacity adequacy based on a partial picture, which may result in “over-protection” of their electricity system. The national focus of most mechanisms also prevents Member States from reaching a broader view on the adequacy situation that would show a possible need for action at an EU or regional level.

31. The Commission therefore encourages Member States to determine the desired level of supply by defining “reliability standards” based on common methods. In practice, having common methodologies would enable a Member State to integrate its own assessment with the assessment made by neighbouring Member States. It may also make it easier to analyse whether interconnectors can address capacity adequacy issues, and how to make DSR and renewables part of the solution. Overall, that should help Member States to “objectivise” the need for and size of intervention.

32. The Commission clearly has reason for criticising the disparity of assessment methods. Still, regardless of the applicable assessment method, it will likely remain very challenging for a Member State to evaluate interconnection flows with a sufficient degree of reliability. Among other reasons, this is because offer and demand fluctuations in neighbouring Member States cannot always be fully anticipated, especially in peak periods.

33. In any event, harmonisation of assessment methods will not come from the sector inquiry itself. The Commission, while recalling existing harmonisation efforts (in particular through the “target methodology” set up by ENTSO-E, the European Network of Transmission System Operators for Electricity), points to its ongoing Market Design initiative. In July 2015 the Commission submitted for public consultation a series of questions relating to (i) the need for a harmonised methodology to assess adequacy, (ii) the appropriate geographic scope of a harmonised adequacy methodology and assessment, (iii) whether the current national adequacy standards should be aligned, (iv) if and how a common European framework for cross-border participation should be introduced, and (v) whether the decision to introduce capacity mechanisms should be based on a harmonised methodology. Although each of those questions potentially raises sensitive issues from a national sovereignty perspective, the Commission indicated in a succinct note that the majority of respondents favoured a more aligned regional or EU-wide method for generation adequacy assessment, as well as an alignment of adequacy standards among Member States and a common EU framework for cross-border participation in capacity mechanisms. The Commission—through DG Energy—is now due to make legislative proposals by the end of 2016.

3.2 Room for improvement in the design of mechanisms

34. Three criteria play a significant role in the design of capacity mechanisms: (i) eligibility criteria, (ii) allocation process and (iii) capacity product. The Commission warns Member States against specific risks that can arise out of incorrectly designed mechanisms, with regard to each of those three criteria.

35. First, eligibility criteria are key to the design of capacity mechanisms, since they should ensure that an optimal selection of capacity providers is made to address the security of supply problem.

25 Interim Report, p. 11.
26 See in particular SWD, p. 55, Table 5 which summarises how each of the 11 Member States carries out adequacy assessments.
27 SWD, p. 59.
28 Interim Report, pp. 12 and 16.
29 SWD, p. 61.
32 SWD, pp. 42–51.
36. The Commission regrets that most existing mechanisms explicitly or implicitly exclude certain capacity providers. In the Commission’s view, selective capacity mechanisms may lead to the development of additional mechanisms in order to compensate capacity sources that were initially left out, as occurred in Spain, where various successive mechanisms complemented the initial one. Moreover, selective capacity mechanisms may result in over-compensation for participants, due to a weaker competitive pressure in the allocation process, which may incentivise capacity providers to bid for a higher capacity price than their actual required level of funding. The Commission, however, cites the GB Capacity Market and the French Mechanism as examples of a growing trend towards mechanisms that are open to a wider group of capacity providers.

37. The Commission also warns against the exclusion of cross-border capacity from capacity mechanisms, which occurs in relation to most of the capacity mechanisms reviewed. Some Member States take no account of foreign capacity when setting the amount of additional capacity needed. Other Member States take into account expected imports by reducing domestic demand when setting the generation adequacy gap. Another set of Member States allows for direct participation of cross-border capacity. The Commission obviously favours the latter option and notes a trend towards direct participation, as for example, the UK included interconnectors in the 2015 auction under the Capacity Market, while Ireland and France are developing plans that would include cross-border participation in their mechanisms. The inclusion of foreign capacity remains “technically challenging,” as the Commission acknowledges, as TSOs have little control—if any—over foreign capacity.

38. Second, the Commission addresses the allocation process, i.e. how the selection process works among eligible parties and how the level of remuneration is determined.34 A distinction can be drawn between administrative and competitive allocation processes. In an administrative process, eligible capacity providers are selected without competition and the State sets remuneration in advance or negotiating it bilaterally with the capacity provider. Conversely, in a competitive allocation process, the capacity remuneration is the result of a competitive bidding process involving eligible capacity providers. Administrative allocation procedures are unlikely to reveal the true value of capacity and as a consequence are unlikely to be cost-effective. In contrast, competitive allocation processes should in principle lead to revealing the true capacity value, provided, however, that the design of the allocation process and the market structure make real competition possible. In any event, an allocation process that fails to reveal the real capacity value will also be unlikely to send the right investment signals. If remuneration is too high, the capacity mechanism will keep unnecessary capacity in the market, or even bring forward new capacity in situations of overcapacity. If, on the other hand, remuneration is too low, there is a risk that existing plants would leave the market or that no investment would be made in new capacity.

39. Third, the Commission turns to what it calls “capacity product,” i.e. the obligations that capacity providers must fulfil in return for receiving remuneration, and the penalties for failure to meet those obligations.35 If obligations are limited and penalties are low, capacity providers will not have sufficient incentives and the capacity product will not be reliable. The Commission also warns about the risk that capacity mechanism penalties may be considered by policy makers as a replacement for electricity scarcity prices, i.e. prices that send the right investment signals in case of scarcity. The Commission’s goal is that “only electricity prices—not capacity mechanism penalties—provide a signal for imports within the internal market.”

4. All capacity mechanisms are not equal in the face of State aid law, or at least some appear much more problematic than others

40. As part of the Interim Report’s “tentative conclusions”36 the Commission admits that there is no one-size-fits-all solution and that, depending on the specific generation adequacy problem, different models may be appropriate. Nonetheless, the Commission considers that the six different types of capacity mechanisms identified above are not equally well-suited to address generation adequacy problems.

