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# Security of Electricity Supply

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## An Investigation of National Measures Aimed at Ensuring a Secure Supply of Electricity and their Compatibility with EU Law

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# Summary

Energy policy is a policy area of great significance for the Member States and for the EU. An integral part of every energy policy is the need to ensure a secure supply of electricity. At EU-level, the challenges to security of supply are to be managed via a coherent and coordinated approach aimed at taking into account the interest of the Union. Demand management, the further integration of the internal market in energy leading to increased trade between the Member States and a common definition of the notion of security of supply are all elements of such a coherent approach. In addition, several pieces of legislation have been adopted specifying a number of measures Member States can or should implement in order to safeguard a secure supply of electricity.

However, the scope of action of the Member States is restricted by the EU State aid regime, aimed at safeguarding competition on the internal market by preventing excessive interference by the Member States in the electricity market. One purpose of this thesis has therefore been to investigate the restrictions EU State aid control puts on the Member States' scope of action when implementing measures to ensure security of supply. Another purpose has been to investigate whether the measures envisaged by the Member States contribute to realizing the EU approach to security of supply or whether the national measures in fact hinder the objectives of the EU approach.

By analyzing four Commission Decisions on State aid, I have been able to investigate the reasoning of the Commission when it comes to determining whether a specific measure aimed at ensuring security of supply constitutes State aid, and whether this State aid can be justified. My conclusion is that the State measures notified are found compatible with the State aid regime, either on the ground that the notified measure does not constitute State aid, or that the measure indeed constitute State aid but that this State aid can be justified.

The consequence of the Commission finding the Member State measures compatible with the internal market is that the national notion of security of supply is reinforced. The measures notified to the Commission cement the borders of the national electricity markets and limit the trade between the Member States. Therefore in practice the success of the EU approach to security of supply is impeded.

# Sammanfattning

Energipolitik har varit och är fortfarande av stor betydelse både för Medlemsstaterna och för EU. Behovet av att trygga en säker och pålitlig energiförsörjning är en central aspekt av en gemensam energipolitik. De senaste decennierna har det på EU-nivå pågått ett arbete att utveckla en enhetlig och samordnad strategi ämnad att trygga en säker elförsörjning inom EU. Några viktiga aspekter i EU:s strategi utgörs av åtgärder ämnade att balansera utbud och efterfrågan, fortsatt integration av den inre marknaden vilket skulle leda till ökad handel mellan Medlemsstaterna, samt ett uttalat behov att på EU-nivå definiera begreppet ”försörjningsstrygghet”. En sådan gemensam definition skulle bidra till möjligheten att framgångsrikt uppnå de mål EU:s strategi ställer upp. Förutom ovan nämnda aspekter förekommer i EU-direktiv bestämmelser vilka specificerar ett antal åtgärder som Medlemsstaterna bör, alternativt måste vidta, i syfte att säkerställa en trygg elförsörjning.

Medlemsstaternas handlingsutrymme begränsas dock av EU:s regler gällande statligt stöd. Detta regelverk syftar till att bevara konkurrensen genom att förhindra statliga åtgärder vilka kan ha en negativ effekt på konkurrensen på den gemensamma elmarknaden. Ett syfte med detta examensarbete har varit att undersöka hur Medlemsstaternas handlingsutrymme begränsas av de restriktioner EU:s regler om statligt stöd ställer upp. Ett annat syfte har varit att undersöka huruvida de åtgärder Medlemsstaterna har vidtagit för att trygga en säker elförsörjning bidrar till att förverkliga målen i EU:s gemensamma strategi, eller om Medlemsstaternas åtgärder i själva verket hindrar uppnåendet av EU:s mål.

Genom att analysera fyra beslut från Kommissionen gällande statligt stöd har jag kunnat undersöka de villkor Kommissionen ställer upp för att en åtgärd ämnad att trygga en säker elförsörjning skall anses falla utanför bestämmelsen om förbud av statligt stöd, antingen genom att åtgärden i fråga inte anses utgöra statligt stöd, eller att åtgärden i fråga visserligen anses utgöra statligt stöd, men kan anses berättigad och därför förenlig med den inre marknaden.

Mina slutsatser är följande. Kommissionen finner i alla fyra beslut att de vidtagna åtgärderna är förenliga med den inre marknaden. En analys av besluten visar att föreslagna åtgärder enbart ser till Medlemsstaternas nationella intressen. Detta befäster gränserna kring de nationella elmarknaderna, hindrar integrationen av den inre marknaden och hindrar handel av elektricitet mellan Medlemsstaterna. I korthet kan därför sägas att Kommissionens praxis i praktiken hindrar framgången av EU:s strategi för försörjningstrygghet.

# Abbreviations

AG	Advocate General
CADA	Capacity and Difference Agreements
SGEI	Services of General Economic Interest
PSO	Public Service Obligations
TEU	Treaty on European Union
TFEU	Treaty on the Functioning of the European Union

# 1 Introduction

## 1.1 Subject and problem

Energy policy is an area that traditionally has belonged to the realm of the Member States. Thus, the Member States have been responsible for energy planning, more precisely determining sources for energy generation, ensuring a balance between demand and supply, maintaining and developing infrastructure for transmission and distribution of energy to industry and households, ensuring that the energy policy complies with national and international environmental standards as well as designing an energy policy for the future, where measures are envisaged as regards how future energy supply should be secured. An integral part of any energy policy has been to ensure that all citizens living in the territory of the Member State in question have access to an uninterrupted supply of electricity at a reasonable price. A secure supply of electricity has been recognized to be a service of general economic interest (SGEI)<sup>1</sup>, in other words a service that is considered to be so essential to the general public that its availability needs to be guaranteed, even in cases where the market is unable to do so. This is the national dimension of security of supply.

In addition to the national dimension, there is a EU dimension of security of supply. With the entry into force of the Lisbon Treaty, the shared competence in energy policy between the Member States and the EU has been confirmed. The goals of the European energy policy are threefold: to ensure the competitiveness of the EU market, to ensure sustainability and to ensure security of supply. Security of supply is thus an integral part of the EU energy policy.<sup>2</sup> However, long before the Lisbon Treaty, common legislation was enacted in an attempt to create an internal market for energy. This process has become known as the liberalization of the energy market. One of the objectives of the establishment of the internal market in energy was to create a EU approach towards security of supply. In order to fully achieve the objectives of the internal market (one of them being security of supply), EU competition law has been widely used. The aim has been to prevent Member State measures that could disrupt the realization of the internal market. Control of State aids has thus been central.

In view of the above, I argue that there are two notions of security of supply. First, we have the national notion where each Member State is responsible for ensuring security of electricity supply on a national level. Second, we have the EU-wide notion where security of supply is an integral part of an integrated and well-functioning internal market. Given the fact that the national notion and the EU notion are developed to meet different

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<sup>1</sup> See Section 2 for a detailed definition of SGEI

<sup>2</sup> See Section 4.2 for a detailed account of the EU energy policy.



objectives, it is possible to imagine a conflict in situations where a national measure to secure supply conflicts with the internal market.

A possible conflict is based on the following. The basic assumption is that the provision of SGEI may not always be profitable. On the contrary, it is assumed that the market under normal conditions would not be able to ensure a secure supply of electricity to all consumers.

In order to cope with this failure of the market, a common way to ensure the provision of SGEI has been to impose public service obligations (PSO) on undertakings active in the energy sector, obliging them to generate sufficient amounts of energy to cover demand. However, in order not to put the concerned undertakings in a less favourable position than their competitors, it is necessary to compensate these undertakings for the costs they have incurred while fulfilling the obligations imposed on them. Nevertheless, while it is considered as legitimate to compensate the undertakings on which PSO have been imposed, it is important to prevent over-compensation, as this would give an advantage to these undertakings. It is here that the EU State aid rules come into play. These rules have been designed to protect the competition on the internal market and to ensure a level playing field for all European undertakings.

It is precisely the borderline between the EU measures to ensure security of supply on a EU level; the Member States' measures to ensure security of supply on a national level and the restrictions EU State aid control puts on the Member States while exercising this right, that this thesis will investigate.

## 1.2 Purpose

Ever since the liberalization of the energy market was initiated in the 90's, with the intention of creating a genuine internal market in energy, one of the main objectives has been to ensure security of energy supply to the EU.<sup>3</sup> This thesis will focus on the European notion on security of supply and investigate in what ways and using what measures the Commission envisages in order to reach this objective.

The EU-wide notion of security of supply will then be contrasted to four Commission Decisions on State aid. These decisions cover old and new Member States, namely Ireland, Spain, Slovenia and Latvia, and are spread out between 2003-2010. These Member States have notified to the Commission plans to grant aid to certain undertakings. The purpose of the aid has been to ensure security of electricity supply. More precisely, the concerned Member States have decided to financially support certain projects that in different ways guarantee security of supply, such as tender for additional capacity, direct grants to certain suppliers and so forth.

