Introduction

- Energy sector faces **structural changes**: security of energy supply, renewable energy sources, lack of investments.
  - In particular, concerns that electricity supplies may be unable to meet demand as a result of insufficient investment due to market uncertainties and regulatory interventions. Low energy prices as the new normal.
  - Demand needs to be met by supply also in times when there is a shortfall from renewable energy sources.
  - **Generation adequacy** concerns.

- Capacity mechanisms have existed in certain countries since the 1990s, but are on the increase. 3 main types:
  - **capacity payment**: providers receive a fixed compensation
  - **strategic storage**: grid managers must create an energy storage to cover risks of shortage
  - **capacity market**: a new market is created on which energy capacity is traded in the form of certificates.

- Focus on the French case (capacity market), and, arguably, the missed opportunity of a new case law, Case C-543/15.
1. The French capacity market mechanism: background for introducing it
   
   • Energy production profile characterised by large share of nuclear and hydropower.
   • Consumption profile characterised by large part of electric heating. Results in consumption peaks in cold periods.
   • Still dominance of the historic incumbent, EDF.

Risk of security of electricity supply

   • Periods of high electricity consumption (winter time, electric heating), lack of storage capacity have as consequence that the French energy market faces inadequate balance between the level of the available energy and the quantity of energy requested during peak periods.
   • RTE assessment (2010): such inadequacy will increase in the coming years and will constitute a genuine threat for the safety of French energy supply by year 2016.
   • In 2012, 2 processes started:
     – Multi-year plan of investment (MPI) – planning Report for 2009-2020
Pillars of the French capacity mechanism:

- **Supply management** = ensure sufficient electricity supply to France, metropolitan territory, in the medium term, during peak loads (winters)
- **Demand response**: modify consumption patterns.

Progressive elaboration of the new rules:

- Rule elaborated and proposed in 2014 by RTE.
- Followed by an important process of consultation.
- CRE (regulator) released a critical, but positive decision.
- Rules approved by Ministry in charge of energy on 22 January 2015.

2. Legal basis

- **French law 2010-1488** of 7 December 2010 reforming the electricity market (NOME),
  - Art. 6 of the NOME law (reflects conclusions Sido-Poignant report) defines the key principles of a capacity mechanism, to be implemented by a governmental decree.
  - “the energy supplier contributes, depending on clients’ consumption specificities, in terms of power and of energy, on the continental metropolitan soil, to the safety of energy supply”.
  - Now codified in French Energy Code Art. L.335-1 to L.335-7
- **Decree n° 2012-1405** dated 14 December 2012 implementing the capacity mechanism - Defines the general organisational framework of the new scheme
- **Decree of 22 January 2015** defining the technical rules and specifying the conditions of implementation of the capacity market mechanism. Adopted in accordance with 2012 Decree.

Completed by:

- **Capacity Market Rules – “The Rules”** - Specify the certification parameters, the suppliers’ obligation, the trading of certificates as well as the associated transparency mechanisms.
### 3. Functioning rules

**Original idea:** A capacity obligation on suppliers, along with a certificate market.

- **Capacity obligation**: Every year, energy suppliers are assigned a capacity obligation. Must hold a certain amount of capacity guarantees (capacity certificates) in proportion of the electricity consumption of their customers in peak periods. Purpose = to ensure their capacity to provide the actual consumption of their clients during critical times.

- **Peak periods**: Obligation will be assigned to suppliers based on the actual consumption of their customers during peak periods (PP) (usually in winter).
  - PP = short period (day or season) with highest failure risk, highest energy consumption, need for additional energy production and/or need for consumption curtailment.
  - **Peak Period PP1**: Suppliers must demonstrate they dispose of sufficient capacity guarantees in order to cover their clients’s energy consumption at its highest peak.
  - **Peak Period PP2**: Owners commit to an availability of their capacities during a peak period. Used as reference in the methods of certification and of capacity control.

