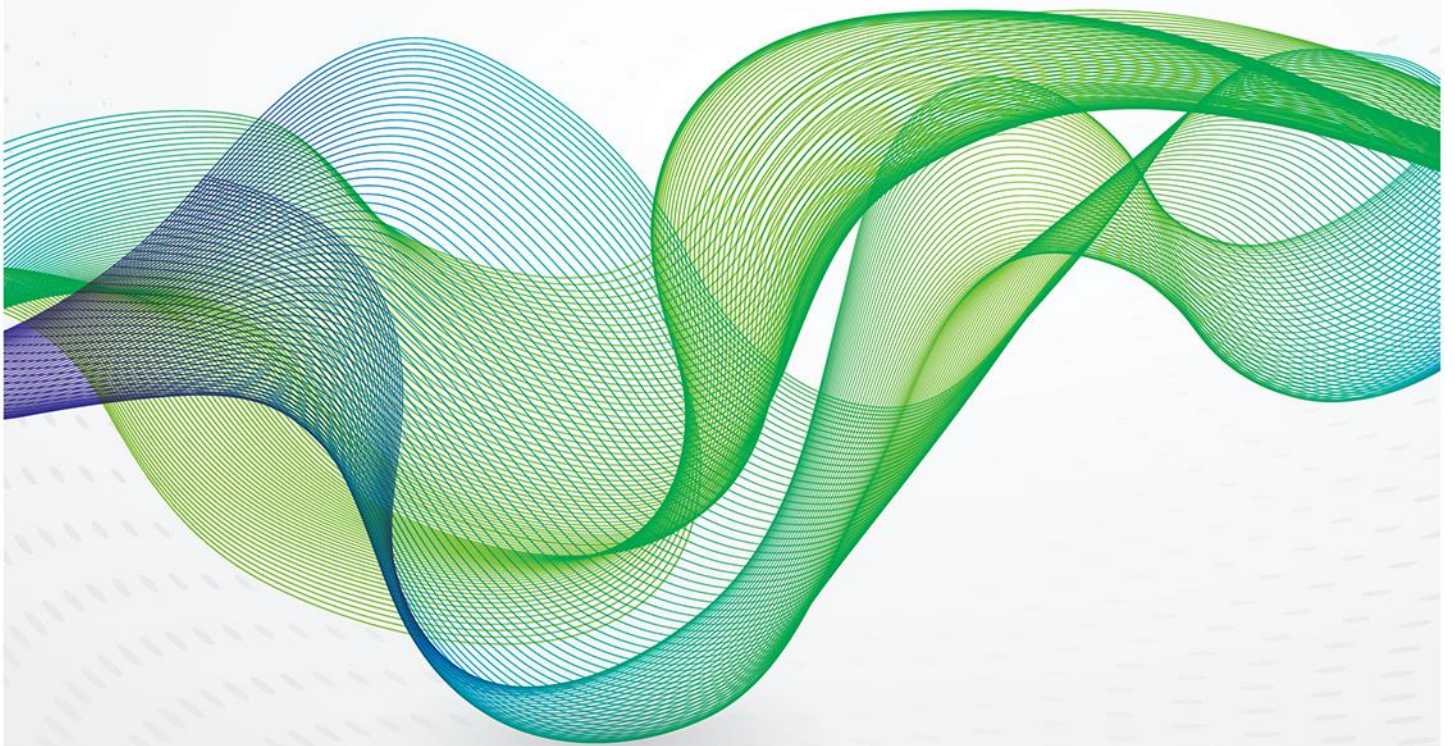




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# Capacity mechanisms in EU Law: A comment on the free movement of goods



OXFORD ENERGY COMMENT

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## 1 Introduction

The European Union (EU) is based on the idea that pooling the resources of all Member States by establishing an area without internal frontiers creates benefits that the Member States cannot achieve individually. At Treaty level, the internal market is pursued through the rules on free movement, which prohibit quantitative restrictions and measures having equivalent effects on all imports and exports.<sup>1</sup> On the basis of Treaty law, the internal market is expected to facilitate the achievement of objectives such as sustainable development, full employment, and the protection and improvement of the quality of the environment.<sup>2</sup> The fundamental assumption underlying this approach is that ensuring the free movement of goods, persons, services, and capital ultimately leads to the achievement of such multidimensional and complex objectives as full employment, for example.<sup>3</sup>

This assumption is open to criticism. Nevertheless, the market-driven approach is also the foundation on which the legal framework of the EU energy markets has been built. This approach is not only reflected in the Treaty provisions, but also informs the sector-specific energy market rules.<sup>4</sup> The sector-specific electricity market legislation is founded on the energy-only model, where producers of electricity are compensated only for the electricity they produce and sell on the market.