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<sup>3</sup> See Section 4.2 for a detailed account of the objectives of the EU energy policy

In brief, the purpose of this thesis is the following: Given the fact that one of the objectives of the liberalization of the energy market and the creation of an internal market is to ensure the security of supply, I will look into detail how this objective is to be achieved. I will then look into the State aid Decisions, in order to determine if and on what grounds the notified State aids are regarded as compatible with the internal market. The focus is thereafter put on determining whether the Decisions contribute towards achieving security of electricity supply on an EU-wide level or whether the Decisions on the contrary can be regarded as interfering or impeding the realization of the mentioned objective.

## **1.3 Delimitations**

This thesis evaluates four Commission Decisions on State aid with reference to the objectives of the liberalization of the energy markets and the EU notion of security of supply. The focus is put on determining under what circumstances a State measure to grant aid for the purposes of ensuring security of supply can be considered compatible with the internal market under Article 106(2) TFEU or the exceptions provided in Article 107 TFEU. The conditions that need to be fulfilled for a State measure to classify as State aid fall outside the scope of the thesis and will not be treated exhaustively.

Measures to safeguard security of supply are wide-ranging and cover insurances against a wide number of risks. The measures that this thesis is going to cover are highly influenced by the risks to security of supply raised by the Member States and the Commission in the Commission Decisions subject to this thesis. Therefore, I will cover measures aimed at ensuring the long-term ability of the interconnection infrastructure to function adequately in order to meet demand. Further, I will cover measures ensuring the adequacy and availability of sufficient generation capacity so as to meet demand. Other aspects of security of supply and measures to safeguard the same fall outside the scope of this thesis.

Lastly, this thesis will focus only on internal aspects of EU security of supply and the external dimension of security of supply will not be covered.

## **1.4 Methodology and Material**

A traditional legal method will be used throughout this thesis. I will look at EU primary and secondary legislation in order to find definitions to central concepts for this thesis, such as SGEI, security of supply and State aid. As no comprehensive definition to these concepts exists in EU primary and secondary legislation as it stands, I will have to look elsewhere in order to gain a comprehensive understanding.

Therefore, as the purpose of the thesis is to discuss the EU notion of security of supply and in the absence of any definition in the Treaties, I will look

into a number of Commission documents, such as Green Papers, Commission Communications and Commission Proposals for legislation as well as relevant secondary legislation, in order to deduce a definition of security of supply. The same applies to the concept of SGEI.

The case law of the Court has been of great importance. First, due to an absence of a EU definition of SGEI, it has been up to the Court to determine the scope of Member State action with regards to defining, organizing and financing SGEI. Therefore, the case law of the Court has been used in order to fill the gaps that EU primary law leaves open. Most notably, the *Altmark*<sup>4</sup> judgement will be referred to.

Lastly, in the Treaty on the Functioning of the European Union (TFEU), the Commission has been given the power to assess the compatibility with the internal market of State measures to grant aid to certain undertakings. As mentioned before, this thesis will put an emphasis on four Commission Decisions, which will be carefully analyzed.

## 1.5 Disposition

This thesis is structured as follows. In *Section 2* I will investigate the notion of SGEI. I will look at how SGEI are dealt with in the Treaties, more precisely Articles 14 and 106 TFEU. Further, I will look into the Electricity Directive for a more sector-specific insight. To get a more comprehensive understanding of the concept, it is also necessary to look at how the Commission has dealt with the concept of SGEI in a number of publications. This section will provide the general background and allow us to better understand why SGEI are of central importance both for the Member States and for the EU.

After having set the general background, I will look at a specific element of SGEI, namely security of electricity supply. In *Section 3*, I will describe the liberalization of the energy sector. An account of this process is necessary, as one of the objectives of the liberalization and the subsequent creation of the internal market in energy has been to improve security of supply. After having made an account of the EU general policies towards ensuring security of supply via the creation of the internal market, I will look more closely into the concept of security of supply in *Section 4*. I will make an attempt to define the concept. I will then give a detailed account on the attempts by the Commission to develop a common EU approach towards security of supply and the substance of this common EU approach. I will in *Section 4* also present the existing EU legislation on security of supply.

In *Section 5*, I will present the EU framework for State aid. I will look into EU legislation that concerns compensation to those undertakings that have been entrusted by a Member State to perform certain PSO, connected to ensuring a secure supply of electricity. More precisely, I will look into the

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<sup>4</sup> Case C-280/00 *Altmark*

circumstances under which such compensation can be considered as compatible with the internal market.

In *Section 6* I will look into four Commission Decisions on State aid, concerning Ireland, Latvia, Slovenia and Spain. This Section will provide a practical insight into how the Commission exercises its control of State aid granted to undertakings as compensation for the performance of PSO with the objective of securing electricity supply.

Lastly, in *Section 7* I will draw conclusions on to what extent and in what ways the Commissions practice on State aid is compatible with the internal energy market and the EU notion of security of supply.

# 2 SGEI

## 2.1 Introduction

As I stated in my introduction, this thesis is going to cover the relationship between the Member States ambition to shield SGEI in general and security of supply in particular from the application of Treaty provisions, more precisely the rules on State aid, and the Union objective of creating a competitive internal energy market free from the distortions to competition that State aid can bring about.

This section is devoted to clarifying how Union law defines SGEI, and more importantly the scope of Member State action with regards to SGEI, or in other words, what criteria does Union law bestow on a Member State, in order for a measure taken by Member State to safeguard SGEI, to be regarded as compatible with Union law.

### 2.1.1 The rationale behind the concept of SGEI

Before going into the details of how SGEI are defined, it is necessary to lay out some of the basics. First, it is important to point out that the core of a SGEI lies in the assumption that certain services are so crucial and essential that their provision needs to be ensured even in those cases where the market lacks a sufficient incentive to do so.<sup>5</sup> These services include network industries, such as electricity and gas, telecommunications, transport, postal services etc.<sup>6</sup> Traditionally, the provision and organization of such services was entirely a national matter, where the Member States provided and financed such services either directly through their own administration, or by entrusting the service to a third party, public or private.<sup>7</sup>

This changed with the adoption of the Single European Act and the enhanced attempts to complete the internal market.<sup>8</sup> As energy was viewed as an important component of all economic activity in the Union, the completion of the internal market was inconceivable without an integrated internal energy market.<sup>9</sup> Unsurprisingly, this implied restrictions in the way Member States could define, organize and most importantly, finance SGEI in the energy sector, since interference by the Member States through the means of State aid could disrupt the competition and thus the proper functioning of the internal market.

Before being able to answer the question on the restrictions to finance SGEI that the State aid provisions entail, it is first necessary to determine what a

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<sup>5</sup> Karayigit, 2009, p. 576

<sup>6</sup> Karayigit, 2009, p. 575f

<sup>7</sup> COM (2003) 270 final, p. 23

<sup>8</sup> Hancher & Hauteclouque, 2010, p. 1

<sup>9</sup> COM (91) 548 final, p. 2

SGEI is. The question is then: what conditions need to be fulfilled in order for a certain service to be recognized as a SGEI under EU law as it currently stands?

## 2.2 SGEI in the Treaties

Even though SGEI are mentioned both in Articles 14 and 106(2) TFEU and in Protocol (No. 26) annexed to the Treaty, there is no precise and complete definition of SGEI in EU law.<sup>10</sup> In the absence of a EU definition, the Member States have the responsibility for defining, organizing, regulating, financing and monitoring SGEI.<sup>11</sup> In other words, the Member States have a wide margin of discretion in determining what is to be considered a SGEI.<sup>12</sup> However, this margin of discretion is circumscribed in two ways. First, through the case law of the Court, a general framework has been established which specifies numerous criteria that need to be fulfilled in order for a service to be considered as a SGEI. Second, the Commission has been given the task to ensure that the margin of discretion is exercised without manifest error.<sup>13</sup> In essence this means that the provision, organization and financing of SGEI are subject to internal market, competition and State aid rules.<sup>14</sup>

### 2.2.1 Article 14 TFEU and Protocol (No 26)

Article 14 TFEU reads as following:

*“Without prejudice to Articles 73, 86 and 87, and given the place occupied by services of general economic interest in the shared values of the Union as well as their role in promoting social and territorial cohesion, the Community and the Member States, each within their respective powers and within the scope of application of this Treaty, shall take care that such services operate on the basis of principles and conditions which enable them to fulfil their missions.”*

Thus, Article 14 TFEU lays down a shared responsibility for the EU and the Member States to develop policies and take measures in order to safeguard that SGEI can be provided under such conditions so that the objectives of these SGEI are attained.