- **Capacity operators**: To meet its obligation, the supplier will have to secure capacity guarantees. If he does not possess the guarantees, the obliged supplier can buy certified guarantees from the capacity operators, or buy on the capacity guarantees market. Capacity operators commit that such capacity will be available in peak periods. 2 types:
  1. Owners of production capacity
  2. Curtailment operators / demand response DR operators. Encourage consumers to reduce their consumption during peak periods.

- **Issuance of the capacity guarantees**:
  - Réseau de Transport d’Electricité (RTE) (EDF independent subsidiary) issues the capacity guarantee to capacity operators.
  - 1 capacity guarantee = 0.1 MW. Validity = 1 year
  - Applies to all capacity (both generation and demand-side response) = technology neutral

- **Certification process**: Certification attributes a volume of capacity guarantees for each capacity. Capacity certification reflects the ability of capacities to meet the system needs.
  - The capacity owner must seek certification (obligation) from the relevant grid manager regarding the capacity connection.
  - Aggregation obligation if installed capacity (puissance) is below 1 MW: Must be above 1 MW.
  - Producers subject to purchase obligation are not covered.

- **Redemption** of guarantees will prove the contribution of the energy suppliers to the risk reduction of failure during peak periods of energy consumption.
- **Trade, exchange**: The capacities guarantees can then be traded, sold to suppliers, on the capacity market. They are exchangeable and transferrable.

- **Trade register**: The capacity guarantees are recorded in a trade register held by RTE. A confidential register. Change of ownership. [https://rega-rte.fr/](https://rega-rte.fr/)

- **Timeframe**:  
  - The capacity mechanism falls within an insurance logic: capacity operators value their capacities depending on their potential to improve SoS in a mid-term perspective.  
  - Starting 4 years ahead of the delivery period, the mechanism generates economic signals complementing those of the energy market.  
  - The capacity mechanism secures investments.

- **Market surveillance**: CRE, energy regulator

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**SoS criterion** is defined by the Minister of Energy (loss of load expectation = 3h)

The price of capacity reveals the value of SoS.  
_price = 0 → there is no risk of SoS_
Timeframe for implementation

- The implementation of the capacity market started on 1 April 2015 and the capacity scheme will be effective during winter 2016-2017.

For the first years of delivery:

- **1 April 2015**: opening of the counter for certification requests, opening of the certified capacity register and of control measures during consumption peak periods, opening of the capacity guarantee register;
- **as from 1 April 2015 until 31 December 2015**: certification of production capacity, already operating, on the first and second years of delivery (2017 and 2018);
- **as from 1 April 2015 until 31 October 2016**: certification of curtailment capacities, already operating or in the form of projects, and of the production capacities, in the form of projects, for the first year of delivery (2017);
- **as from 1 April 2015 until 31 October 2017**: certification of curtailment capacities, already operating or in the form of projects, and of the production capacities, in the form of projects, for the second year of delivery (2018).

4. The ANODE case before the French Council of State

- **Parties** to the case before the French Council of State (**Conseil d'Etat**):

- **ANODE seeks the annulation of Decree no 2012-1405 of 14 December 2012** which defines the principle of the creation of a capacity mechanism in France.

- **Grounds**:
  - The capacity mechanism constitutes state aid, that has not been notified to the European Commission
  - Not conform to harmonised EU secondary legislation
  - Risk of abuse of dominant position
  - Infringement to the free movement rules → **Only question referred to the CJEU**
1. the qualification of the French capacity mechanism under state aid rules

- The Council of State concludes that the mechanism does not involve state resources, and therefore cannot be qualified as "state aid" pursuant to Article 107 of the TFEU.
  - Yes, capacity market functions under the close supervision of the French TSO, RTE and the energy regulator, CRE.
  - But Neither the volume of capacity certificates or their price are determined by the State
  - The state is not involved in collecting payments for the capacity certificates
  - Capacity operators get an advantage, but could not have been sold by the state directly, meaning that the state does not renounce to possible financial earnings
  - Conclusion: no state aid.