Security of supply – and resource adequacy as an element of security of supply – is one of the fundamental objectives of EU energy law.<sup>5</sup> An internal market in which electricity is produced in the most cost-efficient location and transmitted for consumption in the State where the demand and price are the highest is expected to ensure security of supply at the lowest possible cost to the European consumer. However, issues such as inflexible demand, insufficient network connectivity, and an increasing share of subsidized intermittent generation capacity challenge the functioning of these markets. Critical voices have been raised about the suitability of the energy-only model to ensure resource adequacy in practice.<sup>6</sup> Even so, a single energy-only market is the weapon of choice in EU law to ensure objectives such as security of supply.

For many Member States, the internal market approach to security of supply has meant setting aside the pursuit of energy independence at national level in exchange for lower prices that have been enabled by increased competition and cross-border trade.<sup>7</sup> This shift towards more dependence on other Member States calls for mutual trust and solidarity among Member States in a sector that is traditionally subject to strong national protection and national security interests.<sup>8</sup>

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<sup>1</sup> Articles 34 and 35 of the Treaty on the Functioning of the European Union, OJ C 326, 26.10.2012, pp. 47–390 (hereinafter 'TFEU').

<sup>2</sup> Article 3(3) of the Treaty on European Union, OJ C 326, 26.10.2012, pp. 13–390 and Article 26(2) TFEU.

<sup>3</sup> Friedl Weiss and Clemens Kaupa, *European Union Internal Market Law* (Cambridge University Press, 2014), p. 2; Bruno de Witte, 'A Competence to Protect: The pursuit of non-market aims through internal market legislation', in Phil Syrpis (ed.), *The Judiciary, the Legislature and the EU Internal Market* (Cambridge University Press, 2012), pp. 49–62.

<sup>4</sup> See recital 1 and Article 1 of Directive 2009/72/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC, OJ L 211, 14.8.2009, pp. 55–93 (Electricity Directive).

<sup>5</sup> Article 194 TFEU.

<sup>6</sup> Bram Delvaux, *EU Law and the Development of a Sustainable, Competitive and Secure Energy Policy. Opportunities and Shortcomings* (Intersentia, 2013), pp. 38–46; Mauricio Cepeda, Marcelo Saguan, Dominique Finon, and Virginie Pignon, 'Generation adequacy and transmission interconnection in regional electricity markets', 37(12) *Energy Policy* (2009), pp. 5612–22; Alberto Heimler and Frédéric Jenny, 'The limitations of European Union control of state aid', 28(2) *Oxford Review of Economic Policy* (2012), pp. 347–67.

<sup>7</sup> Kaisa Huhta, 'Too Important to be Entrusted to Neighbours? The Dynamics of Security of Electricity Supply and Mutual Trust in EU law', *European Law Review* (2018, forthcoming).

<sup>8</sup> Angus Johnston and Guy Block, *EU Energy Law* (Oxford University Press, 2012), p. 10; cases 25/88 *Bouchara* [1989] ECR 1105, para. 18; C-5/94 *Hedley Lomas* [1996] ECR I-2553, paras. 19–20; C-1/96 *Compassion in World Farming* [1998] ECR I-1251, para. 47; Opinion of AG Ruiz-Jarabo Colomer delivered on 19 September 2002 in joined cases C-187/01 and C-385/01 *Gözütok and Brüggge* [2003] ERC I-1345, para. 124; European Court of Justice, opinion 2/13 of 18 December 2014, para. 191; and joined cases C-404/15 and C-659/15 *PPU, Aranyosi and Căldăraru*, judgment of the Court (Grand Chamber) of 5 April 2016, para. 78.

The dynamics between internal market integration and national security interests are well reflected in the ongoing debate on resource adequacy and, in particular, the national capacity mechanisms that have been adopted to ensure sufficient resources to meet demand at all times.<sup>9</sup> If national generation capacity and demand-side response are not sufficient to meet national demand, a Member State is expected to rely on the neighbouring Member State's market to supply the electricity required. The internal market legislation is based on the premise that this arrangement is mutually beneficial to the Member States involved in such trade. However, what if both Member States face generation inadequacy simultaneously? Will one Member State intervene in the functioning of the internal market by restricting exports of electricity on grounds of national security? These questions lie at the heart of the discussion on capacity mechanisms and the internal market in electricity. Sharing the benefits of pooled resources is uncomplicated, but sharing the risks and insecurities of interdependence is less straightforward. Member States have a natural incentive to protect national security interests from the downsides of market integration. This protectionist approach is reflected particularly in the widespread introduction of capacity mechanisms.