In addition to Article 14 TFEU, Protocol (No 26) annexed to the Treaties confirms that SGEI occupy a vital role in the shared values of the Union. At the same time, the Protocol confirms the wide discretion of Member States to provide, commission and organize SGEI.<sup>15</sup>

To sum up, Article 14 TFEU and Protocol (No 26) indeed place SGEI in a central role in the shared values of the Union. However, practically it does

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<sup>10</sup> Case T-289/03, BUPA, para. 165

<sup>11</sup> Karayigit, 2009, p. 580

<sup>12</sup> COM (2003) 270 final, p. 9, Case T-106/95 FFSA and Others v. Commission, para 216

<sup>13</sup> Karayigit, 2009, p. 578

<sup>14</sup> Karayigit, 2009, p. 591

<sup>15</sup> Article 1 of Protocol (No 26) on Services of General Interest

not provide a definition of SGEI. Therefore, it is essential to turn to Article 106(2) TFEU and more importantly the case law of the Court, as this will provide a thorough understanding on the current state of EU law when it comes to SGEI.

## 2.2.2 Article 106(2) TFEU

Article 106(2) TFEU provides:

*“Undertakings entrusted with the operation of services of general economic interest or having the character of a revenue-producing monopoly shall be subject to the rules contained in the Treaties, in particular to the rules on competition, in so far as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them. The development of trade must not be affected to such an extent as would be contrary to the interests of the Union”*

To put it in a different way, EU competition law is indeed applicable on undertakings that have been entrusted with the operation of a SGEI. However, the competition rules can be set aside if they obstruct the performance of the operation of the SGEI. Here, the Treaty provides a possibility to mitigate the effects of EU competition rules by making it possible to deviate from the competition rules, should this be justified by public service objectives.<sup>16</sup>

The competition rules can only be set aside provided that a number of conditions outlined in Article 106(2) TFEU are fulfilled. I will below describe these criteria in detail. My starting point will be the text of the Treaty and reference to case law will be provided where necessary.

First, the undertaking has to be “*entrusted*” with a SGEI. In other words, the State has to, by the means of a positive act, assign a certain task or confer certain functions on the undertaking. It is not sufficient that the state simply tolerates or approves of the activities in retrospect.<sup>17</sup>

Second, the undertaking has to be entrusted with “*services of general economic interest*”. As stated above, there is currently no EU definition of the notion of SGEI. In BUPA<sup>18</sup> the Court states that the Treaties do not grant the Commission special competence to act with reference to SGEI, nor does the determination of the nature and scope of a SGEI mission fall within the competence of the EU.<sup>19</sup> The effect of this is that the Member States have a discretion in determining the nature and scope of a SGEI mission, provided that they comply with the restrictions defined by Union law. In the Green Paper on Services of General Interest<sup>20</sup> the Commission holds that the concept covers a broad range of services including network industries,

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<sup>16</sup> Case C-202/88, France v Commission, para. 12

<sup>17</sup> Jones, 2011, p. 599

<sup>18</sup> Case T-289/03, BUPA

<sup>19</sup> Case T-289/03, BUPA, para. 166-167

<sup>20</sup> COM (2003) 270 final

such as electricity and gas, telecommunications, transport, postal services etc.<sup>21</sup>

In Dussendorp, AG Jacobs puts forward a short but very accurate description of what should be considered as “*services of general economic interest*”:

*“The reason for the assignment of particular tasks to undertakings is often that the tasks need to be undertaken in the public interest but might not be undertaken, usually for economic reasons, if the service were to be left to the private sector”*<sup>22</sup>

This quote points to the core of the concept of “*services of general economic interest*”, namely the importance of certain services to the public interest.

In BUPA, the Court laid down that a service is to be considered as a SGEI if the service is “*universal*” and “*compulsory*”. In essence this means that “*the Member State must indicate the reasons why it considers that the service in question, because of its specific nature, deserves to be characterised as an SGEI and to be distinguished from other economic activities*”.<sup>23</sup> Thus, even though the Member States have a wide discretion when it comes to defining and organizing SGEI, they need to take into account the restrictions defined by Union law, such as the “*universal*” and “*compulsory*” criteria. Ultimately, the Commission is authorized to ascertain that the Member States have not made a manifest error of assessment when exercising their discretion to define and organize SGEI.<sup>24</sup>

Third, in addition to that the undertaking has to be “*entrusted*” with a service and that this service needs to be a “*service of general economic interest*”, Article 106(2) TFEU requires that the application of the Treaty rules would “*obstruct the performance of the particular tasks*” assigned to the undertakings, in order for the competition rules to be set aside.

To sum up, Article 106(2) TFEU makes it possible for a Member State to escape the application of EU rules on State aid, subject to the conditions outlined above. It has been established that the Member States on the one hand have a wide discretion when it comes to defining the scope of SGEI. On the other hand, the Treaties and the case law of the Court provides for the boundaries within which the Member States must keep, in order to benefit from the exception granted. Consequently, Article 106(2) TFEU cannot be used by the Member States arbitrarily with the sole purpose of removing a particular sector from the application of the competition rules.<sup>25</sup>

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<sup>21</sup> Karayigit, 2009, p. 575f

<sup>22</sup> Opinion of Jacobs AG in Case C-203/96 Dusseldorp, para 103

<sup>23</sup> Case T-289/03, BUPA, para. 172

<sup>24</sup> Case T-289/03, BUPA, para. 169

<sup>25</sup> Case T-289/03, BUPA, para 168



## 2.3 SGEI in secondary legislation

In addition to confirming the Member States' wide discretion when defining SGEI, the Court in BUPA also refers to the distinction between areas where the Member States have conferred competences to the EU, and areas where Member States have maintained their competence. The Court states that a SGEI mission, that neither falls within the exclusive nor shared competence of the EU remains within the competence of the Member States, provided the Member States observe the limits of manifest error and other conditions that Article 106(2) TFEU lays down.<sup>26</sup> The situation is different in cases where the Member States have conferred competences to the EU and where harmonizing legislation has been adopted. In the case where harmonizing EU legislation has been adopted, the Member States' discretion is more limited.<sup>27</sup>

The distinction between areas that have been harmonized and areas that have not is of much relevance for this thesis. Energy falls under shared competence of the Member States and the Union, according to Article 4(2)(i) TFEU. Further, the establishment of the competition rules necessary for the functioning of the internal market falls under exclusive Union competence, according to Article 3(1)(b) TFEU.

Using the internal market as a legal basis, the Commission initiated the liberalization of the energy market, which resulted in adoption of secondary legislation containing reference to SGEI.<sup>28</sup> For the purposes of this thesis, the Third Electricity Directive<sup>29</sup> is relevant. This Directive contains provisions that give the Member States the possibility to impose PSO's on undertakings in order to ensure the provision of SGEI that may relate to, amongst other interests, security of electricity supply. The Third Electricity Directive and its implications for SGEI in the field of security of supply are discussed in detail in *Section 4.3*, but already at this stage the following can be concluded.

Through the secondary legislation, the EU has selected a number of SGEI that are to be protected on a European level and set the framework under which such protection can be operated in order to comply with the internal market.<sup>30</sup> Ensuring security of electricity supply is merely one of these public services. Thus, one can claim that the EU has started to lay down the foundations of a European notion of SGEI in the field of security of supply. However, Member States have retained the right to determine by what means security of supply is to be safeguarded.<sup>31</sup>

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<sup>26</sup> Case T-289/03, BUPA, para. 167-169

<sup>27</sup> Karayigit, 2009, p. 579

<sup>28</sup> COM (2003) 270 final, p.10

<sup>29</sup> Directive 2009/72/EC

<sup>30</sup> Napolitano, 2009, p. 573

<sup>31</sup> Napolitano, 2005, p. 573

## 2.4 Concluding remarks

I have in detail presented the notion of SGEI. I have concluded that there at this point is no Union definition of SGEI. However, in primary and secondary legislation, and in the practices of the Commission and in the Case law of the Court, it is possible to discern a number of constraints that the Member States need to respect when defining and organizing SGEI. In addition to this, the Third Electricity Directive recognizes security of supply as constituting an element of the concept of SGEI.

So far in my description of SGEI, my perspective has been the perspective of the Member States. I have attempted to present the legal framework governing the Member States rights and possibilities to define the scope of SGEI, and in this way safeguard certain interests viewed as crucial for their respective societies. In the following *Section 3* and *Section 4*, I will take the perspective of the Union. Thus, as opposed to focusing on the scope of action for Member States to ensure security of supply, I will look at the contribution Union legislation and Union policies make towards ensuring security of supply.

# 3 Liberalisation of the energy sector

## 3.1 Introduction

I will now describe the liberalization of the energy sector that was initiated in the 1990's, with the First Electricity Directive being adopted in 1996. Since 1996, the legislative activity with regards to the internal market in energy has been intense, with the Second and Third Electricity Directives being adopted in 2003 and 2009 respectively. As one of the objectives of the liberalization and the subsequent creation of the internal market in energy has been to improve security of supply, an account of this process necessary for the purposes of this thesis. My ambition is to outline the emergence of a EU dimension of security of supply and to see what measures the Commission proposes in order to reach the objective of a secure supply of electricity.