- NB: The European Commission reached a different conclusion in its decision!

2. Non-conformity to harmonised secondary legislation

- ANODE's claim: The 2012 Decree disregards the requirements of the principle of proportionality and non-discrimination under the EU Directives applicable on measures taken by MSs in order to guarantee SoS.

- Question: to which extent the French capacity mechanism meets the requirement set in the 2009/72/EC Electricity Directive, 2005/89/EC Security of Electricity Supply Directive and primary EU law as to the purpose (security of energy supply) and the proportionality and necessity of the measure.
  - Directive 2009/72/EC: Art. 3.2: "2. ... Member States may impose on undertakings operating in the electricity sector, in the general economic interest, public service obligations which may relate to security, including security of supply. ... Such obligations shall be clearly defined, transparent, non-discriminatory, verifiable and shall guarantee equality of access for electricity undertakings of the Community to national consumers." MSs can adopt PSO measures, but those must be proportional (Art. 106.2 TFEU) and limited to what is necessary to attain the objectives of general economic interest.
  - Same requirements (proportionality, necessity, consequences for new entrants and costs for consumers) defined in Art. 3.4 of Directive 2005/89/EC

- Court = question dismissed, does not find any breach.
3. Abuse of dominant position

- ANODE argues that the CRM puts automatically EDF – being a dominant electricity producer – in a position to abuse its dominant position on the future market of capacity certificates, with consequences on both the generation and the supply market.

- The Council of State deems the capacity mechanism as being "subsidiary" compared to the existing alternatives for new generation capacity, limiting its effects on the electricity generation market, and so the possible distorting effects created by the alleged dominant position that EDF could get. The Council underlines that "all capacities" are covered to that respect. It also refers to the additional instruments created by the French scheme to ensure transparency on the "capacity guarantees" market.

5. Request for preliminary ruling referred to the CJEU: internal market issues (Case C-543/15)

- Following its decision of 9 October 2015, the French Council of State has filed a request on 19 October for preliminary ruling to the Court of Justice of the European Union (EU) concerning the conformity of the French capacity market mechanism to primary EU law, and in particular Article 34 and 36 of the Treaty on the Functioning of the EU (TFEU) on free movement rules.

- The Conseil d'Etat suspended its judgement pending the CJEU decision.
The question addressed to the Court of Justice: free movement of goods, measure equivalent to a quantitative import restrictions, discrimination based on nationality, security of energy supply objective, and proportionality.

- Although NOME Law: Art. 3, 2012 Decree: Interconnections with other European markets are taken into account for defining the capacity obligation
- It follows from other texts that: only operators located in France (Metropolitan territory) can be certified and so get access to the capacity market, while interconnections to other European markets has to be taken into account in the calculation of the capacity level.
- “Foreign” generation is de facto excluded from the national scheme.
- The Council of State raises the question of the alleged objective of the measure - security of supply - and its proportionality.
- The comparison is drawn with alternative models for capacity mechanisms.

**Question referred to the Court:**

Must Articles 34 and 36 of the Treaty on the Functioning of the European Union be interpreted as precluding a capacity mechanism in the electricity sector such as that at issue in the main proceedings which is described in particular in paragraphs 1, 15 and 17 to 19 of the present decision?