Capacity mechanisms, as instruments to protect Member States' national security of supply interests, tend to be problematic in various ways in relation to EU free movement rules.<sup>10</sup> This is particularly the case in respect of electricity market integration, either because the contribution made by imports is ignored when assessing national resource adequacy concerns or because the participation of foreign capacities or interconnecting capacities is entirely prohibited.<sup>11</sup> As a result, the remuneration provided for participating in a capacity mechanism may be available to domestic resource providers only.<sup>12</sup> Both approaches reflect a desire to protect national security of supply rather than to allow the energy-only design of the market to ensure that the sale of electricity takes place where it is most economically beneficial. In general, the widespread adoption of State-driven capacity remuneration schemes reflects concerns regarding the market-based approach's ability to guarantee security of supply.

This comment examines Member States' capacity mechanisms in the context of the EU rules on free movement, which offer the most powerful legal means to further internal market integration. In particular, this comment explores the assumptions that underlie the EU legal approach to security of supply and the legal means with which the EU addresses these State-driven interventions to ensure resource adequacy. The legal analysis demonstrates that EU law acknowledges Member States' need to intervene when the markets fail to deliver resource adequacy. However, EU law also aims to restrict such State intervention to that strictly necessary to ensure the uninterrupted availability of affordable electricity. This adherence to the energy-only model on a legal level may conflict with the Member States' practical need to ensure resource adequacy under market conditions that are characterized by imperfections such as inflexible demand and insufficient network capacity. Balancing the need to safeguard resource adequacy against the EU's aim of achieving efficiencies through market integration calls for a shared understanding of the respective roles of the State, the EU, and market forces.

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<sup>9</sup> Report from the Commission, Final Report of the Sector Inquiry on Capacity Mechanisms, COM(2016) 752 final; Leigh Hancker, Adrien de Houteclocque, and Malgorzata Sadowska (eds.), *Capacity Mechanisms in EU Energy Markets. Law, Policy, and Economics* (Oxford University Press, 2015).

<sup>10</sup> Paolo Mastropietro, Pablo Rodilla, and Carlos Battle, 'National capacity mechanisms in the European internal energy market: Opening the doors to neighbours', 82 *Energy Policy* (2015), pp. 38–47; Elisabetta Righini and Juan Carlos González Fernández, 'Capacity Mechanisms and State Aid: Between PSOs, Market Liberalisation, and Security of Supply', 7(10) *Journal of European Competition Law & Practice* (2016), pp. 661–75, at 661.

<sup>11</sup> Report from the Commission, Final Report of the Sector Inquiry on Capacity Mechanisms, COM(2016) 752 final; Commission Staff Working Document, Accompanying the document, Report from the Commission, Interim Report of the Sector Inquiry on Capacity Mechanisms, 13.4.2016, SWD(2016) 119 final, pp. 80–4; SA.35980 *GB capacity mechanism* C(2014) 5083 final, para. 20; SA.42011 *Italian capacity mechanism* C(2018) 617 final, para. 59; Graeme Hawker, Keith Bell, and Simon Gill, 'Electricity security in the European Union—The conflict between national Capacity Mechanisms and the Single Market', 24 *Energy Research & Social Science* (2017), pp. 51–8, at 56–7.

<sup>12</sup> Commission Staff Working Document, Accompanying the document, Report from the Commission, Final Report of the Sector Inquiry on Capacity Mechanisms SWD(2016) 385 final, pp. 102–4.



## 2 Free movement rules and capacity mechanisms

The rules on free movement of goods are at the core of ensuring a functional European internal market.<sup>13</sup> This objective finds expression in Articles 34 and 35 TFEU, which prohibit quantitative restrictions on imports and exports and all measures having equivalent effect.<sup>14</sup> Because of the fundamental importance of these rules to the functioning of the internal market, deviations from them are interpreted narrowly.<sup>15</sup>

The EU rules on the free movement of goods and their applicability to energy have been interpreted by the EU courts on various occasions. The European Court of Justice (ECJ) has defined ‘goods’ in a very broad manner in the context of free movement rules.<sup>16</sup> Electricity has been considered to constitute a good that can be traded within the meaning of Articles 34 and 35 TFEU following the ECJ’s seminal ruling in the 1964 case of *Costa v ENEL*. This interpretation was later confirmed in *Almelo* and has been consistently applied in subsequent case law.<sup>17</sup>