Second, after having made an account of the EU general policies towards ensuring security of supply, I will look more closely into the concept of security of supply in *Section 4*. I will look into the Third Electricity Directive in order to determine how EU law deals with the concept. However, already at this point it might be helpful to present a basic definition of the concept, where security of supply entails “*a guarantee that all the energy volumes demanded will be made available at a reasonable price.*”<sup>32</sup>

But first I will describe shortly the objectives of the EU. An understanding of these objectives is necessary as it gives a background to the liberalisation of the electricity sector that subsequently led to increasing focus on SGEL.

## 3.2 Initial objectives – market integration

The Treaty of Rome, also known as the EC Treaty, established the European Community and also specified the objectives that were to be pursued by the same Community. Article 2 EC states that the Community shall have as its task to promote a number of objectives<sup>33</sup> “*by establishing a common market*”.<sup>34</sup> This central aim of the Union is confirmed in the latest edition of the Treaties, more precisely Article 3(3) TEU, which reads “*The Union shall establish an internal market*”.

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<sup>32</sup> Sieps, 2008:1, p.19

<sup>33</sup> Such as a balanced and sustainable development of economic activities, high level of employment, raising of the standard of living and economic and social cohesion etc.

<sup>34</sup> As amended by the Treaty of Amsterdam

In the light of the above described central objective of market integration it is easy to realize that eventually, also areas traditionally falling under the competence of the Member State would be influenced. Or as van Miert (2000) puts it “*liberalization in the European Union has mainly been an unavoidable consequence of the establishment of the internal market.*”<sup>35</sup> Consequently, the internal market was used as a legal basis for the liberalization process.<sup>36</sup> In its Proposal for the First Electricity Directive<sup>37</sup> the Commission states that energy is an important component of all economic activity in the Community that the completion of the internal market is inconceivable without an integrated internal energy market.<sup>38</sup> The Commission continues by outlining the main objectives for the internal market for electricity, namely 1) *ensuring the free movement of products (more precisely gas and electricity)*, 2) *improving security of supply* and 3) *improving competitiveness*. In terms of security of supply, the Commission states that an open market is likely to lead to a more flexible and broadly based supply that in turn will lead to a higher level of supply security.<sup>39</sup>

### **3.3 The liberalization and security of supply**

One of the objectives with the liberalization of the electricity market was thus to improve security of electricity supply in the EU. It is necessary to stress that the liberalization process has been incremental. The First Electricity Directive adopted in 1996 has been replaced with a Second and a Third Electricity Directive. In each of these Directives, as well as in the preparatory acts preceding them, a number of measures and strategies were outlined aimed at reaching the objective of market integration and through that improving security of supply in the EU.

I will below discuss these measures and strategies, as these provide the line of reasoning and the theory with regards to how, in view of the Commission, security of supply at a EU level is to be guaranteed. The details will be provided below, but it is essential to keep in mind that the foundation of the Commissions approach towards security of supply is that the creation of a well-functioning and competitive internal market will automatically ensure security of electricity supply.

It is important to note that I will only cover the measures that have been referred to in the Commission Decisions that are discussed in *Section 6*. However, in addition to what I will cover, the Commission has developed several other strategies, for example the further unbundling of vertically integrated undertakings,<sup>40</sup> the establishment of an agency for the

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<sup>35</sup> van Miert, 2000, p. 1

<sup>36</sup> Albers, 2001-2002, p.909

<sup>37</sup> COM (91) 548 final

<sup>38</sup> COM (91) 548 final, p. 2

<sup>39</sup> COM (91) 548 final, p. 4

<sup>40</sup> Westerhof, 2009, pp. 26ff

cooperation of energy regulators,<sup>41</sup> the coordination between transmission system operators<sup>42</sup> and so forth.

### **3.3.1 Opening of the markets**

In order to achieve a competitive internal market in energy, the Commission proposes opening up the production and transport of electricity to independent operators.<sup>43</sup> The opening of the market will lead to an increasing number of suppliers<sup>44</sup> and diversification in terms of resources used for energy production and will contribute towards the security of electricity supply.<sup>45</sup>

### **3.3.2 Efficient application of competition law**

The Commission recalls that excessive intervention from the Member States in various aspects of the electricity market impedes competition.<sup>46</sup> Therefore, the use of competition law instruments, such as State aid control, is a prerequisite for a successful liberalization.<sup>47</sup>

When it comes to State aid, the Commission emphasises the need for a more efficient control. The Commission states that State intervention through State aids must be compatible with the objectives of the internal market. Otherwise, the risk is that policies developed to suit a certain national context are likely to produce negative effects on the internal market.<sup>48</sup>

### **3.3.3 Development of interconnections and attempts to increase trade**

The Commission stresses the importance of creating a *genuinely* internal market rather than a number of separate, national markets. Therefore, focus is put on increasing trade between the Member States. Increase in trade would lead to that the EU's common resources are used in a more efficient way, where a shortage in one Member State can be balanced against a surplus in another Member State.<sup>49</sup> In order to increase trade between the Member States it is necessary to encourage the development of existing interconnections and the construction of new interconnections between the Member States. An increase in interconnections would overcome the problem of isolated markets.<sup>50</sup> In turn, a genuinely integrated internal

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<sup>41</sup> Westerhof, 2009, pp. 21ff

<sup>42</sup> COM (2006) 841 final, p.16

<sup>43</sup> COM (91) 548 final, p. 7

<sup>44</sup> COM (2001) 125 final, p. 21

<sup>45</sup> COM (2001) 125 final, p. 21

<sup>46</sup> COM (91) 548 final, p. 7

<sup>47</sup> Albers, 2001-2002, p. 912

<sup>48</sup> SEC (90) 1248 final, p. 5

<sup>49</sup> COM (2001) 125 final, p. 10

<sup>50</sup> COM (2001) 125 final p. 15f

market, with an increasing number of suppliers and where the common resources are efficiently used would lead to security of supply.

### **3.3.4 Public service objectives**

In addition to the focus put on the establishment of a genuine internal market the Commission makes direct reference to public service objectives. The Commission states that the EU commonly pursues a number of public service objectives in the electricity sector.<sup>51</sup> However, the Commission considers that the safeguards guaranteeing the public service objectives need to be reinforced. Therefore, it is regarded as necessary to adopt provisions that oblige Member States to take appropriate measures to ensure that a number of public service objectives are met, such as security of supply.

These provisions cover a number of areas. First, it is necessary to ensure the appropriate levels of maintenance and development of infrastructure and in particular interconnections between the Member States.<sup>52</sup> This would increase the trade between the Member States and contribute towards security of supply. Second, and on a more general level, the Commission proposes that the Member States should be required to carefully monitor the developments on the electricity market, such as the demand/supply balance, the level of future demand and so forth. Closely connected to the obligation to monitor it the right for Member States to launch tenders for additional capacity, should shortages in electricity generation occur.<sup>53</sup> These provisions are to be found in the Third Electricity Directive. A detailed account of the Third Electricity Directive is given in *Section 4*, where the EU policy on security of supply is discussed.

## **3.4 Concluding remarks**

A central objective of the EU has been the creation of an internal market. It is regarded as unavoidable that also sectors traditionally under Member State competence, such as the energy market would be influenced by ambitions to create a genuinely internal market through the liberalization process.

One of the objectives of the liberalization of the energy market was to ensure security of supply to the EU. The measures by which this objective was to be achieved are a genuinely integrated market with an increasing number of suppliers and a diversification of resources, efficient application of competition law to help market integration and well-defined public service objectives.

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<sup>51</sup> COM (2001) 125 final, p.17

<sup>52</sup> COM (2001) 125 final, p. 20

<sup>53</sup> COM (2001) 125 final, p. 21

# 4 Security of supply

## 4.1 Introduction

In the literature, there exist several definitions and interpretations of security of supply. The most basic interpretation holds that security of supply entails “a guarantee that all the energy volumes demanded will be made available at a reasonable price.”<sup>54</sup> In other words, it is necessary to guarantee that every citizen at any given time will have access to sufficient electricity at a reasonable price. The Commission definition of security of supply entails measures “to ensure a supply of energy to all consumers at affordable prices while respecting the environment and promoting healthy competition”.<sup>55</sup>

There are several aspects to these definitions, as measures to ensure security of supply can be geared towards 1) *the long-term availability of electricity and access to sources from which electricity can be produced*, 2) *the long-term ability of transmission/distribution systems to function adequately in order to meet demand*, 3) *the adequacy and availability of sufficient generation capacity so as to meet demand* and 4) *the short-term operational ability of transmission and distribution systems to balance demand and supply, in order to deliver electricity to end users on a daily basis*. The Commission approach towards security of supply focuses on points 2) and 3).<sup>56</sup>

Thus, in view of the Commission, in order to ensure security of supply, it is essential to; 1) *ensure the availability and proper functioning of networks for transmission and distribution, so that the electricity produced can reach the end consumer*, and 2) *ensure that sufficient amounts of electricity are generated, by looking at generation capacity of the market and comparing this to demand*.<sup>57</sup> The question is then how this objective can be reached. Several options are possible.

