

On 14 November 2018, the General Court of the European Union issued its judgment in Case T-793/14 *Tempus Energy Ltd and Tempus Energy Technology Ltd v Commission*, overruling the European Commission's (Commission's) decision (provided on 23 July 2014) to approve the aid scheme establishing a capacity market in the UK. Tempus is a demand side response (**DSR**) provider that contended that the Capacity Market scheme privileges generation over DSR in a discriminatory and disproportionate manner that goes beyond what is necessary to achieve its objectives and satisfy the state aid rules. The DSR market in Britain has increased substantially and at a fast pace, with 1,206 MW of DSR awarded Capacity Market agreements in the 2017 Capacity Market auction, up from 174 MW in the first 2014 Capacity Market auction. However, DSR only has access to one-year agreements in the Capacity Market auction, in contrast to generation, which can access three- and fifteen-year agreements<sup>1</sup>.

The effect of the General Court's judgment was to annul the State Aid Approval for – and, therefore, the legality of granting aid through – the Capacity Market. We set out the impact of this decision in our [insight on 15 November 2018](#) and, in this follow-up, we take a closer look at the General Court's judgment and the questions which have emerged following the annulment.

## Part 1. The Initial Commission State Aid Approval and the Subsequently Introduced Capacity Market Scheme

More than four years ago, on 23 July 2014, the Commission did not raise objections to the aid scheme for the Capacity Market in the UK, on the basis that the scheme was compatible with the internal market pursuant to Article 107(3)(c) TFEU<sup>2</sup> (the "**State Aid Approval**").

Following the Commission's State Aid Approval, the government introduced the Capacity Market as part of its Electricity Market Reform (EMR), pursuant to the Energy Act 2013. Under the scheme, successful generators in the Capacity Market auction receive a Capacity Market agreement for a specific obligation and price per MW and are to paid monthly payments based on the auction clearing price, their obligation and the time of the year. The scheme is funded by way of a "capacity market supplier charge" imposed on suppliers, with such charge being based on the supplier's market share.

The Capacity Market is governed by the Capacity Market Rules and the Electricity Capacity Regulations 2014/2043.

Under the Capacity Market, a Capacity Market Unit (**CMU**) is a unit of electricity generation capacity and is the product that forms the capacity to be purchased in the Capacity Market. DSR CMUs are defined with reference to a commitment to reduce demand: this commitment requires the DSR operator to cause its customer to reduce the import of electricity (as measured by half-hourly meters) and/or export electricity generated by on-site generating units.

## Part 2. Tempus' Arguments and Pleas

Tempus brought its action as an application under Article 264 TFEU for **annulment of the Commission's State Aid Approval**.

According to Tempus, "the design of this market ensures profits for coal, gas and diesel generators, leaving cheaper, cleaner alternatives virtually unable to compete" and that the Capacity Market scheme allows the government to use bill payers money to finance the fossil fuel industry "without their consent, with several billion pounds committed so far", effectively shutting out other "innovative" energy solutions for guaranteeing supply<sup>3</sup>. Tempus submitted that the Commission could not conclude, following nothing more than preliminary examination and in the light of the information available at the time of the decision, that the planned aid scheme did not raise doubts as to its compatibility with the internal market.



1 "[ADE Response to Capacity Market state aid challenge](#)", accessed 18 November 2018.

2 Treaty on the Functioning of the European Union.

3 "Tempus Landmark European Court-ruling", Tempus Press Release.

## a. Tempus' First Plea

Tempus' first plea alleged that, by failing to open the formal investigation procedure, the Commission infringed Article 108(2) TFEU – the principles of non-discrimination, proportionality and legitimate expectation – and made an incorrect assessment of the facts. Tempus submitted that:

- The Commission failed to properly assess the potential role of DSR in the Capacity Market.
- The restrictions on the duration of DSR agreements under the Capacity Market violated the principles of legitimate expectation and non-discrimination, and are based on an incorrect assessment of the facts.
- The requirement for DSR operators to choose between transitional and enduring market auctions violated the principles of legitimate expectation and non-discrimination.
- The Capacity Market's cost recovery<sup>4</sup> methodology violated the principles of non-discrimination, legitimate expectation and proportionality.
- The use of open-ended capacity events, rather than time-bound ones, in the enduring auctions of the Capacity Market was contrary to the principles of non-discrimination and legitimate expectation (this disadvantages DSR operators by obliging all Capacity Market participants to guarantee open-ended capacity events, whereas the majority of capacity events are time bound. By doing so, the Capacity Market failed sufficiently to take into account the specific nature of DSR operators and discouraged them from participating in the Capacity Market).
- The Capacity Market's bid bond requirement to obtain access to the Capacity Market auctions violated the principles of non-discrimination and legitimate expectation (Tempus submitted that imposing the bid bond requirement on participants in the Capacity Market may cause a market entry problem for DSR operators, given that the sector is still in its infancy. The problem is aggravated by the requirement to bid to cover open-ended capacity events.).
- The Capacity Market's failure to provide for additional remuneration for savings in transmission and distribution losses from DSR violated the principles of non-discrimination and legitimate expectation (According to Tempus, the capacity provided by DSR operators reduces not only the overall amount of capacity required and circulating in the capacity market, but also the amount of the capacity lost in transmission and distribution of the electricity by around 7%-8%. Tempus took the view that those savings should be incorporated into the remuneration of DSR operators in order to incentivise improvements to grid efficiency.).

<sup>4</sup> Costs incurred to fund capacity payments are to be paid by all licensed electricity suppliers.

## b. Tempus' Second Plea

Tempus' second plea was that the Commission failed to provide adequate reasoning for its State Aid Approval<sup>5</sup>.

## Part 3. The General Court's Judgment

It is important to note that General Court's judgment **was decided on procedural grounds**. It was **not a challenge to the nature of the Capacity Market mechanism itself**.

The General Court annulled the Commission's State Aid Approval on the basis that the Commission could not satisfy itself whether the scheme raised doubts in respect of certain aspects of the planned aid scheme, without initiating a formal investigation procedure in order to better assess its compatibility with the internal market. The General Court's main rationale is summarised below:

### a. On whether the preliminary examination phase "raised doubts as to the compatibility with the internal market" so that the Commission should have initiated a formal investigation procedure under Article 108(2) TFEU:

- First, the General Court pointed out that the concept of "doubts" as to the compatibility of the Capacity Market with the UK's internal market is exclusive, i.e. the Commission may not decline to initiate the formal investigation procedure in reliance on other circumstances.
- Furthermore, when the Commission does not succeed in eliminating all doubt at the end of a preliminary examination it is obliged to initiate the formal investigation procedure – that investigation must be conducted objectively, comparing the grounds of the decision with the information that could have been available to the Commission when it took a decision on the compatibility of the disputed aid with the internal market.

### i. Proving the "Existence of Doubts"

- The General Court noted that the lawfulness of a decision concerning state aid is to be assessed in the light of the information available to the Commission when the decision was adopted<sup>6</sup>.
- In the present case, Tempus had to establish that the Commission had not researched and examined all of the relevant information in such a way that, when it provided State Aid Approval, it had at its disposal assessment factors that could reasonably be considered to be sufficient and clear for the purposes of its assessment or that, while it had those factors at its disposal, the Commission failed duly to take them into account in such a way as to eliminate all doubt as to the compatibility of the capacity market with the internal market.

<sup>5</sup> Action brought on 4 December 2014 – [Tempus Energy and Tempus Energy Technology v Commission](#), Official Journal of the European Union, accessed 18 November 2018.

<sup>6</sup> This position being established case law - judgment of 15 April 2008, *Nuova Agricast*, C-390/06.

- The General Court held that taking into account, *inter alia*, the importance of the role that could be played by DSR within the Capacity Market, the available elements concerning the potential of DSR are such as to give an **indication that there were doubts as to the compatibility of the scheme with the internal market**, which, upon reading the State Aid Approval, cannot be held to have been allayed following the Commission's preliminary examination. The General Court noted, *inter alia*, that the Commission was:
  - Not in a situation where it could simply rely on the information provided by the UK without carrying out its own investigation in order to examine and, if necessary, seek relevant information from, where appropriate, other interested parties for the purposes of its assessment.
  - Further aware of the difficulties referred to in a report compiled by a panel of technical experts (PTE), who were commissioned by the UK to examine National Grid's estimates concerning the capacity to be auctioned in the first (T-4) December 2014 Capacity Market auction. The PTE raised concerns recharging the lack of information and understanding regarding DSR, noting that there was no organisation that was collecting the data needed to understand and gather information on the potential of DSR.