Capacity mechanisms are likely to be caught by the scope of Articles 34 and 35 TFEU if cross-border participation is restricted. The right of foreign capacity providers to participate in a national capacity mechanism is typically limited at national level, which amounts to a restriction on imports within the meaning of Article 34 TFEU. A Member State is also likely to restrict domestic capacity providers’ ability to deliver to a foreign capacity mechanism scheme if there is an ongoing domestic scarcity situation at the time that another Member State’s capacity mechanism is activated.<sup>18</sup> These limitations are likely to be caught by the prohibition established in Article 35 TFEU. In fact, many Member States continue to reserve the right to limit cross-border trade if domestic security of supply is threatened.<sup>19</sup> Both of these typical limitations demonstrate the underlying objective of prioritizing the protection of domestic security of supply over regional or European security of supply.

The ECJ has consistently rejected arguments put forward by Member States to the effect that the free movement rules do not apply to the energy sector because of its vital importance to modern society.<sup>20</sup> As a result of this stance, electricity cannot be exempted from the application of Treaty rules simply because it is of particular importance for the life or the economy of a Member State.<sup>21</sup> However, the Treaty does establish conditions based on which exemptions from Articles 34 and 35 TFEU are possible.

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<sup>13</sup> Article 26 TFEU. See also C-15/81 *Schul* [1982] ECR 1409, para. 33.

<sup>14</sup> For contextual interpretation of the full effect of the Treaty, see C-347/88 *Commission v Greece* [1990] ECR I-4747, para. 42.

<sup>15</sup> C-49/89 *Corsica Ferries France v Direction générale des douanes* [1989] ECR -4441 para. 8; joined cases 177 and 178/82 *Jan van de Haar and Kaveka de Meern BV* [1984] ECR -1797 and C-67/97 *Bluhme* [1998] ECR I-8033; 36/75 *Rutili v Minister for the Interior* [1975] ECR 1219, para. 27; 30/77 *R v Bouchereau* [1977] ECR -1999, para. 30; C-157/94 *Netherlands* [1997] ECR I-5699, para. 37; C-159/94 *Commission v France* [1997] ECR I-5815, paras. 53–55; C-54/99 *Église de scientologie* [2000] ECR I-1335 para. 17; C-326/07 *Commission v Italy* [2009] ECR I-2291, para. 70; C-503/99 *Commission v Belgium* [2002] ECR I-4809, para. 47; C-463/00 *Commission v Spain* [2003] ECR I-4581, para. 34; C-483/99 *Commission v France* [2002] ECR I-4781, para. 48; Peter Oliver, ‘Measures of Equivalent Effect I: General’, in Peter Oliver (ed.), *Oliver on Free Movement of Goods in the European Union* (Hart Publishing, 2010), pp. 84–156, at 91.

<sup>16</sup> Morten Broberg and Nina Holst-Christensen, *Free Movement in the European Union*, 3<sup>rd</sup> edition (DJØF, 2010), pp. 109–14; C-2/90 *Commission of the European Communities v Kingdom of Belgium* [1992] ECR I-4431; 7/68 *Commission of the European Communities v Italian Republic* [1968] ECR 423, para. 2. On the concept of goods, see Laurence W. Gormley, *EU Law of Free Movement of Goods and Customs Union* (Oxford University Press, 2009), pp. 399–403.

<sup>17</sup> Cases 6/64 *Costa v ENEL* [1964] ECR 585; C-393/92 *Almelo* [1994] ECR I-1477, paras. 27–28; C-157/94 *Commission v Netherlands* [1997] ECR I-5699; C-159/94 *Commission v France* [1997] ECR I-5815; and C-158/94 *Commission v Italy* [1997] ECR I-5789, para. 17; joined cases C-105/12 to C-107/12 *Essent and Others* [2013] Judgment of the Court 22 October 2013, para. 59. See also Malcolm Jarvis, ‘Scope: Subject Matter’, in Peter Oliver (ed.), *Oliver on Free Movement of Goods in the European Union* (Hart Publishing, 2010), pp. 15–22.

<sup>18</sup> This tendency has also been addressed in the 2016 Winter Package proposals. See, in particular, Article 21 of the Proposal for a Regulation of the European Parliament and of the Council on the internal market for electricity (recast), COM(2016) 861 final.

<sup>19</sup> Paolo Mastropietro, Pablo Rodilla, and Carlos Batlle, ‘National capacity mechanisms in the European internal energy market: Opening the doors to neighbours’, 82 *Energy Policy* (2015), pp. 38–47, at 38–40.