Before looking more closely into these options, it is necessary to address the risks or hazards, whose occurrence can disrupt electricity supply. These risks or hazards can be of differing nature. Inadequate investment in generation capacity can result in insufficient production and supply shortages. Inadequate investment in transportation, distribution capacity and/or maintenance of the networks can result in failures to distribute to all customers the electricity that is in fact available.<sup>58</sup> Other risks that have been mentioned are seasonal variations in generation where certain sources of energy generate sufficient capacity only during limited periods of the

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<sup>54</sup> Sieps, 2008:1, p.19

<sup>55</sup> Goldberg, 2009, p. 136

<sup>56</sup> Goldberg, 2009, p. 136

<sup>57</sup> Knops, 2009, p.91

<sup>58</sup> Sieps, 2008:1, p. 20

year (for example hydropower, where generation is maximised during spring time but can be quite low during the rest of the year), or in the context of the EU, insufficient interconnections between the Member States that isolates the national markets and limits the possibilities to import electricity from another Member State, in case of shortage on the national market.<sup>59</sup>

One approach to overcome these risks to security of supply has been central governmental planning.<sup>60</sup> Before liberalization, the European energy markets were monopolies to a large extent, where generation and transmission/distribution were integrated into the same undertaking, often publicly owned and government controlled.<sup>61</sup> This resulted in the State having the overall responsibility to ensure sufficient generation as well as adequate functioning of the networks. With the liberalization of the energy market, the State's ability to react to security of supply challenges was limited.<sup>62</sup>

Therefore, after the liberalization was implemented, an alternative approach was required. The ambition was that the market itself would provide for generation of sufficient amounts of electricity as well as ensure adequate maintenance and investment of the networks.<sup>63</sup> However, the Member States and recently also the Commission have pointed out the need for regulation in order to ensure security of supply in the Union.<sup>64</sup>

The question is then; how is security of electricity supply to be guaranteed? Who is to be responsible to ensure that generation of electricity keeps the pace with demand for electricity and that the level of investment in the networks and interconnections is sufficient in order to ensure that electricity can be delivered to end users? Below I will present the Commission's suggested answers to these questions.

## **4.2 The development of a EU approach**

### **4.2.1 General remarks on EU energy policy**

Issues related to security of supply have gained increasing importance in the EU. This is confirmed in the Commission Communication titled "*An Energy Policy for Europe*" where the Commission declares its intent to work for a common EU energy policy and outlines the objectives of this policy, namely competitiveness, sustainability and security of supply.<sup>65</sup>

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<sup>59</sup> These risks are presented by various Member States as grounds of justification for State aid measures. For a detailed account see Section 5.

<sup>60</sup> Knops, 2009, p.92

<sup>61</sup> Manoussakis, 2009, p. 228

<sup>62</sup> Egenhofer, 2006, p. 4

<sup>63</sup> Cameron, 2007, p. 519

<sup>64</sup> Speech by Joaquín Almunia "Reforming EU State aid rules on public services: The way forward" SPEECH /11/300, 02/05/2011

<sup>65</sup> COM (2007) 1 final, p. 3



In this context it is necessary to mention that a common European energy policy is quite a recent phenomenon, where a formal competence for the EU was introduced only with the Maastricht Treaty. The Lisbon Treaty clarified and formalized the EU competences in the sphere of energy policy.<sup>66</sup> First, Article 4(2)(i) TFEU confirms that the EU and the Member States shall have shared competences with regard to energy. Further, Article 194 TFEU provides the objectives of the EU energy policy, namely (a) *to ensure the functioning of the energy market*; (b) *to ensure security of energy supply in the Union*; (c) *to promote energy efficiency and energy saving and the development of new and renewable forms of energy*; and (d) *to promote the interconnection of energy networks*.

Thus, recent developments of EU law, with the enhanced attempts to create a common energy policy with security of supply as an integral part of this policy and the new Article 194 TFEU which points out security of supply as an objective of EU energy policy, make it possible to distinguish what is the initial stage of a EU dimension of security of supply. This view is shared by the Commission, that established that with the internal market in electricity, there is a gradual substitution of the national dimension of security of supply by a common dimension.<sup>67</sup> This gradual shift is confirmed by a number of measures taken at EU level, such as coordination of national measures as well as development of new, common approaches to security of supply.<sup>68</sup>

## **4.2.2 A EU approach to security of supply**

Before going into the details of the EU approach towards securing electricity supply in the EU, it is necessary to point out that the EU policy towards security of supply consists of a series of measures, proposed by the Commission, that in different ways promote security of supply in the EU. I will below give an account of this fragmented approach.

### **4.2.2.1 Measures to control demand**

In 2000 the Commission adopted a Green Paper entitled “*Towards a European strategy for the security of energy supply*”.<sup>69</sup> In the Green Paper, the Commission identifies two main threats to security of supply, namely the projected increase in demand and the increased dependency on energy imports.<sup>70</sup> Therefore, the Commission calls for a long-term strategy for energy supply security in order to ensure uninterrupted availability of energy products on the market at prices that are affordable for consumers.<sup>71</sup>

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<sup>66</sup> Goldberg, 2009, p. 134f

<sup>67</sup> COM (91) 548 final, p. 11

<sup>68</sup> SEC (90) 1248 final, p. 7

<sup>69</sup> COM (2000) 769 final

<sup>70</sup> COM (2000) 769 final, pp. 67-68

<sup>71</sup> COM (2000) 769 final, p. 3

However, as it has been impossible for the Member States to agree on a common and coherent energy policy,<sup>72</sup> the Commission concludes that the scope for EU action is limited when it comes to increasing generation. Therefore, as a solution, the Commission proposes that the common EU strategy towards security of supply should be based on first, controlling the growth of demand and second, managing supply dependence.<sup>73</sup> The strategy requires measures to be taken both on a horizontal and a sectoral level. On the horizontal level, completion of the internal market, energy taxes and energy-saving schemes are crucial. On the sectoral level, energy-saving in transport and buildings is of relevance.<sup>74</sup>

#### **4.2.2.2 Measures to further integrate the internal market**

Another proposed measure is the further integration of the internal energy market. There are several elements to this. An increase in cross-border trade is the first element. The Commission notes that the level of trade in electricity is much lower compared to other sectors and that this poses a security of supply problem.<sup>75</sup> Closely connected to the objective of increased trade in electricity in the internal market, is the need for adequate interconnections between the Member States, since a lack of interconnections will hinder the development of trade and thus limit security of supply.<sup>76</sup> The second element is State aid control, as this keeps the internal market running smoothly. The Commission notes that it is important to investigate whether certain sources of energy are put at an advantage, and concludes that some sectors should no longer benefit from State aid, such as oil, gas or nuclear power, while other sectors, more precisely renewable sources of energy, are in need for State aid to gain a foothold.<sup>77</sup>

#### **4.2.2.3 Focus on system security and adequate supplies of electricity**

In 2003 the Commission published a Communication<sup>78</sup> where it outlines the key objectives for the electricity and gas industry in Europe. In terms of security of supply, the Commission declares; “*it must be ensured that the internal market develops in a manner that provides the highest possible standards of security of supply*”,<sup>79</sup>. For the Commission, this entails two elements, first, *system security* and second, *ensuring adequate supplies of electricity*, both in the medium and long term.<sup>80</sup>

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<sup>72</sup> COM (2000) 769 final, p. 12

<sup>73</sup> COM (2000) 769 final, p. 69

<sup>74</sup> COM (2000) 769 final, pp. 68-72

<sup>75</sup> COM (2000) 769 final, p.60

<sup>76</sup> COM (2000) 769 final, p. 60

<sup>77</sup> COM (2000) 769 final, p. 56

<sup>78</sup> COM (2003) 743 final

<sup>79</sup> COM (2003) 743 final, p.3

<sup>80</sup> COM (2003) 743 final, p.3

In terms of *system security*, the Commission first points out the necessity of ensuring an adequate infrastructure.<sup>81</sup> This includes the development of interconnections between the Member States, in order to promote trade of electricity products.<sup>82</sup> In terms of *ensuring adequate supplies of electricity*, the Commission emphasizes the need for measures to balance demand and supply. Any security of supply policy requires measures for reduction of demand. This will prevent the need for investments in new generation capacity and should be the first step to take for Member States concerned about security of supply. Should demand management not be sufficient to ensure security of supply, appropriate measures could be taken in order to encourage investment. However, the Commission points out that it is primarily the market that should ensure the necessary investment and that state intervention should be taken only with great care.<sup>83</sup>

### **4.2.3 The added value of a EU approach towards security of supply**

As has previously been stated, the EU and the Member States have shared competence with regard to energy policy. An integral part of this EU energy policy is to ensure the functioning of the energy market, to ensure the security of supply and to promote the interconnection of the energy networks, according to Article 194 TFEU. A consequence of the shared competence is a lack of coherence between the measures proposed to ensure security of supply on a national level and the measures envisaged to ensure security of supply on a EU level.<sup>84</sup>