41. The Commission’s most severe criticism regards capacity payments, i.e. models where a central body sets the price of capacity: in the case of market-wide capacity payments, that price is paid to all capacity expected to meet demand in the market; in the case of targeted capacity payments, the price is paid only to a subset of capacity operating in the market (e.g. a particular technology). Such mechanisms exist or are foreseen in Italy, Poland, Portugal, Spain and Ireland. According to the Commission, capacity payments risk overcompensating capacity providers because they rely on administrative price setting rather than competitive allocation procedures (see Section I.3 supra).37 Since they do not competitively reveal the value of capacity, capacity payments schemes “are therefore likely to be the least efficient models of capacity mechanism.”38

37 SWD, p. 118.
38 SWD, p. 119.
II. Beyond the sector inquiry: (State aid) Enforcement actions relating to capacity mechanisms

42. The four other types of capacity mechanisms are less likely to result in overcompensation and stand better chances of appropriately addressing particular generation adequacy concerns—although the Commission identifies shortcomings specific to each of those four types of mechanism. In order to address a transitional capacity problem, tenders for new capacity and strategic reserves may be appropriate. Conversely, if a Member State wishes to address a longer-term and more general adequacy concern, central buyer mechanisms and de-central obligation mechanisms could be preferred.

43. However, the Commission also considers that a de-central obligation, where market forces establish the price for the required capacity volume, may present the risk that “an incumbent with some degree of market power may abuse its position in the trade of its obligations.”39 We will come back to this when discussing the French Mechanism (see Section II infra).

44. Given the Commission’s preliminary appraisal of the various types of mechanisms, one may have assumed that the Commission would focus its enforcement efforts on the two mechanisms that it describes as most problematic, namely market-wide and targeted capacity payments. Somewhat unexpectedly, the Commission’s enforcement has not followed this line so far: a few months after opening the sector inquiry, the Commission opened formal procedures against France in relation to (i) the French Mechanism, i.e. a country-wide volume-based de-central obligation and (ii) the Brittany tender, i.e. a volume-based tender for new capacity in Brittany. However neither of those mechanisms belongs to the categories that the Commission considers the most problematic. In other words, as of today the Commission does not yet practice what it preaches. This is because it has chosen to act as a matter of priority against mechanisms that do not appear to raise, in principle, the most conspicuous issues, and has thus far surprisingly left untouched mechanisms that it has recognized as liable to raise issues. This is especially striking with regard to the French Mechanism, which falls under what could be described as one of the Commission’s “favourite” categories of mechanisms. This state of affairs may, however, not last for long, as the sector inquiry is expected to give rise to enforcement actions in relation to other Member States.

45. The sector inquiry is not an end in itself. Indeed, under Article 25(1) of the Procedural Regulation, sector inquiries are conducted where the Commission has “reasonable suspicion” that measures may materially restrict or distort competition. The Interim Report gives an idea of the type of concerns that the Commission may want to investigate in relation to capacity mechanisms and the kinds of mechanisms that are deemed most problematic from a competition perspective. Moreover, the Commission admits that the sector inquiry is there to help it collect information for the purposes of applying the EEAG.

46. Compatibility under the EEAG depends on six cumulative criteria: objective of common interest; need for State intervention; appropriateness of the intervention; incentive effect; proportionality; and avoidance of undue negative effects on competition and trade. Section 3.9 of the EEAG specifically addresses “generation adequacy” measures, i.e. capacity mechanisms. The EEAG have so far been applied to only three capacity mechanisms, with only one final decision issued and two pending formal procedures. In the wake of the sector inquiry, further enforcement action may be expected.

47. Before addressing compatibility criteria, the EEAG also provides for various “safe harbours,” including one applicable to capacity mechanisms. Under this safe harbour, no notification is required for aid schemes (i.e. not ad hoc aid) in the form of a “generation adequacy measure,” if (i) their amount is below €15 million per undertaking and (ii) a competitive bidding process has occurred.40 This will not be further explored in this article.

48. This section will first describe the past and present of State aid enforcement pertaining to electricity capacity mechanisms (1.). It will then detail what the Commission expects Member States to prove under the EEAG when notifying a capacity mechanism (2.). Last, it will explore how capacity mechanisms may also raise issues in relation to non-State aid TFEU provisions (3.).

39 SWD, p. 123.

40 EEAG, § 20(g).
1. The past and present of State aid enforcement pertaining to capacity mechanisms

49. The EEAG have already served as a basis to assess the compatibility of numerous aid measures, especially for aid in support of renewable energy. However, the Commission has applied the EEAG to capacity mechanisms only in three cases—two of which are still ongoing. The Commission has found compatible aid in relation to the GB Capacity Market (1.1). In addition, it recently expressed doubts as to the compatibility of aid with the French Mechanism (1.2) and the Brittany Tender (1.3). Each of those mechanisms is described below.

1.1 The GB Capacity Market: A centrally managed auction

50. In Great Britain, electricity demand was due to increase, while a significant share of the current generation capacity was about to be closed down. The UK government estimated that the British electricity market would reach critical levels of generation adequacy around 2017–2018 and therefore set up a “Capacity Market” based on annual centrally managed auctions organised by a System Operator (SO)—National Grid—to procure the level of capacity required to ensure generation adequacy. The mechanism works as described in the following paragraphs.

51. Every year, a decision is made whether to run capacity auctions, and for what amount of capacity, depending on the capacity assessment carried out by the SO. The auction is for delivery in four years’ time, e.g. the 2014 auction is for delivery in 2018–2019, with the delivery year running from 1 October 2018 to 30 September 2019. A further year-ahead auction is held in the year immediately prior to the delivery year of the main auction; additional “reserve” capacity is auctioned, so as to refine the adjustment between demand and capacity. There are also two “transitional” auctions limited to DSR capacity, meant to support the growth of this sector and ensure it can compete in the Capacity Market in the future.