<sup>20</sup> Case 72/83 *Campus Oil* [1984] ECR 2727, para. 14.

<sup>21</sup> Case 72/83 *Campus Oil* [1984] ECR 2727, para. 17. Stephen Weatherill, *The Internal Market as a Legal Concept* (Oxford University Press, 2017), pp. 33–48.

### 3 Exemptions from free movement rules in the interest of security of supply

Safeguarding resource adequacy through State-driven interventions is an exemption to the assumption on which the EU electricity markets are founded. Due to capacity mechanisms having this exceptional role, many of their elements are prima facie prohibited by various legal provisions, such as Articles 34 and 35 TFEU. Although capacity mechanisms are easily caught by these prohibitions, the increasing adoption of these schemes indicates that the exemptions available can be interpreted in favour of national security of supply measures, despite the fact that they are viewed as having adverse effects on the internal market.

Article 36 provides the legal basis for derogations from Articles 34 and 35 TFEU.<sup>22</sup> It establishes that the measures prohibited in Articles 34 and 35 TFEU can be justified on grounds of objectives such as public morality, public policy, or public security. Such restrictions cannot, however, constitute arbitrary discrimination or a disguised restriction on trade between Member States – a proportionality assessment is therefore needed.<sup>23</sup>

Security of supply has been established as a legitimate justification for exemption from the rules on free movement of goods on the basis of the public security justification provided for in Article 36 TFEU.<sup>24</sup> However, security of supply is a concept that has no single established definition, let alone a legally binding one. Due to the lack of a clear legal definition and the inherently broad meaning of security of supply, invoking this justification requires substantial arguments in favour of the restriction. The burden of proof falls on Member States. They must be able to demonstrate that the restriction on the grounds of Article 36 TFEU is justified.<sup>25</sup> It may prove difficult to make such a case convincingly as the complex nature of capacity mechanisms does not allow them to be categorized as being purely beneficial in terms of security of supply. It is well established that capacity mechanisms increase the price of electricity and may therefore even have a damaging impact in relation to some aspects of security of supply.<sup>26</sup> Furthermore, it is established case law that import and export restrictions cannot be imposed on the basis of purely economic considerations.<sup>27</sup> This means that restricting foreign participation in a capacity mechanism because of a need to limit the costs of capacity remuneration cannot successfully be used as an argument to invoke Article 36 TFEU. Nevertheless, the public security defence should be the starting point for assessing the restrictive elements of national capacity mechanisms.

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<sup>22</sup> Panos Koutrakos, 'Public Security Exceptions and EU Free Movement Law', in Panos Koutrakos, Niamh Nic Shuibhne, and Phil Syrpis (eds.), *Exceptions from EU Free Movement Law: Derogation, Justification and Proportionality* (Hart Publishing, 2016), pp. 190–217; Laurence W. Gormley, *EU Law on Free Movement of Goods and Customs Union* (Oxford University Press, 2009), pp. 463–5; Paul Craig and Gráinne de Búrca, *EU Law, Text, Cases and Materials*, 6<sup>th</sup> edition (Oxford University Press, 2015), pp. 698–9; Alina Kaczorowska-Ireland, *European Union Law* (Routledge, 2009), pp. 630–56; Nigel Foster, *Foster on EU Law* (Oxford University Press, 2015), pp. 278–84.

<sup>23</sup> Article 36 TFEU.

<sup>24</sup> 72/83 *Campus Oil* [1984] ECR 2727. However, other grounds for justifying security of supply measures have been suggested in literature. See Henrik Bjørnebye, *Investing in EU Energy Security: Exploring the Regulatory Approach to Tomorrow's Electricity Production* (University of Oslo, PhD thesis 2009), pp. 82–85, which suggests security of supply could be reviewed on public health grounds, which are also provided for in Article 36 TFEU.

<sup>25</sup> C-251/78 *Denkavit Futtermittel* [1979] ECR 3369, para. 28; C-297/05 *Commission v Netherlands* [2007] ECR I-0000, para. 76; C-420/01 *Commission v Italy* [2003] ECR I-6445, paras. 30–31; and C-270/02 *Commission v Italy*, [2004] ECR I-1559, para. 22. For more on this issue, see Niamh Nic Shuibhne, 'Exceptions to the free movement rules', in Catherine Barnard and Steve Peers (eds.), *European Union Law* (Oxford University Press, 2014), pp. 473–503, at 489–90. Conversely, where the Commission or an undertaking argues that an infringement of Article 34 or Article 35 has taken place, it must prove that a Member State measure infringes the article in question. On the failure to do so, see case T-57/11 *Castelnuovo Energia v Commission* [2014] Judgment of the General Court of 3 December 2014, paras. 194–201.

