Commission Decision (EU) 2020/348 of 24 October 2019 on the aid scheme SA.35980 – 2019/C United Kingdom – Electricity Market Reform: Capacity Mechanism (notified under document C(2019) 7610) (Only the English text is authentic) (Text with EEA relevance)

COMMISSION DECISION (EU) 2020/348

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on the aid scheme SA.35980 – 2019/C United Kingdom – Electricity Market Reform: Capacity Mechanism

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THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union, and in particular the first subparagraph of Article 108(2) thereof,

Having regard to the Agreement on the European Economic Area, and in particular Article 62(1)(a) thereof,

Having given notice to the parties concerned to submit their comments pursuant to those Articles[(1)] and having regard to their comments,

Whereas:

1. PROCEDURE

(1) Following pre-notification contacts, the United Kingdom (UK) authorities notified to the Commission on 23 June 2014, in accordance with Article 108(3) of the Treaty, of a proposed measure to support capacity providers in the electricity market in Great Britain ('GB')[(2)]. That measure is referred to in this Decision as 'the measure'.

(2) On 23 July 2014, the Commission decided not to raise objections to the aid scheme establishing the measure on the ground that the scheme fell within point (c) of Article 107(3) of the Treaty and was therefore compatible with the internal market[(3)] ('the 2014 Decision').

(3) The first auction in the capacity market to which the measure relates ('the Capacity Market' or 'CM') took place on 16-18 December 2014. The auction was for delivery of capacity four years later, i.e. in 2018.

(4) On 15 November 2018, the General Court of the European Union annulled the 2014 Decision, in its judgment in Case T-793/14 – Tempus Energy and Tempus Energy Technology v Commission ('the GC judgment'). In summary, the General Court

Changes to legislation: *There are currently no known outstanding effects for the Commission Decision (EU) 2020/348. (See end of Document for details)*

considered that, based on the length and circumstances of the pre-notification phase and the lack of appropriate investigation by the Commission at the preliminary examination stage with regard to some aspects of the Capacity Market, more specifically with regard to the role and treatment of demand side response in the notified capacity mechanism, the Commission should have had doubts as to the compatibility of the measure with the internal market. Those doubts should have led it to initiate the procedure provided for in Article 108(2) of the Treaty, thereby allowing interested parties to submit their observations to the Commission and to put the relevant information at its disposal so that it would be better able to assess the Capacity Market's compatibility with the internal market.

(5) Additional information was received from the UK on 20 December 2018.

(6) On 25 January 2019, the Commission appealed the GC judgment (Case C-57/19). As the appeal does not have suspensive effect, in order to comply with the GC judgment, the Commission reassessed the CM.

(7) Following that reassessment, the Commission informed the UK, by letter dated 21 February 2019, that it had decided to initiate the procedure laid down in Article 108(2) of the Treaty in respect of the measure.

(8) The Commission decision to initiate the procedure ('the Opening Decision') was published in the *Official Journal of the European Union*[(4)]. The Commission called on interested parties to submit their comments.

(9) The UK sent its comments on the Opening Decision to the Commission by letter dated 12 April 2019. The Commission received comments from 35 interested parties. It forwarded them to the UK and gave the UK the opportunity to react. The Commission received the UK's comments in response by letters dated 7 June 2019, 19 July 2019 and 12 September 2019.

(10) On 29 March 2017, the United Kingdom submitted the notification of its intention to withdraw from the Union pursuant to Article 50 of the Treaty on European Union (TEU). In accordance with Article 50(3) TEU, the Treaties are to cease to apply to the withdrawing State from the date of entry into force of a withdrawal agreement or, failing that, two years after the notification, unless the European Council, in agreement with the Member State concerned, unanimously decides to extend this period. The period has been extended twice, last time by European Council Decision (EU) 2019/584[(5)], which extended it until 31 October 2019.

(11) On 11 January 2019, by Decision (EU) 2019/274[(6)], the Council authorised the signature of the withdrawal agreement agreed at negotiators' level on 14 November 2018. On 17 October 2019, the European Council endorsed the revised Withdrawal Agreement agreed at negotiators' level. On 21 October, the Council, on a proposal from the Commission[(7)], amended Decision (EU) 2019/274 so as to authorise the signature of the revised Agreement. The Union re-confirmed that it stands ready to proceed swiftly with its signature and conclusion in the event that the United Kingdom Parliament approves the withdrawal agreement. Part Four of the withdrawal agreement provides

for a transition period starting on the date of entry into force of the agreement, during which Union law is to continue to apply to and in the United Kingdom as laid down therein.

(12) In any event, this Decision applies only as long as Union law applies to and in the United Kingdom.

2. DETAILED DESCRIPTION OF THE MEASURE

2.1. Overview of the measure

(13) In 2014, the UK estimated that the electricity market in GB would reach critical levels of generation adequacy around 2017/2018. The UK therefore designed the measure as a capacity market where the System Operator would organise centrally-managed auctions to procure the level of capacity required to ensure generation adequacy.

(14) The auctions organised under the measure were initially open only to existing and new generators, demand side response (DSR) operators and storage operators. Interconnectors were permitted to participate as from the second auction in 2015.

(15) Bidders who are successful in the auctions are awarded capacity agreements under which they will receive a steady payment for the duration of the capacity agreement in return for a commitment to deliver electricity at times of system stress if called upon to do so by the System Operator. Financial penalties apply if the capacity provider does not deliver the amount of energy required in accordance with its according to its capacity commitment. The measure is financed through a levy on electricity suppliers.