52. The SO pays successful bidders for the duration of the capacity agreement. In consideration for such payment, successful bidders are required to provide capacity at times of stress on the system or face significant penalties. The measure is financed through a levy on electricity suppliers.

53. The duration of a capacity agreement varies depending on the bidders: new capacity providers (building new plants) are eligible for a 15-year duration; existing capacity providers have access to one-year agreements, or to three-year agreements if they commit to engage in refurbishment works exceeding a certain amount.

54. The UK applied for State aid approval for a 10-year period. On 23 July 2014, the Commission found the measure to be compatible with the internal market on the basis of the EEAG (the “Decision on GB Capacity Market”). Details of the Commission’s assessment can be found in Section II.2 infra. Third parties have lodged two appeals against the decision, claiming that the Commission should have opened a formal procedure. One of the applicants essentially argued that the Commission had failed to properly assess the potential role of DSR in the GB Capacity Market and the fact that certain features of that mechanism were detrimental to DSR operators. The other applicant focused its criticism on the alleged discriminatory treatment stemming from the various applicable contract durations. At the time of writing, the General Court had not ruled on any of these cases.

1.2 The French Mechanism: A de-central market-wide obligation

55. The GB Capacity Market seems to be the Commission’s “favourite” type of mechanism. Not only does the Staff Working Document cast a generally positive view of that kind of mechanism, but in addition a high-ranking DG COMP official recently stated that “anyone who models their system on the UK model can expect less opposition from [the Commission] than if they try something new.”

56. The French energy market is characterized by a high “thermo-sensitivity” (i.e., electricity consumption increases when the temperature drops) and a very volatile consumption peak. In order to assure resulting security of supply concerns, the French Parliament set out the principle of a capacity obligation mechanism on 7 December 2010 in an Act reforming the organization of the electricity market in France (“NOME” Act). Details of the mechanism were then specified in a 2012 Decree and a 2015 Order.

57. As a starting point, in year N–4, RTE (the French TSO) forecasts the overall capacity requirement to match demand in peak periods of year N taking interconnections into consideration. RTE sets parameters that will determine each electricity supplier’s capacity obligation in year N.

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42 MLex, 22 April 2016, EU looks to learn from renewable-energy errors with capacity markets.
58. As a consequence, suppliers are obligated to hold a specific amount of capacity certificates to cover the capacity needs of their customer portfolio during peak periods of year N. Suppliers may acquire capacity certificates up to a trading deadline. RTE determines ex post, based on a detailed methodology, whether suppliers hold enough capacity certificates to cover their actual capacity obligations for year N, subject to a bonus/malus system.

59. Each capacity provider (generator or DSR operator) is required to file with RTE (or a Distribution System Operator, “DSO”) a request for certification of its capacity for a year N. Capacity providers sign a contract with RTE specifying their capacity commitment, modalities of correction of the planned availability, control modalities and penalties. RTE determines ex post whether contracted capacity was available during year N, subject to a bonus/malus scheme.

60. Capacity certificates are exchangeable and tradable on the French capacity market. RTE keeps a record of those transactions through a capacity register where all electricity suppliers and capacity operators hold capacity accounts. Financial payments resulting from a given capacity transaction will be directly and privately settled between the parties to the transaction. The commercial terms of capacity transactions must be communicated to the CRE (the French energy regulator) for yearly publication of volume and price statistics.

61. The first delivery year is scheduled to be 2017 and certification has already started in April 2015. The mechanism is not set for a specific duration.

62. On 13 November 2015, the Commission opened a formal State aid procedure into the French Mechanism, which France had not notified as State aid (the “Decision on French Mechanism”). In substance, the Commission reached the preliminary view that the French Mechanism involves State aid and may not be compatible with the internal market based on the EEAG criteria.

63. As to the qualification of State aid, the Commission goes through a detailed examination to support the view that the French Mechanism involves the use of State resources. In particular, it largely builds upon the Vent de Colère case, where the Court of Justice of the European Union (CJEU) found State resources to be involved in the French contribution au service public de l’électricité (“CSPE”), i.e. a surcharge collected from all final electricity consumers in France. Such surcharge served to offset, in full, the additional costs borne by EDF and other distributors due to their legal obligation to purchase wind-generated electricity at a price higher than the market price. The CJEU found that since those (private) funds were channelled through the French Caisse des dépôts et consignations, a State-owned and managed body, the State had control over them and therefore the resources must be considered as State resources—although at no point did the State own the funds. Building on that case, the Commission considers that the French Mechanism also involves State resources because the financial flows on the market for capacity certificates remain under constant State control, even though those flows take place exclusively between private parties (i.e., capacity holders, electricity suppliers and consumers). Indeed, the Commission emphasizes that the State-appointed RTE (a TSO ultimately controlled by the State) manages the bonus/malus fund and collects funds from defaulting market participants, while the CRE could impose sanctions on suppliers that do not hold sufficient capacity certificates to meet their obligations. Moreover, the State calculated the methodology for the reference price applicable to the bonus/malus scheme; according to the Commission, the bonus/malus reference price will impact the market price of certificates on the market. The Commission acknowledges that RTE does not, at any point, own the amounts paid on the bonus/malus fund; however, it considers that those funds remain under public control and therefore at the authorities’ disposal, because it is the State’s decision that any sum left in the fund should be passed on to final consumers.

64. Interestingly, the French Council of State (“Conseil d’État”) decided, only a few weeks before the Commission opened the formal procedure, that the French Mechanism was not State aid, precisely because, in the judges’ view, the French State had no control over the resources at stake. It seems that the Council of State’s assessment focused on the lack of State control over transactions on the capacity market and did not specifically address potential State control over the funds relating to the bonus/malus scheme—which is the core of the Commission’s line of reasoning.