In particular [my underlying]:

a) Even though the mechanism remunerates capacities only on the basis of their availability, not of their actual production, and having regard to the taking into account of the effects of interconnections in the determination of suppliers’ obligations, which relaxes the causal link between the exclusion of foreign capacities from the mechanism, as laid down by the decree, and the restrictive effect on cross-border electricity trading which could arise therefrom in terms of investors’ resource allocation choices and suppliers’ procurement choices, must Article 34 TFEU be interpreted as precluding such an exclusion measure?

b) Having regard to developments in the European legal framework governing the internal market in electricity, is the objective of security of electricity supply for the inhabitants of a Member State capable of being covered by the concept of public security provided for in Article 36 TFEU?

c) Having regard, in particular, to the discretion granted to Member States with respect to defining suitable policies to ensure their security of electricity supply, what criteria may be used to ascertain whether a decentralised market-based capacity mechanism, involving, in the present state of the European electricity market, a measure excluding foreign capacities which is offset by the taking into account of interconnections in the determination of suppliers’ obligations, is capable of satisfying the condition of proportionality required for Article 36 TFEU to apply?
Issues, as discussed by the Council of State

- The content of the French legislation.
- As there is no exhaustive harmonisation in Directive 2009/72/EC or Directive 2005/89/EC on that matter, it is possible to assess the scheme under primary EU rules, Art. 34 and 36 TFEU.
- The CRM may threaten free movement rules.
- The CRM must be qualified as a measure having equivalent effect quantitative restriction
  - The 2012 Decree does not aim to regulate electricity trade
  - It limits certification – which provides an advantage – to national generation capacity and curtailment activities, while capacity obligations does take into account interconnections. Result: favours national generation compared to imports of electricity.
  - Court concludes that the exclusion of foreign capacities from certification has the potential of limiting imports of electricity.

- Question of compatibility under Art. 34 and 36 TFEU (must be proportionate and necessary).
  - Art. 36: "The provisions of Articles 34 and 35 shall not preclude prohibitions or restrictions on imports, exports or goods in transit justified on grounds of ...public security. Such prohibitions or restrictions shall not, however, constitute a means of arbitrary discrimination or a disguised restriction on trade between Member States."

- Case law as to the interpretation of "public security": Case C-72/83 (Campus Oil Limited) (paras. 34-35).
  - "the aim of ensuring a minimum supply of petroleum products at all times is to be regarded as transcending purely economic considerations and thus as capable of constituting an objective covered by the concept of public security." (para. 35)
  - The Court is of the opinion that the French CRM aims to fulfill such objective of security of energy supply on the French metropolitan territory.

- Remaining question: Is that proportionate to exclude foreign capacities from certification, but integrate interconnections into the calculation of the capacity obligation?
  - Proportionality of the measure:
    - Imports of electricity contribute to security of energy supply as national generation does.
    - This exclusion is neither proportional nor necessary. Other capacity mechanisms could have been used, less restrictive on foreign capacities.
• Case closed
  – ANODE withdrew its application. Possible reasons:
    • Ongoing Commission sector inquiry
    • Ongoing review of the capacity mechanism in France (see next slide)
    • M&A operations: Direct Énergie acquired Combined-cycle power plant Bayet from Alpiq. CRM could be of interest now.
  – 16 March 2016: Council of State withdrew its request for preliminary ruling
  – 12 April 2016: order from the president of the Court, case removed from the court register

Evolution of the French capacity mechanism CRM:
The elaboration of 2.0 Capacity market

• Art. 20, 2012 Decree requires CRE to submit to the Ministry every year a report based on preliminary works by RTE on the integration of the French capacity market into the European market. Objective: improve the mechanism.

• RTE mandated by the French Minister to assess the European integration of the capacity market, i.e.:
  – **Increased European integration of the capacity market**: possible evolutions with integration of foreign capacities, national capacity market with differentiation by borders, SoS and welfare consequences
  – **A more regional approach**: prerequisites for the definition of a regional target model, market design criteria for XB participation (better rules of implicit/explicit XB participation), facilitation of a coordinated regional solution for capacity markets

• RTE – White paper - Public consultation regarding the participation of interconnections and/or foreign capacities in the French capacity market – December 2015

• White paper for the French Minister and Regulator to propose short and long-term solutions. 1st set of studies published by RTE. 2nd set of studies to be published by RTE on the European integration of the French capacity market in 2016

Internal market issues as part of the Sector Inquiry

- April 2015 – Commission launches a state aid sector inquiry into national capacity mechanisms
  - Purpose: gather information on capacity mechanisms to examine whether they ensure sufficient electricity SoS without distorting competition or trade in the EU internal market
  - Information on past, existing or planned capacity mechanisms in 11 MSs (Belgium, Croatia, Denmark, France, Germany, Ireland, Italy, Poland, Portugal, Spain and Sweden).