In order to mitigate the negative effects that national policies might have on the EU policies on liberalization of the energy markets and the creation of an internal market aimed at ensuring security of energy supply at a EU level, it is necessary to develop a European concept of security of supply.<sup>85</sup> To be more specific, a EU concept of security of supply would for the energy sector result in that security of supply would be enhanced. This would be achieved through a common management of the EU networks, more investment in interconnections and improved cooperation between the authorities that on national level have been entrusted with different aspects of security of supply.<sup>86</sup>

A coherent EU approach to security of supply would thus mean that disruptions of supply in one Member State would be quickly solved by relying on surplus supply from another Member State. In this way, the situation would be avoided when each Member State would have to fully provide for its own security of supply.<sup>87</sup>

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<sup>81</sup> COM (2003) 743 final, pp. 8-9

<sup>82</sup> COM (2000) 769 final, p. 60

<sup>83</sup> COM (2003) 743 final, p. 7

<sup>84</sup> Pedersen, 2008, p. 2

<sup>85</sup> Pedersen, 2008, p. 2f

<sup>86</sup> Pedersen, 2008, p. 17

<sup>87</sup> Glachant, 2008, p. 14

## 4.3 Security of supply in secondary legislation

Above I have described the view of the Commission on how the Union should handle issues related to security of supply. In response to the objectives outlined by the Commission, several pieces of legislation have been enacted, which in different ways aim to ensure security of supply. This legislation will be described below.

### 4.3.1 The Third Electricity Directive

The Third Electricity Directive is a part of the so called Third Energy Package and is intended to further integrate the electricity markets of the Member States and to create a genuine internal market characterised by effective competition. The preamble describes the aims of the internal market in electricity, namely *“to deliver real choice to all consumers of the European Union, be they citizens or businesses, new business opportunities and more cross-border trade, so as to achieve efficiency gains, competitive prices, and higher standards of service, and to contribute to security of supply and sustainability.”*<sup>88</sup> Ensuring security of supply is thus a part of the objectives of the Directive and the internal market.

In order to complete the internal market, the Third Energy Directive draws on the shortcomings on earlier Directives. Therefore, the Third Electricity Directive reinforces the provisions on unbundling in Article 9, as this will enhance investment in generation capacity<sup>89</sup> and is likely to result in investment in cross-border interconnections.<sup>90</sup> On top of these general provisions that indirectly will enhance security of supply by further integrating the internal market, the Third Electricity Directive also contains provisions that directly refer to security of supply.

The scope of the Directive is defined in Article 1, where it is laid down that the Directive establishes common rules for the generation, transmission, distribution and supply of electricity with the view to improving and integrating competitive electricity markets in the Community. Further, Article 1 outlines that the Directive lays down universal PSO.

These PSO are dealt with in Article 3(2), which gives the Member States the right to impose on undertakings PSO in the general economic interest, which may relate to the security of supply, regularity, quality and price of supplies and environmental protection. These obligations shall be clearly defined, transparent, non-discriminatory and verifiable and shall guarantee equality of access for electricity undertakings of the Community to national

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<sup>88</sup> Directive 2009/72, preamble para. 1

<sup>89</sup> Nowak, 2010, p. 29f

<sup>90</sup> Westerhof, 2009, p. 20f

consumers. Further, Article 3(10) provides that the Member States shall implement measures to achieve the objectives of social and economic cohesion, which shall include security of supply. Such measures may include adequate economic incentives for the maintenance and construction of the necessary network infrastructure, including interconnection capacity.

Article 4 requires Member States to monitor security of supply issues. This monitoring shall cover the balance of supply and demand on the national market, the level of expected future demand and envisages additional capacity being planned, the quality and level of maintenance of the networks and measures to cover peak demand and to deal with shortfalls of one of more suppliers.

Article 8 obliges the Member States to ensure the possibility to tender for new capacity in the interest of security of supply. However, such tendering procedures are to be initiated only if on the basis of the authorization procedure,<sup>91</sup> the generating capacity to be built is insufficient.

On top of the above mentioned provisions, that all specifically refer to security of supply, Article 15(3) is also necessary to mention. This provision gives the Member States the right to, for reasons of security of supply, direct that priority is given to the dispatch of generators using indigenous primary energy fuel sources, to an extent not exceeding 15% of the overall primary energy necessary to produce the electricity consumed in that Member State.

In practice, Article 3(2) and 15(3) have had greatest importance, as these provisions have been referred to by the Member States when trying to justify State aids granted. These provisions are discussed in detail below in *Section 6*.

### **4.3.2 The Security of Supply Directive**

The Security of Supply Directive<sup>92</sup> is a result of the Commission Communication on Energy Infrastructure and Security of Supply, where the Commission recognized the need for concrete action in the form of a Directive, in order to ensure a reliable and efficient supply of electricity.<sup>93</sup>

In the proposal for the Security of Supply Directive, the Commission stressed the importance of the need to balance supply and demand. The development of demand management policies should therefore be central. The Commission does recognize that some new investment in generation capacity is needed, but states that such decisions should be left to the market

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<sup>91</sup> The authorization procedure, described in Article 7, is to be used for the construction of new generating capacity. Member State shall lay down objective, non-discriminator criteria related to safety and security of the electricity system, protection of public health and safety, protection of environment and so forth. This provision is to ensure access to the market to all undertakings that are capable of fulfilling the criteria stipulated.

<sup>92</sup> Directive 2005/89/EC

<sup>93</sup> COM (2003) 743 final, pp. 12-13

players. Only when the market is unable to provide the necessary investment, the Member States should take measures. Further, the Commission emphasises the need for investment in interconnections infrastructure as a crucial element of a Union approach to security of supply.<sup>94</sup>

In the preamble of the Security of Supply Directive, it is stated that a competitive internal EU electricity market requires transparent and non-discriminatory policies on security of electricity supply. To that end, it is crucial to define the roles and responsibilities of the competent authorities/Member States, in order to safeguard electricity of supply. The absence of policies safeguarding security of supply, or significant differences between the policies of the Member States would lead to distortion of competition.<sup>95</sup>

Article 1 defines the scope of the Directive, which is to safeguard security of electricity supply and the proper functioning of the internal market and to ensure an adequate level of generation capacity, an adequate balance between supply and demand and an appropriate level of interconnections between Member States. Further, Article 1 lays down that the Directive establishes a framework within which Member States are to define transparent, stable and non-discriminatory policies on security of supply, compatible with the internal market for electricity.

Article 3 obliges the Member States to take the necessary measures in order to facilitate a stable investment climate in order to ensure a high level of security of supply. Member States should further define the roles and responsibilities of competent authorities and all relevant market actors. When implementing these measures, the Member States shall take into account the importance of ensuring continuity of electricity supplies, the importance of a transparent and stable regulatory framework, the internal market and the possibilities for cross-border cooperation in relation to security of supply. Further, Member States may take into account the degree of diversity in electricity generation, the importance in reducing the long-term effects of the growth of electricity demand and the importance of encouraging energy efficiency and in particular demand management technologies.

Article 5 obliges Member States to take appropriate measures to maintain a balance between demand for electricity and the availability of generation capacity. Member States may take measures to facilitate new generation capacity and the entry of new generation companies to the market.

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<sup>94</sup> COM (2003) 740 final, pp. 2-5

<sup>95</sup> Directive 2005/89/EC, preamble, para. 3

## **4.4 Concluding remarks**

In this Section I have made an attempt to outline the inception of a common EU approach towards security of supply. I have shown that the Commission repeatedly returns to a number of measures; integration of the internal market leading to increase in trade between the Member States, demand side management and the importance of a coherent, coordinated approach. I have also made an account of the Third Electricity Directive as well as the Security of Supply Directive, as regards the provisions where EU law puts obligations on the Member States specific to security of supply.

In the following Section, I will present the EU State aid regime. This account is necessary as it provides a framework for which the Member States need to stay within, when designing measures aimed at ensuring security of supply.

# 5 State aid

## 5.1 Introduction

*Section 2* discussed the limits EU law lays down on the Member States' rights to *define and organize* SGEI in the field of security of electricity supply. This Section will look into EU legislation that concerns *compensation* to those undertakings that have been entrusted by a Member State to perform a certain PSO, connected to ensuring a secure supply of electricity. I am here referring to the EU rules on State aid.

EU rules on State aid are an integral part of EU competition policy. The objective is to safeguard competition on the internal market. State aid rules ensure a level playing field for European undertakings and prohibit Member States to grant aid to support unprofitable undertakings as this distorts competition on a national as well as a European level.