65. Turning to the compatibility of the aid, the Commission is generally concerned that the capacity mechanism may favour certain companies over their competitors and hinder the entry of new players. The Commission also questioned whether the objectives pursued by the mechanism could not be attained with less costly and distorting measures. Last, the Commission questions whether the mechanism is suitable to encourage investments in new capacity.

66. As already indicated, the Commission opened the formal procedure at a point where it had already gathered a significant amount of information in the context of the sector inquiry. However, it does not stem from the Staff Working Document that the French Mechanism would belong to the most problematic categories of all capacity mechanisms. It is therefore unclear why the Commission made it a priority to scrutinise the French Mechanism rather than other national mechanisms. Various reasons may explain the Commission’s action: first, the

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45 Case SA 39621 – France – French country-wide capacity mechanism, op. cit.
47 Decision on French Mechanism, §§ 120–125.
48 French Council of State, 9 October 2015, Association nationale des opérateurs d’étaillants en énergie (ANOGE), No 389417.
fact that the first delivery year was 2017 and that the Commission wanted to pre-empt any issues before the actual implementation of the mechanism; second, it may be that the Commission already had more information about the French Mechanism than it did in relation to other mechanisms—against which it will most likely act in the future.

1.3 The Brittany Tender: Adding capacity to address local constraints

67. In parallel to the aforementioned country-wide capacity mechanism, France sought to address alleged security of supply concerns specifically relating to the Brittany region. That region, where electricity consumption rose quicker than the French average, had a rather limited production capacity and was isolated from the rest of the French electricity transportation system. As a consequence, the French authorities considered it as exposed to a risk of black-out. For that purpose, the French authorities launched a tender to support the construction of a new gas-fired power plant (a Combined Cycle Gas Turbine, “CCGT”) in Brittany. The French authorities notified the measure to the Commission as “non-aid.”

68. On 13 November 2015, the Commission opened a formal procedure into that mechanism (the “Decision on Brittany Tender”). The Commission’s assessment under the EEAG will be detailed in Section II.2 infra.

2. What the Commission expects Member States to prove under the EEAG

69. As indicated above, the Commission assesses the compatibility of State aid in the form of capacity mechanisms on the basis of criteria set out in Section 3.9 of the EEAG, namely: (i) objective of common interest; (ii) need for State intervention; (iii) appropriateness of the intervention; (iv) incentive effect; (v) proportionality; and (vi) avoidance of undue negative effects on competition and trade between Member States.

70. Each of those criteria is described in subsections (2.1) to (2.5) below, and illustrated, where appropriate, with the Commission’s appraisal in the case of the GB Capacity Market, and with the Commission’s preliminary assessment in the pending cases of the French Mechanism and the Brittany Tender.

71. As a general trend, the Commission found each of those criteria to be met in relation to the GB Capacity Market, which it sees as kind of a “model case” (see supra). In contrast—and although that may sometimes seem inconsistent with the interim results of the sector inquiry—the two French mechanisms appear, at this stage, to raise doubts in relation to nearly every EEAG criterion.

72. Where appropriate, reference will also be made to sections of the Staff Working Document which points out specific concerns that arise with regard to other types of mechanisms, since that may give an idea of the Commission’s potential assessment of those mechanisms in the context of potential ad hoc investigations.

2.1 The measure must pursue an objective of common interest and be necessary

73. Under the EEAG, the measure must pursue an objective of common interest (§§ 219–221 of the EEAG) and it must be necessary to attain that objective (§§ 222–224 of the EEAG). Those criteria, although presented separately in the EEAG, are actually interrelated and were assessed altogether in the GB Capacity Market case and in the decision opening a formal investigation in the French Mechanism case.

74. Objective of common interest. As the Commission acknowledges, measures for generation adequacy can be designed in a variety of ways, i.e. they can take the form of investment or operating aid. They can also pursue different objectives, i.e. address short, medium or long-term concerns depending on the situation in the relevant Member State. However, the measure must actually pursue a security of supply concern. In that regard, the Commission raised doubts as to the Brittany Tender, which could solve short-term security of supply concerns but in the long run may fail to correct the malfunctions of the market, in particular because it can result in creating a subsidy-dependent market, and thereby make the problem even worse.50

75. In addition, the Commission requires that support to a capacity mechanism does not contradict the objective of phasing out environmentally harmful subsidies (including for fossil fuels). Member States should also consider alternative ways of achieving generation adequacy, e.g. by facilitating demand-side management, or increasing interconnection capacity.

76. Most importantly, the Commission expects Member States to clearly define the precise objective pursued, “including when and where the generation adequacy problem is expected to arise.” This assessment must be consistent with the generation adequacy analysis conducted by ENTSO-E. In both the GB Capacity Market and the French Mechanism cases, the Commission carefully scrutinised the soundness of the Member States’ methodology and the consistency of their assessment with that of ENTSO-E.51

50 Decision on Brittany Tender, §§ 81–84 and 113.
77. The Commission adds in the Interim Report that Member States should use common methods to assess their adequacy requirements. As already discussed, the Commission should address this aspect in legislative proposals by the end of 2016, in the context of the Market Design initiative.

78. Necessity of the measure. For State intervention to be justified, it must be backed by a detailed demonstration, which must properly analyse and quantify the nature and cause of generation adequacy problems. Member States should clearly demonstrate why the market cannot be expected to deliver adequate capacity absent any intervention. To paraphrase the Staff Working Document, the necessity of an intervention should be established "by determining the necessary generation capacity that cannot be expected to be provided by the market, even after alternative measures have been considered." 53

79. The Commission indicates that it will take into account variable generation, demand-side participation, actual and potential interconnectors, and other elements which might cause or exacerbate the generation adequacy problem (regulatory or market failures, including caps on wholesale prices).