<sup>26</sup> International experience of capacity mechanisms shows that their existence can have a cost impact amounting to between 10% and 20% of wholesale electricity prices. See Commission Staff Working Document, *Generation Adequacy in the internal electricity market - guidance on public interventions*, Accompanying the document, Communication from the Commission, *Delivering the internal electricity market and making the most of public intervention*, SWD(2013) 438 final, p. 32.

<sup>27</sup> Cases 7/61 *Commission v Italy* [1961] ECR 317; 72/83 *Campus Oil* [1984] ECR 2727, para. 35; C-398/98 *Commission v Greece* [2001] ECR I-7915, para. 30; C-54/99 *Église de scientologie* [2000] ECR I-1335, para. 17; C-120/95 *Decker v Caisse de maladie des employés privés* [1998] ECR I-1831, para. 39; C-158/96 *Kohll v Union des caisses de maladie* [1998] ECR I-1931, para. 41; C-463/00 *Commission v Spain* [2003] ECR I-4581, para. 35; C-367/98 *Commission v Portugal* [2002] ECR I-4731, para. 52; C-35/98 *Verkooijen* [2000] ECR I-4071, para. 48; C-265/95 *Commission v France* [1997] ECR I-6959, para. 62.



Arguably, many things have changed since the ECJ first made the connection between the public security defence and security of supply in the 1980s.<sup>28</sup> These political, technical, economical, and legal changes, as well as developments in the role of the State in providing important societal services, offer a strong body of argumentation against the capacity mechanisms constituting a legitimate public security defence.

First and most pressingly, the changing economic approach to markets and the legal requirements imposed by the EU on Member States have fundamentally reshaped the structure of the European electricity markets and the roles of the players operating within those markets. The State should no longer serve as the provider of all services but rather as the facilitator of non-discriminatory competition, which is believed to ensure security of supply at least cost to the consumer.

Second, exceptions to fundamental rules of EU law should be interpreted strictly.<sup>29</sup> In practice, this means that Member States cannot subjectively determine the scope of their public security requirements without this issue being subject to the control of EU institutions.<sup>30</sup> This interpretation is also in line with the provisions on EU competences, which are shared in energy matters.<sup>31</sup>

Third, it is established case law that Article 36 TFEU cannot be successfully invoked when a matter is extensively harmonized.<sup>32</sup> The EU electricity markets are subject to extensive legal requirements aimed at bringing about a competitive internal market in electricity.<sup>33</sup> These harmonizing measures and the relevance of the legislative changes proposed in the Winter Package of 2016 are discussed below.

#### 4 The Winter Package: relevance of deepening harmonization

In the absence of exhaustive harmonization, the introduction and design of capacity mechanisms are governed by a legal patchwork comprising provisions laid down in secondary legislation, such as various regulations and directives, as well as those laid down in primary law, that is, the general provisions of the EU treaties.

It is established case law that extensive harmonization excludes recourse to Article 36 TFEU.<sup>34</sup> The rationale of this rule is that harmonizing legislation is expected to sufficiently protect the interests laid

<sup>28</sup> 72/83 *Campus Oil* [1984] ECR 2727.

<sup>29</sup> Cases 36/75 *Rutili v Minister for the Interior* [1975] ECR 1219, para. 27; 30/77 *R v Bouchereau* [1977] ECR-1999, para. 30; C-157/94 *Commission v Netherlands* [1997] ECR I-5699, para. 37; C-159/94 *Commission v France* [1997] ECR I-5815, paras. 53–55; C-54/99 *Église de scientologie* [2000] ECR I-1335, para. 17; C-326/07 *Commission v Italy* [2009] ECR I-2291, para. 70; C-503/99 *Commission v Belgium* [2002] ECR I-4809, para. 47; C-483/99 *Commission v France* [2002] ECR I-4781, para. 48; C-463/00 *Commission v Spain* [2003] ECR I-4581, para. 72.

<sup>30</sup> C-326/07 *Commission v Italy* [2009] ECR I-2291, para. 70; C-54/99 *Eglise de scientologie* [2000] ECR I-1335, para. 17; C-463/00 *Commission v Spain* [2003] ECR I-4581, para. 34; C-483/99 *Commission v France* [2002] ECR I-4781, para. 48; 36/75 *Rutili v Minister for the Interior* [1975] ECR 1219, para. 27.