The central substantive provisions is Article 107 TFEU, which provides that aid granted by a Member State shall be incompatible with the internal market, provided that the requirements mentioned in the Article are fulfilled. However, this prohibition is not absolute. On the contrary, there are a number of exceptions that provide for a possibility to justify State aid. These exceptions are also found in Article 107 TFEU. In addition, a State aid measure can be justified with reference to Article 106(2) TFEU. According to Article 108 TFEU, it falls under the competence of the Commission to determine whether a certain State aid measure can be justified or whether it is to be regarded as incompatible with the internal market.

As is apparent from the above stated, the Commission has a certain discretion in determining whether a State measure considered as State aid can be justified. Therefore, in an attempt to clarify the application of State aid rules, and with special focus put on SGEI, the Commission adopted in 2005 a SGEI Framework.<sup>96</sup> The SGEI Framework defines the conditions under which a State aid measure can be justified pursuant to Article 106(2) TFEU. The SGEI Framework expires in November 2011. However, the Commission has initiated a review of the SGEI Framework in order to clarify, simplify and diversify its rules.<sup>97</sup>

When discussing the financing of SGEI, the Altmark case, delivered by the Court in 2003 is central. In Altmark, the Court specifies four conditions that, should they be fulfilled, result in the notified measure not being classified as State aid.

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<sup>96</sup> Community framework for State aid in the form of public service compensation (2005/C 297/04)

<sup>97</sup> COM (2011) 146 final, Speech by Joaquín Almunia "Reforming EU State aid rules on public services: The way forward" SPEECH /11/300, 02/05/2011



## 5.2 Legislative framework

### 5.2.1 Article 107 TFEU

Article 107 TFEU states:

*“...any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market.”*

Thus, the Treaty provides that State financing of PSO, which fulfils the requirements of Article 107 TFEU is to be classified as State aid and is incompatible with EU law. Article 107 TFEU will become applicable if the following criteria are fulfilled; 1) *the measure must be granted by a Member State or through State resources*, 2) *the measure must confer an advantage on the recipient undertaking*, 3) *the measure must be selective*, 4) *the measure must distort or at least threaten to distort competition* and 5) *the measure must affect trade between Member States*.<sup>98</sup> In a wide body of case law, the Court has developed on each of these criteria. For the purposes of this thesis, I will look solely on whether a measure confers an advantage on the recipient undertaking. This element is central, as it plays a crucial role both in the Altmark criteria and the Commission Decisions, which will both be described in detail below.

The exceptions to the general prohibition of State aid are to be found in the second and third paragraph of Article 107 TFEU. For this thesis the relevant ground for justification thesis is found in Article 107(3)(c) TFEU. This provision lays down that *“aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest”* may be considered compatible with the internal market. It is worth to note here that none of the exceptions to the general prohibition of State aid explicitly covers SGEI.

### 5.2.2 The SGEI Framework

In addition to Article 107(3)(c) TFEU, which provides a possibility to justify State aid, Article 106(2) TFEU can be used for the same purpose. The substance of this provision is discussed in detail in Section 2.2.2. Here my focus is solely on the conditions under which State aid can be found compatible with the internal market, pursuant to Article 106(2) TFEU.

These conditions are to be found in the SGEI Framework, which was adopted in 2005 in an attempt to provide greater legal certainty to the application of Article 106(2) TFEU. More precisely, the SGEI Framework

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<sup>98</sup> Cameron, 2007, p. 430

sets up a number of criteria, which should they be fulfilled, will result in that the State aid measure in question will be considered compatible with the internal market. These criteria are outlined below.

### **5.2.2.1 Genuine SGEI within the meaning of Article 106 TFEU**

According to paragraphs 9 and 10 of the SGEI Framework, there needs to be a genuine SGEI within the meaning of article 106(2) TFEU. The Member States have a wide discretion in determining the nature of the SGEI. The Commission's task in this case is to determine whether the Member State has made a manifest error of assessment while making use of the discretion to define and organize SGEI. Thus, this condition corresponds to earlier Commission practice and Court case law, as described in *Section 2*.

### **5.2.2.2 Act of entrustment specifying the PSO**

Further, it is required that the operation of the SGEI has been entrusted to an undertaking in an official act. This act must specify the following: the precise nature and the duration of the PSO, the undertakings and territory concerned, the nature of any exclusive or special rights assigned to the undertaking, the parameters for calculating, controlling and reviewing the compensation and the arrangements for avoiding and repaying any overcompensation.<sup>99</sup>

### **5.2.2.3 The amount of compensation**

In addition, it is necessary to specify the methods of calculating the compensation. First, the amount of compensation may not exceed what is necessary to cover the costs incurred in discharging the PSO, taking into account a reasonable profit for discharging the obligations. The costs to be taken into account are all the costs incurred in the performance of the SGEI, such as variable costs incurred, a contribution to the fixed costs common both to the SGEI and other activities, cost related to investments insofar they are linked to the functioning of the SGEI and so forth. The calculation of the costs must follow criteria that have been defined beforehand and be based on generally accepted accounting principles.<sup>100</sup> Second, the compensation must actually be used for the operation of the SGEI. It is not justified to use the compensation to operate on other markets.<sup>101</sup> Third, the undertaking entrusted with the provision of a SGEI is entitled to a reasonable profit that should normally not exceed the average rate for the sector concerned in recent years.<sup>102</sup>

### **5.2.2.4 Over-compensation**

The Member State is obliged to regularly arrange for checks to ensure that there has been no overcompensation, since overcompensation is not necessary for the operation of the SGEI and therefore constitutes incompatible State aid that must be repaid to the Member State. This

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<sup>99</sup> SGEI Framework, para. 11-13

<sup>100</sup> SGEI Framework, para. 14, 16

<sup>101</sup> SGEI Framework, para. 15

<sup>102</sup> SGEI Framework, para. 18

requires that there must be room to modify the parameters for the calculation of compensation, should this be required.<sup>103</sup>

### 5.2.3 Altmark

The Altmark judgement delivered by the Court in 2003 has proved to be a groundbreaking judgement. The case concerned subsidies granted to Altmark Trans, in order to compensate the undertaking for the performance of the PSO to operate a certain public transport service. The subsidies were granted since it was regarded that it would not be profitable to operate the services without such subsidies.

In its judgment, the Court first lays down that a State measure falls within the scope of Article 107 TFEU if all the criteria mentioned in that Article are fulfilled. As the Court puts it;

*“First, there must be an intervention by the State or through State resources. Second, the intervention must be liable to affect trade between Member States. Third, it must confer an advantage on the recipient. Fourth, it must distort or threaten to distort competition.”*<sup>104</sup>

The Court focuses its investigation on determining whether the State subsidies conferred an advantage on the recipient, within the meaning of Article 107(1) TFEU.<sup>105</sup> The Court first states that measures that are likely to favour a certain undertaking are to be classified as State aid. The Court then concludes that in those cases, where State measures are to be regarded as compensation for the services provided by the recipient undertaking and where this compensation does not have the effect of putting the recipients in a more favourable competitive position than their competitors, the State measure is not to fall under the scope of Article 107 TFEU. However, in order for such compensation to fall outside the scope of the State aid rules, four conditions need to be satisfied.<sup>106</sup>

First, the recipient must have clearly defined PSO to discharge. Second, the parameters on the basis of which the compensation is calculated must be established in advance in an objective and transparent manner, to avoid the compensation conferring an economic advantage on the recipient undertaking over competing undertakings. Third, the compensation cannot exceed what is necessary to cover all or part of the costs incurred in the discharge of the public service obligations, in order to ensure that the recipient is not given an advantage which distorts or threatens to distort competition by strengthening the competitive position of the recipient. Fourth, in cases where the undertaking chosen to discharge PSO is not chosen pursuant to a public procurement procedure, the level of compensation must be determined on the basis of an analysis of the costs

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<sup>103</sup> SGEI Framework, para. 20-23

<sup>104</sup> Case C-280/00 Altmark, para. 75

<sup>105</sup> Case C-280/00 Altmark, para. 83

<sup>106</sup> Case C-280/00 Altmark, para. 87-88

which a typical well-run undertaking would have incurred in the discharge of such obligations.

Should all these conditions be fulfilled, the aid granted to the undertaking is to be considered as solely compensation for the performance of the PSO. As this compensation does not confer an advantage on the undertaking concerned, the aid granted is not to be considered as State aid.

## **5.2.4 Concluding remarks on State aid**

After a State measure has been notified to the Commission, it is possible to assess this measure in a number of different ways and according to different criteria. The first step of any assessment is to determine whether the State measure constitutes State aid, in other words, are the criteria in Article 107(1) TFEU fulfilled? At this stage, the Commission can rely on *Altmark* and determine that the measure does not constitute State aid since it does not confer an advantage on the undertaking in question. The Commission can also conclude that any of the other criteria set up in 107(1) TFEU are not fulfilled.

Should the Commission determine that the State measure is to be classified as State aid, the next step is to determine whether the State aid can be justified, based on either Articles 107 (3) TFEU or on Article 106(2) TFEU and the SGEI Framework. If the measure is regarded as justified, the State aid prohibition will not apply.