80. In relation to the GB Capacity Market case, the Commission was satisfied that the mechanism addressed two market failures that prevented the market from bringing the necessary capacity to meet demand. More generally, in the Staff Working Document the Commission considers that, provided eligibility criteria are open to all potential capacity providers, central buyer mechanisms are able to address a systemic missing money problem or local shortages. 55

81. In contrast, in its decision to open the formal procedure, the Commission expressed doubts as to the necessity of the French Mechanism. In the Commission's view, it is not established that France needs a capacity mechanism now, in view of overcapacity in the French market, inconsistencies between the French TSO's capacity adequacy assessment and the assessment performed by ENTSO-E, and the existence of alternative measures geared towards security of supply (development of interconnections, DSR measures, and support of renewables). The Commission even suggests that alternative measures could be envisaged before introducing a capacity mechanism, such as introducing electricity tariffs varying between peak time and normal time, with a view to incentivising industrial customers to reduce demand in peak time. In this respect, the Commission notably did not mention that France has already done much and continues to pursue such alternative measures. 58

82. By the same token, in the Brittany Tender case, the Commission challenged France's claim that Brittany was faced with a security of supply problem. 59

2.2 The intervention must be appropriate

83. As a second criterion, the Commission expects Member States to prove that their intervention is appropriate (§§ 225–226 of the EEAG).

84. Under the EEAG, as a first requirement, the aid should remunerate solely the service of pure availability provided by the generators (per MW of capacity being made available), not the sale of electricity (per MWh sold).

85. In addition, the measure should be open and provide adequate incentives to (i) existing and future generators, and (ii) operators using "substitutable technologies" (such as DSR or storage solutions). In that context, aid should be delivered through a mechanism which allows for potentially different lead times. For example, in the Brittany Tender case, the Commission considered that the tender restricted the type of capacity holders that were eligible to take part and criticized the fact that the tender was closed to existing producers.

86. Last, the measure should take into account how interconnection capacity (i.e., capacity from other Member States) can remedy a generation adequacy problem. This criterion is probably one of the most difficult to meet. For example, in the GB Capacity Market case the Commission considered the measure to be appropriate, 61 and found that although foreign capacity could not be included in the first auction, it would be included as of 2015, once cross-border arrangements have been implemented, as the UK specifically committed to do. In the French Mechanism case, the Commission took issue with the exclusion of foreign capacity from direct participation in the mechanism. Unsurprisingly, the interim results of the sector inquiry also highlight the need for cross-border participation.

52 Interim Report, pp. 12 and 16.
53 SWD, p. 111.
54 Decision on GB Capacity Market, § 127. The first market failure was that "reliability is a public good," i.e. customers cannot choose their desired level of reliability, and therefore, the UK was right to set an enduring reliability standard (loss of load expectation of 3 hours/year). The second market failure relates to the "missing money" problem, i.e. energy market revenues alone may fail to bring forward sufficient investments in capacity; the Capacity Market addresses that issue by giving capacity providers certainty on a part of their revenues.
55 SWD, p. 120.
56 Decision on French Mechanism, §§ 155–162.
57 Ibid., § 164.
58 Délibération de la CRE du 18 février 2016 portant décision de modification du tarif d’utilisation des réseaux publics d’électricité (TURPE) pour définir un dispositif transitoire de pointe mobile pour le domaine de tension HTA et portant orientations sur la structure des prochains TURPE.
59 Decision on Brittany Tender, §§ 114 and 117.
60 Ibid., §§ 126–127.
61 Decision on GB Capacity Market, §§ 131–139.
62 Decision on French Mechanism, § 172.
63 SWD, pp. 87–88.
87. As a more general requirement, a measure will be considered as appropriate where there are no less distortive means to achieve the same objective of common interest (EEAG, § 40). The Brittany Tender case provides a good example of such requirement: The Commission has doubts that the measure will be appropriate, since it considers that the security of supply in Brittany could be attained through less distortive means, such as the creation of a regional tariff zone, the implementation of smart meters, and/or the strengthening of the electricity distribution network.

2.3 The intervention must have an incentive effect

88. The Commission expects the Member State to demonstrate that absent the aid, the beneficiary would not have undertaken the project (§ 227 of the EEAG). The aid should not subsidise the “costs of an activity that an undertaking would anyhow incur” or compensate for the “normal business risk” of an activity (§ 49 of the EEAG). The Member State must come forward with information not only concerning the aided project, but also a comprehensive description of the “counterfactual scenario, in which none of the Member States award aid to the beneficiary” (§ 58 of the EEAG).

89. This criterion was relatively easily met in the GB Capacity Market case, where the Commission found that in a counterfactual scenario without the Capacity Market, generation adequacy would reach critical levels as of 2018–2019.

90. In the French Mechanism case, the Commission considers at this stage that because of the existence of penalties against non-compliant participants (both capacity holders and electricity suppliers), the mechanism is likely to have the incentive effect required by the EEAG.

2.4 The intervention must be proportionate

91. Under the EEAG, aid is considered as proportionate where the aid amount per beneficiary is limited to the minimum needed to achieve the desired objective (§ 49 of the EEAG). The Commission devised specific criteria applicable to capacity mechanisms (§§ 228–231 of the EEAG).

92. First, the rate of return for beneficiaries must be reasonable. In that regard, a competitive bidding process, based on clear, transparent and non-discriminatory criteria, is considered as leading to reasonable rates of return under normal circumstances. In addition, the measure should have built-in mechanisms to ensure that windfall profits cannot arise. As a last point, the Commission expects that the measure is constructed so as to ensure that the price paid for availability automatically tends to zero when the level of capacity supplied is adequate to meet capacity demand.

93. While the GB Capacity Market did not raise any issues on this point, the Commission expressed doubts as to the two French mechanisms.