(16) The first auction was organised in 2014 for delivery of capacity in 2018. It was followed by three further four-year ahead ('T-4') auctions (in 2015, 2016 and 2017), one one year-ahead ('T-1') auction (in 2017), and two transitional auctions ('TAs') in 2016 and 2017).

(17) The UK suspended the measure on 15 November 2018 following the GC judgment, mentioned in recital 4 and currently under appeal. The UK confirmed that no further aid would be granted through auctions in the Capacity Market and that payments for the aid granted through the auctions that had already taken place had been halted pending a decision by the Commission to approve the measure.

(18) Nevertheless, following the GC's judgment, the UK did put in place the following measures:

(a) A replacement T-1 top-up auction for delivery of capacity in the 2019/20 delivery year was held in June 2019, as a result of which conditional capacity agreements were awarded which were conditional on the State aid approval being obtained and on the necessary procedural steps being taken under the legislation establishing the Capacity Market;

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(b) Compliance with capacity agreements awarded in previous auctions was still enforced so that, subject to a positive State aid decision, deferred capacity payments could be made to capacity providers who had complied with their obligations during the standstill period;

(c) Electricity suppliers were to continue passing on the levy to consumers during the standstill period to ensure they would be in a position to pay outstanding supplier charges in respect of the standstill period fully and promptly if State aid approval were granted; and

(d) Prequalification procedures were launched on 22 July 2019 for a T-1 auction (delivery year 2020/2021), a T-3 auction (delivery year 2022/2023) and a T-4 auction (delivery year 2023/2024), each of which was due to take place in the first quarter of 2020.

2.2. **Legal basis and government arrangements**

(19) The legal basis for the measure is the UK Energy Act 2013. Secondary legislation in the form of the Electricity Capacity Regulations 2014, the Electricity Capacity (Supplier Payments etc.) Regulations 2014 and the Capacity Market Rules governs implementation of the measure.

(20) The UK regularly reviews the CM mechanism in the light of feedback received from each auction process. It has also conducted a number of public consultations to make incremental improvements to the regulatory detail of certain specific features of the scheme. The energy regulator (Ofgem) also annually gathers stakeholder views on potential changes to the operational and administrative features of the scheme and makes amendments to the rules. In addition, a more formal and comprehensive review is scheduled to take place every five years, involving both the government and Ofgem, to assess the extent to which the Capacity Market effectively delivers on its objectives and remains the most effective form of intervention to address those objectives. The objectives include considering underlying market failures. In essence, the review consists of the following two stages:

(a) Ofgem carries out five-year reviews of those areas of the Capacity Market design that are covered in the Capacity Market Rules, looking at the effectiveness of the scheme and whether its existing arrangements are fit for purpose, and

(b) the Government assesses the Capacity Market and its objectives from a more high-level perspective and addresses the question of whether the Capacity Market is still needed in the future or should be phased out and the extent to which the objectives of the Capacity Market could be achieved in way that imposes less regulation. This is informed by the Government's annual internal consideration of whether to run the Capacity Market auction as well as the findings of Ofgem's first stage review. The Government carries out public consultations as part of this review process.

(21) The UK Government initiated the first five-year review process by publishing a Call for Evidence in August 2018, thus inviting views and evidence at a high level on issues such as whether there is a continuing need for the CM, and the identification of any priority areas where changes should be made. In September 2018, Ofgem published an Open Letter asking for views and evidence on whether the Rules continue to meet their objectives. The final report of the UK's government five-year review was published on 22 July 2019[(8)], while Ofgem's final report was published on 31 July 2019[(9)]. Besides, the Science and Technology Committee of the UK's House of Commons published a report on 22 August 2019 mentioning, among other themes, the GB Capacity Market[(10)].

(22) The measure is implemented by the UK Government, Ofgem, the Delivery Body (National Grid – 'NG'), the Settlement Body (a new institution created under the Energy Act 2013, subject to government direction and oversight) and the settlement service provider (Elexon). A brief high-level description of their roles and responsibilities is set out below.

(23) The UK Government is responsible for the strategic oversight of the Capacity Market and for changes to the Regulations governing the scheme and to ensure continued accountability for key aspects of the Capacity Market design. The Regulations include for example general eligibility criteria for entry to Capacity Market auctions, functions of the System Operator for delivery of the Capacity Market, and the settlement of payments.

(24) The UK Government designed the Capacity Market Rules, but Ofgem is responsible for implementing them (both the UK Government and Ofgem may amend the Rules). The Capacity Market Rules include technical rules and procedures concerning pre-qualification and capacity auctions, the contents of capacity agreements and the obligations of capacity agreement holders. When considering changes to the Rules, Ofgem is bound by a set of objectives enshrined in the Regulations and the Rules, which ensures transparency and confidence in the governance of the Capacity Market. Ofgem is also responsible for the resolution of disputes raised by applicants about the outcome of pre-qualification.

(25) The System Operator is the National Grid. It undertakes the delivery role for the Capacity Market, including: providing advice to Ministers on the security of supply outlook and recommending the amount of capacity to auction in order to meet the reliability standard; pre-qualifying auction participants, administering the capacity auctions and issuing the contracts (so-called 'capacity agreements') with the successful bidders; developing and administering new supporting procedures such as the provision of Capacity Market warnings.

(26) The UK Government sets out the delivery functions of the System Operator in secondary legislation, which are 'relevant requirements' enforceable by Ofgem. This gives the Government certainty about what will be delivered and a clear basis for Ofgem to manage NG's performance in its delivery role. A panel of technical experts