<sup>31</sup> On shared competences and energy, see Article 4 TFEU; Panos Koutrakos, 'Public Security Exceptions and EU Free Movement Law', in Panos Koutrakos, Niamh Nic Shuibhne, and Phil Syrpis (eds.), *Exceptions from EU Free Movement Law: Derogation, Justification and Proportionality* (Hart Publishing, 2016), pp. 190–217; Laurence W. Gormley, *EU Law on Free Movement of Goods and Customs Union* (Oxford University Press, 2009), pp. 463–65; Paul Craig and Gráinne de Búrca, *EU Law, Text, Cases and Materials*, 6<sup>th</sup> edition (Oxford University Press 2015), pp. 698–9; Alina Kaczorowska-Ireland, *European Union Law* (Routledge, 2009), pp. 630–56; Nigel Foster, *Foster on EU Law* (Oxford University Press, 2015), pp. 278–84.

<sup>32</sup> 120/78 *Rewe-Zentral v Bundesmonopolverwaltung fuer Branntwein* [1979] ECR 649; joined cases C-267/91 and C-268/91 *Keck Mithouard* [1993] ECR I-6097, para. 15; 148/78 *Ratti* [1979] ECR 1629; 251/78 *Denkavit* [1979] ECR 3369; C-190/87 *Oberkreisdirektor des Kreises Borken and Others v Moormann* [1988] ECR 4689; C-102/96 *Commission v Germany* [1998] ECR I-6871; C-473/98 *Toolex* [2000] ECR I-5681, para. 25; C-5/94 *Medley Lomas* [1996] ECR I-2553, para. 18; C-573/12 *Ålands Vindkraft* [2014] Judgment of the Court (Grand Chamber) of 1 July 2014, para. 58; Paul Craig and Gráinne de Búrca, *EU Law, Text, Cases and Materials*, 6<sup>th</sup> edition (Oxford University Press 2015), pp. 703–4; Nina Boeger, 'Minimum harmonisation, free movement and proportionality', in Phil Syrpis (ed.), *The Judiciary, the Legislature and the EU Internal Market* (Cambridge University Press, 2012), pp. 62–91.

<sup>33</sup> Recital 1 of the Electricity Directive.

<sup>34</sup> 120/78 *Rewe-Zentral v Bundesmonopolverwaltung fuer Branntwein* [1979] ECR 649; joined cases C-267/91 and C-268/91 *Keck Mithouard* [1993] ECR I-6097, para. 15; 148/78 *Ratti* [1979] ECR 1629; 251/78 *Denkavit* [1979] ECR 3369; C-190/87 *Oberkreisdirektor des Kreises Borken and Others v Moormann* [1988] ECR 4689; C-102/96 *Commission v Germany* [1998] ECR I-6871; C-473/98 *Toolex* [2000] ECR I-5681, para. 25; C-5/94 *Medley Lomas* [1996] ECR I-2553, para. 18; C-573/12 *Ålands Vindkraft* [2014] Judgment of the Court (Grand Chamber) of 1 July 2014, para. 58; Paul Craig and Gráinne de Búrca,



down in Article 36 TFEU as constituting grounds for prohibitions or restrictions and, therefore, remove the need to invoke them as such grounds.<sup>35</sup>

The Winter Package published by the European Commission in late 2016 includes provisions that directly address the introduction and design of national capacity mechanisms.<sup>36</sup> In particular, Article 21 of the proposed regulation on the internal market for electricity (hereinafter the ‘Recast Electricity Regulation’) establishes rules on cross-border participation in capacity mechanisms.<sup>37</sup> From the point of view of the free movement of goods, Article 21 lays down three important and mutually reinforcing obligations. First, capacity mechanisms other than strategic reserves have to be open to the direct participation of capacity providers located in another Member State, provided there is a network connection between that Member State and the bidding zone applying the mechanism.<sup>38</sup> Second, Member States must ensure that foreign capacity capable of providing equivalent technical performance to domestic capacities has the opportunity to participate in the same competitive process as domestic capacity.<sup>39</sup> Third, Member States are not allowed to restrict capacity that is located in their territory from participating in the capacity mechanisms of other Member States.<sup>40</sup> These rules would require modifications to many Member States’ capacity mechanisms, which tend to restrict cross-border participation.