94. With regard to the French Mechanism case, the Commission inquired into potential overcompensation for participants, in three respects. First, because electricity suppliers faced some uncertainty as to their real needs in terms of capacity certificates, they risked over- or under-estimating those needs, which may lead to overcompensation. Second, the Commission appeared to doubt that competition would lead to the determination of the most accurate price for capacity, in view of the modalities of DSR participation, the exclusion of foreign capacity, and the de facto exclusion of potential new entrants (who would have difficulties in estimating the size of their future client portfolio). Third, according to the Commission, the electricity incumbent’s dominance on both the production and the supply markets may enable that company, as a capacity holder, to “artificially inflate” the price of certificates while, as a supplier, passing on to consumers any resulting cost increase, without suffering substantial competitive constraints. Upon reading the Staff Working Document, however, the Commission uses much softer language regarding that third point, as it now only points out that a de-central obligation mechanism may not be appropriate “if there is a perceived risk that an incumbent with some degree of market power may abuse its position in the trade of the obligations.” It remains to be seen whether that will translate into a more favourable assessment in the Commission’s final decision regarding the French Mechanism.

95. Similarly, in the Brittany Tender case, the Commission expressed concerns relating to potential overcompensation. It considered that some of the admission criteria may have prevented potential candidates from taking part in the tender, and that absent those criteria, a greater number of companies would have participated, thereby potentially minimizing the overall cost for the State. In addition, the mechanism, which was scheduled to last 20 years and offered a fixed amount per MW, did not provide for any kind of “catch-up” mechanism to prevent overcompensation, in spite of the uncertainty surrounding the future price of electricity. Those concerns echo the Commission’s criticism of tenders for new capacity in the Staff Working Document. 67
2.5 The intervention must avoid undue negative effects on competition and trade

96. Finally, the Commission requires that the measure be designed so as to allow participation for “any capacity which can effectively solve the generation adequacy problem” (§§ 232–233 of the EEAG). The Member State must therefore ensure participation of generators using different technologies and operators offering measures with equivalent technical performance (DSR, interconnectors, storage). It must also make it possible for operators from other Member States to participate, where that is physically possible. More generally, the Commission will expect the participation of a sufficient number of participants in order to establish a competitive price for the capacity.

97. Member States’ mechanisms must also avoid negative effects on the market, such as export restrictions, wholesale price caps, or bidding restrictions. More specifically, the measure should not reduce incentives to invest in interconnection capacity and should not undermine market coupling. State support should also not undermine investment decisions on generation which preceded the State measure. It should not “unduly” strengthen market dominance. Last, Member States should give preference to low-carbon generators in cases of equivalent technical and economic parameters.

98. In the GB Capacity Market case, the Commission found those criteria to be fulfilled. In contrast, the two French mechanisms raise more doubts in the Commission's view.

99. The Commission is concerned that the French Mechanism may create substantial distortions of competition, not only on the French market but also on cross-border electricity markets. According to the Commission, the French Mechanism may have a downward effect on the overall price of electricity in France, which may in turn impede interconnection projects, since lower revenues could be expected in return. The Commission also repeats that the exclusion of foreign capacity risks locking up the French market—although it notes that France is working on plans to allow direct participation of foreign capacity.

100. At this stage, the Brittany Tender is also deemed problematic for three reasons. First, the tender is not technology-neutral, since it is only for a CCGT plant. Second, DSR could also have contributed in part to addressing the capacity adequacy issue. Third and maybe more controversially, the Commission found that although the designated candidate (Direct Énergie) was a new entrant, the fact that it was entitled to sell electricity to EDF with a 5% discount meant that the tender may actually contribute to strengthening the incumbent’s position in the market for the supply of electricity.

101. In addition to the specific concerns expressed in the two French cases, the Staff Working Document mentions as a recurrent concern a potential “crowding-out” effect, meaning that support for the appearance or maintenance of subsidised generation capacity may be detrimental to non-subsidised capacity, since it risks depressing electricity prices that remunerate all capacity providers. The Commission emphasises that issue in relation to strategic reserve mechanisms, with a number of remarks relating to the Belgian mechanism. The effects of interruptibility schemes—a specific type of strategic reserve—are also to be “monitored closely” because in the Commission’s view, depending on their selection criteria, they may have the potential to distort industrial markets. Targeted capacity payments raise similar issues, since ineligible capacity providers may be deterred from investing.

102. Conclusion on the Commission’s practice so far. The Commission’s nascent decision-making practice, while providing useful illustrations of the EEAG criteria, cannot yet be said to deliver a comprehensive vision of what the Commission expects from Member States when they set up capacity mechanisms. The Sector inquiry may provide the Commission with a “shopping list” of national mechanisms that would deserve further scrutiny and help build strong leading cases for the years to come. Among the obvious candidates are the two types of capacity mechanisms that, according to the Commission, risk overcompensating capacity providers because they rely on administrative price setting rather than competitive allocation procedures. Those capacity mechanisms are price-based mechanisms offering (i) market-wide and (ii) targeted capacity payments. As it turns out, those mechanisms are applied in Italy, Poland, Portugal, Spain and Ireland. Those Member States may therefore expect to undergo further investigation from the Commission, if the relevant mechanisms involve State aid.

3. Beyond State aid rules, compliance with other TFEU provisions

103. Complying with the rather stringent requirements of Section 3.9 of the EEAG may not suffice to get a measure “off the hook.” Indeed, a measure that fulfils such requirements may still be found incompatible with the internal market if the measure or the conditions attached to it (including its financing method when it forms an integral part of it) entail a “non-severable violation of Union law” (§ 29 of the EEAG).

104. The EEAG indicate more specifically that in the field of energy, any levy intended to finance a State aid measure must comply in particular with Articles 30 and

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73 Decision on GB Capacity Market, §§ 149–153.
74 Decision on French Mechanism, §§ 203–208.
75 Decision on Brittany Tender, §§ 135–138.
76 SWD, p. 115.
77 SWD, p. 117.
78 SWD, pp. 118–119.
110 TFEU. It could also be envisaged that where the Commission finds that a capacity mechanism does not involve State aid, it challenges some of the mechanism’s features based on other TFEU provisions, in the context of an infringement procedure.

