

STANDBY POWER STANDSTILL: CAPACITY MARKET SUSPENDED AFTER EUROPEAN COURT DECISION

Ahead of a winter that is forecast to see a repeat of the beast from the east, the UK's scheme for supporting back up power generation to keep the lights and heating on has been thrown into jeopardy by a European court decision. The decision of the General Court of the Court of Justice of the European Union (**GC**), in favour of Tempus Energy against the European Commission, annuls the Commission's decision not to raise State aid objections to the establishment of the electricity capacity market, prior to its approval in July 2014.

In a nutshell, the judgment:

- has suspended the State aid approval for the capacity market until a re-clearance of the decision is issued;
- requires that the Commission reconsiders whether to undertake a formal (Phase 2) investigation and strongly suggests that it should; and
- effectively stops all payments to holders of capacity market agreements, and any future capacity auctions, until the Commission issues a new decision.

The case

In December 2014 Tempus Energy, a UK-based provider of electricity demand management technology, also known as 'demand-side response' (**DSR**), lodged an appeal at the GC claiming that the Commission should have had "serious doubts" about the compatibility of the UK's capacity market scheme with EU State aid rules and should therefore have opened a Phase 2 investigation into those doubts. Tempus Energy's central argument was that those doubts should have arisen because the design of the capacity market lead to discrimination against DSR providers (for example in terms of contract lengths available and the de minimis threshold for DSR participation).

The immediate impact of the case

As a result, the capacity market will enter a "standstill period" which prevents the Government from holding any capacity auctions, making any capacity payments under existing agreements or undertaking any other action that grants State aid, pending the outcome of the Commission's investigation. The Government has so far interpreted the ruling to mean that they can continue with aspects of the scheme which do not involve the transfer of aid, for

Key issues

- The UK capacity market has been suspended following the EU General Court's ruling.
- All payments to holders of capacity market agreements have also been suspended indefinitely.
- The UK Government is seeking to re-obtain approval from the Commission to re-instate the capacity market.
- It could be between 6-18 months for the Commission to undertake a formal investigation.

example the pre-qualification process for the 2019 auctions. As a consequence of the decision, the Government has taken the decision to postpone indefinitely the upcoming T-4 and T-1 auctions for delivery years 2022/23 and 2019/20 respectively.

All credit cover for the postponed T-1 and T-4 auctions and for future delivery years that is currently being held will be returned. Holders of existing capacity market agreements may also request the return of credit cover for those agreements arising from past auctions.

The Government's next steps

The decision does not mean the capacity market is dead. The judgment does not say that the capacity market constituted illegal State aid but annuls the State aid clearance given by the Commission in 2014, so requiring the Commission to re-open its investigation. The Electricity Capacity Regulations, which provide for the creation and operation of the capacity market, have not been repealed as a result of the ruling.

The Government has also indicated that it is seeking to re-obtain State aid approval from the Commission as soon as possible. To achieve this, the Commission is likely to undertake a Phase 2 investigation, which will include an extensive market consultation and is expected to last somewhere between 6-18 months, before providing a new State aid approval for the capacity market. This will necessitate the Government and the Commission considering whether any changes to the design of the capacity market are required. The Commission, as the respondent in the case, and the UK government (as intervener) may decide to appeal the decision of the GC. However, the UK Government is expected to ask the Commission to re-open and run its investigation into the capacity market in parallel with any such appeal, in which case an appeal would not extend the current uncertainty.

While there is uncertainty about how long this process will take and exactly what the final outcome will be, the Government is also intending to seek separate State aid approval from the Commission to run a one-off "replacement" T-1 auction (covering winter 2019/20) and the postponed T-4 is intended to be run as a T-3 Auction in next year's auction round, subject to the Commission completing its formal investigation and providing State aid approval for the capacity market in general.

Recoverability of payments already made

The Government has confirmed it is taking no steps to recover payments that have already been made under existing capacity market agreements at this stage. It might be required to do so in the future, in particular if the Commission concludes, at the end of its investigation, that amounts already granted cannot be cleared as compatible with the internal market. However, that outcome is unlikely, given that the Commission has cleared all of the fifteen capacity schemes that it has considered to date.

Potential claims?

If the capacity market is reinstated it is also unclear whether holders of capacity market agreements will be entitled to the sums currently being withheld because of the standstill, or how backdated payments can be recovered from suppliers. This issue is part of a wider discussion on the exact legal status of a capacity market agreement. As the nature of the rights and obligations inherent in these agreements is not entirely clear, any legal routes for compensation are also currently opaque. Holders of capacity market

agreements are pressing the Government to clarify their rights to backdated payments once State aid clearance has been re-issued.

Market Response

It is no surprise that generators with capacity market agreements, particularly those constructing new-build power stations, will be negatively impacted by the standstill in payments and ongoing uncertainty. DSR providers have equally been hit but many have expressed their hopes that the Phase 2 investigation would result in more favourable treatment of DSR in the capacity market auctions.

According to Aurora Energy Research, a day after the judgment, power prices for next winter had already increased by an average of £1.4/MWh. Aurora Energy Research also predicts that if the capacity market is not reinstated, wholesale power prices would increase to as high as £121/MWh (double the current prices) next winter as a way of generators recovering their fixed costs.

Next steps

- The Government has indicated that it will provide guidance to National Grid (as the delivery body) on the implications of the judgment including the ability of capacity providers to withdraw from their agreement during the standstill period. This is expected to be published in the next few days or weeks.
- The Government has stated that it has begun discussions with the Commission to re-obtain State aid approval for the capacity market. The Commission is expected to take anywhere between 6-18 months to re-issue its approval.
- The Government has also stated that it will seek approval for a one-off "replacement" T-1 auction to be run in early 2019. If this is possible a decision will need to be made in the next few weeks.
- Other aspects of the capacity market scheme will continue, such as the completion of the prequalification process for the 2019 auctions.
- The Commission and/or the UK will need to decide whether to appeal the judgment by 25 January 2019.

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