The proposed secondary rules on cross-border participation are essentially an effort to directly ensure the free movement of electricity across borders. In other words, Article 21 of the Recast Electricity Regulation appears as *lex specialis* in relation to Treaty rules on the free movement of goods in terms of capacity mechanisms. Should these secondary provisions enter into force, the new rules established for cross-border trade would essentially close off any remaining opportunities to successfully invoke Article 36 TFEU.

## 5 Conclusions

Under EU law, State intervention to ensure resource adequacy should be viewed as the exception to the rule under which markets are expected to be the primary driver of security of supply. In practice, this approach runs up against Member States’ national security of supply concerns, which are exacerbated within the energy transition. Nevertheless, the rules on free movement of goods, which offer the strongest legal means to pursue internal market integration and facilitate cross-border trade, clearly prohibit capacity mechanisms insofar as they restrict cross-border trade. The legal basis for exemption from the rules on free movement of goods is interpreted narrowly. Therefore, a capacity mechanism that restricts cross-border trade is unlikely to be justifiable when the argument for such a mechanism is protectionist in nature.

It is clear that failure of the market to deliver sufficient and timely investments in resource adequacy may constitute a legitimate reason to justify restrictions on cross-border trade pursuant to Article 36 TFEU. However, the question remains as to whether State-driven capacity mechanisms may ever be regarded as an appropriate and proportionate vehicle for pursuing resource adequacy in a legal system based so fundamentally on the idea of market-based investment and competition.

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*EU Law, Text, Cases and Materials*, 6<sup>th</sup> edition (Oxford University Press 2015), pp. 703–4; Nina Boeger, ‘Minimum harmonisation, free movement and proportionality’, in Phil Syrpis (ed.), *The Judiciary, the Legislature and the EU Internal Market* (Cambridge University Press, 2012), pp. 62–91.

<sup>35</sup> Cases 5/77 *Carlo Tedeschi* [1977] ECR 1555, paras. 34–35; and 72/83 *Campus Oil* [1984] ECR 2727, para 27.

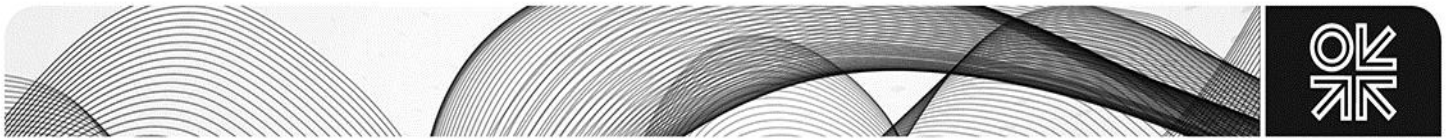
<sup>36</sup> Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee, the Committee of the Regions and the European Investment Bank Clean Energy for All Europeans, COM(2016) 860 final.

<sup>37</sup> Proposal for a Regulation of the European Parliament and of the Council on the internal market for electricity (recast), COM(2016) 861 final.

<sup>38</sup> Article 21(1) of the Proposal for a Regulation of the European Parliament and of the Council on the internal market for electricity (recast), COM(2016) 861 final.

<sup>39</sup> Article 21(2) of the Proposal for a Regulation of the European Parliament and of the Council on the internal market for electricity (recast), COM(2016) 861 final.

<sup>40</sup> Article 21(3) of the Proposal for a Regulation of the European Parliament and of the Council on the internal market for electricity (recast), COM(2016) 861 final.



The relevance of the public security defence with regard to capacity mechanisms has, however, never been explicitly reviewed by the EU courts. In 2015, a case concerning the compatibility of the French capacity mechanism with free movement rules was referred to the ECJ after the French national association for retail energy providers (ANODE) sought the annulment of the national capacity mechanism design, arguing that it was contrary to EU law.<sup>41</sup> The referring French court inquired whether the existing prohibition of quantitative restrictions on imports should be interpreted as precluding national legislation that restricted the participation of foreign capacity and whether such a measure was capable of being justified on grounds of public security. However, ANODE withdrew its application for annulment in 2016. Consequently, the French court withdrew its request for preliminary ruling and, as a result, the case was removed from the court register.<sup>42</sup> Therefore, the ECJ did not have the opportunity to review the compatibility of capacity mechanisms with EU free movement rules. If the proposed changes to the 2016 Winter Package enter into force, such a review is unlikely to be conducted under Treaty rules in the future, but rather under the harmonized rules laid down in the Recast Electricity Regulation.

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<sup>41</sup> C-543/15 *ANODE* [2016] Order of the President of the Court of 12 April 2016.

<sup>42</sup> C-543/15 *ANODE* [2016] Order of the President of the Court of 12 April 2016.