## b. On Discriminatory/Advantageous Treatment of DSR Within the Capacity Market

### i. Length of Agreements

The General Court ruled that the difference in the length of the agreements offered to DSR operators and that of those offered to generators indicated that there were doubts as to the compatibility of the measure at issue with the internal market. It was for the Commission to examine the level of capital expenditure and the financial needs of DSR operators for the purposes of establishing that there was no infringement of the principle of equal treatment between generating CMUs and DSR CMUs, despite it being impossible for DSR operators to be granted agreements of longer than one year. Having regard to the technology neutral objectives pursued by the measure at issue and the criteria established by the measure at issue, it was necessary to carry out such an examination prior to reaching a conclusion that the measure was compatible with the internal market.

### ii. On Cost Recovery Methodology

- Tempus claimed that the cost recovery method adopted, namely cost recovery based on electricity consumption between 4 p.m. and 7 p.m. each weekday in winter, rather than consumption during the three highest annual demand peaks (i.e. triads), disadvantages DSR operators and infringes the principle of proportionality by increasing the amount of aid granted.
- The General Court held that the fact that the Commission did not have all the information with regard to the consequences of changing the cost recovery method, in the context of the preliminary examination procedure, was another indication that there were doubts.

### iii. On Conditions of Participation in the Capacity Market

- Tempus claimed that the State Aid Approval infringed the guidelines<sup>7</sup>, in particular, the obligation to encourage and provide adequate incentives to DSR operators, due to the conditions of participation in the Capacity Market to which DSR operators were subject and which made it difficult for them to participate in the scheme.
- The General Court held that:
  - The amount of the bid bond may constitute a barrier to entry for new DSR operators; and
  - It was apparent from the interplay between the T-4 and the T-1 Capacity Market auctions and some of the conditions of participation in the Capacity Market applicable to DSR operators should have led the Commission to have doubts as to, first, the capacity of the measure at issue to reach the objectives claimed by the UK in terms of development of DSR and, second, its compatibility with the requirements of the guidelines in terms of adequate incentives for DSR operators and, consequently, as to the compatibility of the measure at issue with the internal market.

### iv. On Lack of Additional Remuneration for DSR Operators in Respect of the Savings in the Amount of Electricity Lost During Transmission and Distribution

On this point, the General Court rejected Tempus' arguments.

## c. On Whether the Commission Failed to Provide Adequate Reasoning for Its State Aid Approval

The General Court concluded that in view of the annulment of the State Aid Approval (on the basis of this first plea), there was no need to examine the second plea.

## Part 4. What Happens Next?

In reviewing the Capacity Market (again), the Commission will need to take utmost account of the General Court's judgment and very likely need to undertake a formal investigation before (again) providing State Aid Approval for the Capacity Market. It is impossible to tell how long it will take the Commission to conclude this formal investigation. It also remains to be seen whether, at the same time, the Commission will appeal the General Court's judgment before the Court of Justice of the EU. The Commission has two months from the day of the judgment to bring such appeal.

## Part 5. The Unanswered Questions

The decision has raised a host of questions, some of the most important which we have set out below:

1. How long will the standstill period last?
2. Are payments deferred or simply lost?
3. What happens to previous payments?
4. Notwithstanding the suspension in payments, do providers with existing agreements have the obligation to deliver if called upon?
5. What about future Capacity Market auctions?

In [Ofgem's letter to Capacity Market stakeholders](#), dated 21 November 2018, the regulator confirmed that "the government is seeking immediate State Aid Approval for a one-off "replacement" T-1 auction that will cover winter 2019/20. Alongside this, the government is working to reinstate the full Capacity Market regime and are discussing the swiftest means of doing so with the Commission".

To this date, Capacity Providers do not know whether payments will be deferred or simply lost. Worse still for the Capacity Providers is the possibility of the UK having to take steps to recoup previous payments, although the government has communicated that it "hopes this can be avoided". As part of the Commission's formal investigation, the Department of Business, Energy and Industrial Strategy (**BEIS**) will discuss with the Commission the extent to which aid already paid may need to be recovered.

BEIS is also reviewing the judgment and has informed stakeholders it will provide guidance to the Delivery Body on whether Capacity Providers will need to comply with their agreements (including in respect to delivery obligations) as soon as possible.

## Contacts

If you want more information about how these changes to the Capacity Market may impact your business, please reach out to one of our dedicated **Capacity Market Support Team** below.



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