- 13 April 2016 - Interim report of sector inquiry on electricity capacity mechanisms
  - Found out 28 capacity mechanisms
  - «capacity mechanisms can increase security of electricity supply»
  - But «unecessary badly designed capacity mechanisms can distort competition, hinder electricity flows across borders and lead to consumers overpaying for electricity.»
  - Confirms a general trend towards more open and inclusive mechanisms, which are in principle open to participation from all categories of capacity providers.
  - Objective: taking imports into account when operating capacity mechanisms.
  - See results Working Group on cross-border participation in capacity mechanisms (Anne 2 SWD)

- Public consultation until 6 July 2016
- Autumn 2016: final report on Sector Inquiry from the Commission
- May lead to new legislative proposals in electricity market design package (end 2016)

«For a capacity mechanism to be well-designed it needs to be open and take into account electricity that can be provided across EU borders, thereby also contributing to building an Energy Union in Europe.»

Commissioner Margrethe Vestager, in charge of competition policy, 13.4.2016
6. Commission’s individual decisions on French capacity market

- **13.11.2016**: European Commission opened **2 in-depth investigations** to assess compatibility of French capacity adequation mechanisms with state aid rules.

- **SA.39621** - Country wide capacity mechanism
  - Concern: Could favour certain companies over their competitors and hinder the entry of new players
  - France argued that the CRM should be qualified as public service obligation (PSO) pursuant to Art. 1.15 of Directive 2009/72/EC, but the **Commission did not agree** (Altmark criteria not fulfilled).
  - CRM **to be assessed under EEAG**, section 3.9 (aid for generation adequacy).
  - SoS recognised as an **objective of common interest**, but subject to assessment: need for state intervention, appropriateness, incentive, effect, proportionality, avoidance of undue negative effects on competition and trade.
    - Stresses inconsistencies in the arguments of the French government as to the necessity of the CRM (para 161).
    - Other measures could be introduced, more cost-effective.
    - Not sufficient integration of interconnections and foreign capacities (para 172).
    - «could» have an incentive effect
    - Doubts that the measure is proportional
    - May have negative effects on competition and trade

- **SA.40454** - Tender to support gas-fired power plant in Brittany (CCGT)
  - Suspects that it **could support only one type of technology or solution**, and exclude other potential solutions, such as: other power generation, demand-side management, network extensions or storage solutions.
  - Risk of creating a subsidy dependent market, where investors develop projects only on the basis of public tenders granting state aid. Will not solve the adequacy problem, but make it worst.
“France has a legitimate interest to ensure the security of energy supply for its population and protect against the risk of black-outs. It’s our role to ensure that this is done in a cost-effective and competitive way, so that electricity prices are kept in check.”

Commissioner Margrethe Vestager, in charge of competition policy, 13.11.2015

7. Conclusion: Case C-543/13, a missed opportunity?

• ... or just an episode in the saga leading us to the framing of EU rules for capacity markets?
• The case of a France mirrors current developments...
  ...and powers struggle.
• State intervention on power and related markets
• Energy price signal + capacity price signal. Risk of introducing a new signal: the implementation of a complementary mechanism that is off the market could distort the energy market price signal. Risk of financing expensive unnecessary capacity.
• Electricity market re-design
• SoS under the test of EU internal market and solidarity, also as part of the Energy Union Strategy.
• Harmonising methods for assessing appropriate level of SoS? Coordination of investment decisions?
Takk for oppmerksomheten!

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