105. This section will therefore briefly analyse how capacity mechanisms could be caught under non-State aid TFEU provisions (either in the context of a State aid assessment or not), i.e., not only under Articles 30 and 110 TFEU (3.1) but also under Articles 34 and 36 TFEU (3.2), Article 106(1) TFEU (3.3) and/or Articles 101 and 102 TFEU (3.4)79.

3.1 Articles 30 and 110 TFEU

106. Article 30 TFEU prohibits customs duties (including those of a fiscal nature) on imports and exports and charges having equivalent effect between Member States. That is a very general provision which has been used to catch a number of measures which, in one way or another, had an effect equivalent to customs duties.

107. In contrast, Article 110 TFEU relates to discriminatory internal taxation, as it prohibits Member States from imposing, directly or indirectly, on the products of other Member States, “any internal taxation of any kind in excess of that imposed directly or indirectly on similar domestic products,” or “any internal taxation of such a nature as to afford indirect protection to other products.”

108. The Commission assessed the GB Capacity Market’s compliance with those two provisions. Payments under that mechanism were to be financed by a levy imposed on all electricity suppliers. The Commission considered that the tax would be very similar to a tax on the electricity consumed. The question was therefore whether by taxing all electricity suppliers but only allowing domestic capacity to participate in the mechanism, the UK was imposing discriminatory treatment against electricity imports from other Member States. The Commission answered in the negative and found no breach of the aforementioned provisions, since in its view, foreign capacity was not in a similar situation as domestic capacity. The Commission appears to have been satisfied with the reasons provided by the UK to explain why interconnected capacity could not be eligible for the first auction in 2014, and noted that the UK had committed to including forms of interconnected capacity as of 2015 once legally and technically feasible.80 The Staff Working Document indicates that interconnectors are now authorised to bid.81

3.2 Articles 34 and 36 TFEU

109. Article 34 TFEU prohibits “quantitative restrictions on imports and all measures having equivalent effect (…) between Member States.” Article 36 TFEU allows for a potential justification on grounds of “public policy and public security,” provided, however, that the relevant prohibition or restriction does not constitute a means of arbitrary discrimination or a disguised restriction on trade between Member States.

110. Those provisions are of particular relevance to the French Mechanism case, whose current version does not allow foreign capacity to participate. In the ANODE case, the French Council of State (“Conseil d’Etat”), in ruling on an action against a regulatory text implementing the French Mechanism, had referred to the CJEU a question for a preliminary ruling on the issue of whether the French Mechanism, insofar as it excluded the direct participation of foreign capacity, could be considered as a measure equivalent to a quantitative restriction (MEQR), and if so, whether it could be justified and proportionate.82 In the Council of State’s view, the French Mechanism did not involve State aid, because the French State could not be said to exercise control over the funds. It should be noted that at the time of referral, the Commission had not yet opened its formal State aid investigation on that mechanism. The reference for a preliminary ruling was, however, subsequently withdrawn and the case removed from the Court’s docket in April 2016.83 The authors of this article believe that the Council of State had genuine concerns about the exclusion of foreign capacity and based its question to the CJEU on free movement provisions since it believed that no State aid was involved. However, once the Commission opened its State aid investigation and specifically addressed the exclusion of foreign capacity as part of its State aid compatibility assessment, the Council of State might have deemed it more appropriate (and perhaps quicker) for the Commission to resolve the question of including foreign capacity (on the basis of State aid rules), rather than the Court of Justice (on the basis of internal market rules).84

3.3 Article 106(1) TFEU

111. Capacity mechanisms may also be assessed from the angle of Article 106(1) TFEU, which states that Member States, in the case of public undertakings and undertakings benefiting from special or exclusive rights, should “neither enact nor maintain in force any measure contrary to the rules contained in the Treaties, in particular to those rules provided for in Article 18 and Articles 101 to 109.” That provision has mainly been used...

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79 For a more detailed analysis of free movement provisions in the context of capacity mechanisms, see P. Oliver, Chapter 11 in L. Häncher, A. de Haentecloque and M. Sadowska, op. cit. 
80 Decision on GB Capacity Market, §§ 157–161. 
81 SWD, p. 78.
in conjunction with Article 102 TFEU, in cases where a national measure (i) leads the undertaking to behave in such a way as to abuse its dominant position; or (ii) has the potential to lead the undertaking to behave in such a way as to abuse its dominant position; or (iii) produces similar effects to those of an abusive behaviour. The combination of those provisions gained renewed interest following the Greek lignite case where the CJEU stated that an infringement would be established irrespective of whether any abuse actually existed, and that it was sufficient that the State measures at issue created “unequal conditions of competition between companies.”

112. In the aforementioned ANODE case, the French Council of State was unimpressed by a claim based on Articles 106 and 102 TFEU, which alleged that the design of the French Mechanism would enable EDF to hold a predominant share of the certificates market since the electricity incumbent was dominant in the markets for the production and supply of electricity. The Council of State considered in particular that the legislative and regulatory provisions of the French Mechanism did not “necessarily and automatically” place the incumbent in a position to abuse its dominant position in the markets for the production and supply of electricity and in the market for capacity.

113. While far more could be written about the powerful effect of Article 106(1) TFEU in relation to electricity capacity mechanisms, for the purpose of this article we will leave the discussion here, in the absence of any further developments at the time of writing.

3.4 Articles 101 and 102 TFEU

114. Although the sector inquiry primarily focuses on State aid, it is regrettable that at this stage, no guidance is given as to how capacity mechanisms may give rise to, or be impacted by anticompetitive behaviour within the meaning of Articles 101 and 102 TFEU. The energy sector has in the past given rise to a number of antitrust decisions, and capacity mechanisms could very well be one of the new areas offering room for anticompetitive behaviour as well. Of course, each type of capacity mechanisms carries a different kind of antitrust risk. The Staff Working Document highlighted for example that central buyer mechanisms may be more appropriate than de-central obligation mechanisms “to mitigate risks of market power abuse.” It would go beyond the scope of this article to engage into a systematic analysis of each and every potential antitrust concerns pertaining to capacity mechanisms. At this stage, however, the two instances below already provide good examples of those concerns.

115. In 2012, the French Competition Authority (FCA) issued an opinion regarding a draft decree setting out the French Mechanism. It noted that EDF would be dominant on both sides of the market for capacity certificates, i.e. on the issuance of capacity certificates (as a producer) and on the acquisition of such certificates (as a supplier). The FCA added that the resulting significant market power in relation to the setting of the price of certificates could lead the electricity incumbent to abusive exclusionary conduct, and in particular margin squeeze, in case EDF would sell excess certificates at a higher price to downstream competitors on the electricity supply markets than to its own vertically integrated supply branch. In order to avoid such a risk, the French government followed FCA’s recommendation that the draft mechanism be amended so as to allow the French energy regulator (CRE) to be informed of the transfer prices applied by the incumbent to its “internal” transactions (i.e. between its generation and supply branches).

116. A 2014 decision from the Belgian Competition Authority (BCA) is also worth mentioning. As part of the Belgian strategic reserve mechanism, Electrabel was under a legal obligation to withhold a capacity of 1050 MWh (the so-called “primary reserve”). Electrabel was suspected of manipulating the market by withholding additional capacity (of up to 300 MWh) and selling part of that additional capacity on the Belgian day-ahead market at a “price scale,” i.e. the price of capacity increased as it got closer to the 300 MWh ceiling. The BCA found that the constitution of the additional reserve was not abusive as such, in particular in view of the relatively small volumes concerned and the lack of a strategy or a plan from Electrabel to raise electricity wholesale prices. However, it considered that the price premium applied by Electrabel in relation to the sale of the additional capacity constituted excessive pricing contrary to Article 3(1) of the then applicable Belgian Competition Act and Article 102(a) TFEU, because the margins were “excessively disproportionate” as compared to the marginal cost of production. As a consequence, the BCA imposed a rather limited fine of €2 million, taking into account a directly affected turnover estimated at less than €5 million.

117. The findings of the State aid sector inquiry into capacity mechanisms could also encourage small energy players to lodge complaints before competition authorities for various kinds of alleged anticompetitive behaviour. However, competition law may not be the sole remedy: for example, market manipulation could be more...
effectively tackled based on the REMIT Regulation,\(^93\) which does not require establishing dominance or undertaking a full competitive assessment of the relevant market(s).\(^94\)

### III. Conclusion: Capacity mechanisms “united in diversity”?

118. After collecting expert feedback from selected respondents, the Commission will now test its preliminary findings and tentative conclusions with a broader base of stakeholders, since the general public is invited to comment. In view of the depth of the Staff Working Document, it seems unlikely that a broader consultation will bring significant additional technical information to the debate. However, it may bring more legitimacy to the Commission’s follow-up action.

119. Following the sector inquiry, the Commission is expected to pursue legislative action and enforcement action. A parallel may be drawn with the Commission’s antitrust energy inquiry in the previous decade, which resulted in both legislative action (the third Energy Package)\(^95\) and enforcement against incumbents under Articles 101 and 102 TFEU.

120. Legislative action is expected in the context of the Market Design initiative. By the end of 2016, the Commission should submit legislative proposals regarding the method to assess generation adequacy. Upon announcing the publication of the Interim Report, Commissioner Vestager hinted that proposals would push for a “more harmonized approach” (i.e., “an EU-wide, fact-based security of supply assessment addressing the situation”) but should not result in “hard law.”\(^96\) Such a pragmatic approach—if it is eventually confirmed—seems well-suited to the sensitivity of the topic. It will, however, require DG Competition and DG Energy to share the same view on the future of the European electricity market, which some see as doubtful.\(^97\)

121. Enforcement action is also likely to arise in the coming months or years, in relation to capacity mechanisms that Member States did not notify for State aid clearance to the Commission. Indeed, the EEAG criteria are so stringent that Member States arguably stand little chance of justifying ex post that they designed their capacity mechanisms in compliance with each and every EEAG criterion. The most reliable way to ensure compliance is to seek State aid clearance from the Commission—including by notifying a mechanism as “non-aid,” as the case may be—and to ensure beforehand that the design of the mechanism meets all EEAG requirements. Judging from the Commission’s criticism of capacity payment mechanisms, countries such as Italy, Poland, Portugal, Spain and Ireland may have to prepare for Commission investigations—if that is not already the case. Should the Commission, following such investigations, find that certain measures constitute unlawful and incompatible State aid, it would order Member States to recover aid from beneficiaries. In the current depressed market context, the prospect of reimbursing potentially significant amounts of State aid could seriously affect the profitability of the concerned electricity companies.

122. Based on some of the first reactions to publication of the Interim Report,\(^98\) the sector inquiry is unlikely to result in a full consensus. In all fairness, it is not for the sector inquiry to decide on the future of capacity mechanisms. The fate of those mechanisms lies more in the hands of case-by-case enforcement and legislative action, which may substantially reshape this aspect of the energy sector over a few years’ time.

123. All in all, capacity mechanisms are yet another example of an area where the EU’s action is crucial to transform the existing uncoordinated patchwork into a network of interoperable elements. In these troubled times for EU integration, capacity mechanisms offer an opportunity for the EU to give a concrete meaning to its motto: “united in diversity.”

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96 MLex, 13 April 2016, EU seeks common approach to capacity-mechanism assessments.


98 MLex, 13 April 2016, Greenpeace says capacity mechanisms “pervert” the energy market; MLex, 13 April 2016, Wind industry warns EU off relying on capacity mechanisms.
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