In the following Section, I will look into four Commission Decisions on State aid, in order to determine how the provisions described above are applied in practice.

# 6 The Commission Decisions

## 6.1 Ireland

### 6.1.1 Background

In October 2003, the Irish authorities notified to the Commission a scheme aimed at introducing PSO in order to stimulate new generation capacity. The purpose of the scheme was to ensure the security of electricity supply in Ireland.<sup>107</sup> The scheme was based on the Generation Adequacy Report for 2003-2009 prepared by the Irish Transmission System Operator. This report found that the Irish electricity market would be faced with a capacity shortfall from 2005 onwards. In order to maintain levels of electricity generation, there was a need to install additional power plants, the first one by 2005 and two additional ones by 2007 and 2009.<sup>108</sup>

### 6.1.2 Description of the scheme

In response to the report, the Irish Commission for Energy Regulation decided to initiate a process aimed at facilitating the development of new power plants on the Irish market. For this purpose, it was decided that Capacity and Differences Agreements (CADA) were to be signed with undertakings that were prepared to take on the construction of new power plants.<sup>109</sup>

The CADA were designed in the following manner. Undertakings wishing to take part in the scheme would have to participate in a bidding process. The CADA would be granted to the undertakings offering the cheapest conditions for generation of additional electricity.<sup>110</sup> The winners of the bidding process would be offered to sign the CADA for a period up to ten years and would under this period receive compensation, based on the size of capacity they made available for the generation of electricity.

### 6.1.3 The Commission's assessment

In its assessment concerning the presence of State aid, the Commission refers to the four conditions laid down by the Court in Altmark. Should these conditions be fulfilled, the state measure in question is not to be considered as State aid and would fall outside the application of the EU competition rules.

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<sup>107</sup> State Aid N 475/2003, paras. 1-2

<sup>108</sup> State Aid N 475/2003, paras 4-5

<sup>109</sup> State Aid N 475/2003, paras 6-7

<sup>110</sup> State Aid N 475/2003, para 16

The first Altmark condition states that the recipient undertaking has to be required to discharge clearly defined PSO. The Commission takes the stand that ensuring security of supply can be considered as a legitimate objective of general economic interest. The Commission bases its conclusion on several facts. The Commission refers to Article 3(2) of The Second Electricity Directive.<sup>111</sup> This provision allows Member States to impose public service obligations on undertakings that may relate to security, including security of supply. Further, the Commission emphasises that electricity is vital for the economy and the everyday life of European citizens and therefore it is necessary for the public interest to ensure an interruption-free supply of electricity.<sup>112</sup>

However, while recognizing that ensuring security of supply is a legitimate aim, the Commission establishes that there are limitations as to in what ways Member States can take measures in order to secure security of supply.<sup>113</sup> The Commission formulates a two-step test aimed to ensure that the aid measure is proportionate, more precisely; are there other measures that Ireland could take that would have less impact on competition and trade between Member States? The first step that needs to be taken by the Member State is to control growth of demand. Only when policies to control growth of demand are not sufficient to ensure security of supply, should the Member State look for measures in order to increase generation.<sup>114</sup> The second step is to develop new interconnections or alternatively to increase the capacity of already existing interconnections between Member States. This option is preferred as it encourages the integration of the internal market. However, in the view of the geographical situation of Ireland, the Commission recognises that it would not be economically rational to increase interconnections.<sup>115</sup>

Therefore, as it is not a viable option to safeguard security of supply by developing new interconnection infrastructure, the Commission holds that security of supply can be guaranteed by setting up reserve capacity. In other words, setting up reserve capacity can in itself be considered a SGEL, under certain conditions. The Commission notes that a distinction should be made between *normal capacity* and *reserve capacity*. *Normal capacity* is the capacity that the market would spontaneously cover, as private investors are likely to ensure that sufficient capacity is available to cover demand. *Reserve capacity* on the other hand is not likely to be covered by the market, as market players would not be ready to invest in order to meet additional capacity under extreme conditions, since such events are not frequent and unpredictable.<sup>116</sup>

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<sup>111</sup> The Second Electricity Directive has been replaced with the Third Electricity Directive. However the relevant provision can be found in the same Article 3(2) of the Third Electricity Directive.

<sup>112</sup> State Aid N 475/2003, para. 28

<sup>113</sup> State Aid N 475/2003, para. 30

<sup>114</sup> State Aid N 475/2003, para. 31

<sup>115</sup> State Aid N 475/2003, paras 32-34

<sup>116</sup> State Aid N 475/2003, paras. 34-35

The Commission concludes that Ireland has distinguished between *normal capacity* and *reserve capacity* and further that the existence of an urgent need for *reserve capacity* has been clearly and objectively shown in the General Adequacy Report. Further, the selection of the new capacity operators allows competitors based outside Ireland, provided that they can show that they are in a position to provide electricity to Ireland via interconnectors. Therefore the Commission concludes that the first Altmark condition is fulfilled.<sup>117</sup> After an investigation of the remaining Altmark criteria, the Commission concludes that the notified measure is not to be regarded as State aid.

## 6.2 Slovenia

### 6.2.1 Background

In February 2005, the Commission decided to open an infringement procedure against Slovenia, regarding the compatibility with the internal market of a certain state support scheme.<sup>118</sup> The scheme was introduced in Slovenia in 2001, with the dual objective of supporting the generation of electricity from renewable sources and to ensure security of energy supply from indigenous sources. For the purposes of this thesis, focus will solely be put on the second objective, namely security of supply.

Slovenia holds that it has, in accordance with Article 11(4) of The Second Electricity Directive<sup>119</sup> put in place a SGEI in the field of security of supply.<sup>120</sup> This provision gives a Member State the right to, for reasons of security of supply, give priority to generation of electricity using indigenous primary energy fuel sources, provided that this production does not exceed 15% of the overall primary energy necessary to produce the electricity consumed in the Member State concerned.

### 6.2.2 Description of the scheme

The Trbovlje Power Plant produces electricity out of Slovenian brown coal and will under the scheme be under the obligation to produce electricity from a specified amount of Slovenian brown coal, in accordance with Article 11(4) of the Second Electricity Directive. The scheme gives the right to the Trbovlje Power Plant to have its whole production purchased by the network operator to which it is connected and at a price that is fixed by the State on a yearly basis.<sup>121</sup> In turn, the network operators that have been put under the obligation to purchase the whole production of the Trbovlje Power Plant are entitled to recovery of the losses they have incurred from the

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<sup>117</sup> State Aid N 475/2003, paras. 37-45

<sup>118</sup> Case No C 7/2005

<sup>119</sup> Now Article 15(3) of the Third Electricity Directive.

<sup>120</sup> Case No C 7/2005, para. 44

<sup>121</sup> Case No C 7/2005, para. 11

purchase obligation through payments from a fund established by law.<sup>122</sup> These losses are mainly a result of that the network operators are obliged to purchase electricity at a price that might be higher than the market price.

In the decision to open proceedings, the Commission came to the preliminary conclusion that the above described scheme is contrary to EU law. First, the purchase obligation was to be considered as State aid within the meaning of Article 107 TFEU and second, that there were doubts as to whether the scheme could be considered as compatible with the internal market. More precisely, the Commission held it was not able to define a SGEI with which the Trbovlje Power Plant would have been entrusted.<sup>123</sup>

### **6.2.3 The Commission's assessment**

In its preliminary conclusion the Commission stated that it was not able to define a SGEI with which the Trbovlje Power Plant would have been entrusted. However, in its final decision, the Commission acknowledges that the compensation to the Trbovlje Power Plant might be considered as compensation for the costs incurred while providing a SGEI in the field of security of electricity supply. Further, the Commission states that in certain cases, the compensation might even not be considered as State aid. The Commission here refers to the four conditions set up by the Court in *Altmark*. The Commission then proceeds to assessing the Slovenian scheme according to the *Altmark* conditions.

The first condition stipulates that the recipient undertaking must actually have clearly defined PSO to discharge. Slovenian law entrusts the Trbovlje Power Plant with a security of supply obligation. Further, the Commission refers to its earlier decisions where it established that Article 11(4) of The Second Electricity Directive read in conjunction with Article 3(2) of the same Directive can be interpreted as providing the basis for public service obligations in the field of security of supply. Therefore, the Commission concludes that the first *Altmark* condition is fulfilled. A quick assessment of the three remaining criteria that are all regarded as fulfilled, lead the Commission to conclude that the notified measure is not to be regarded as State aid.

## **6.3 Latvia**

### **6.3.1 Background**

In December 2009 the Latvian authorities notified to the Commission the intention to grant aid to an undertaking for the construction and operation of a new thermal power plant.<sup>124</sup> Due to an increase in demand for electricity and the closure of the Ignalina Nuclear Power Plant at the end of 2009 and

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<sup>122</sup> Case No C 7/2005, para. 12

<sup>123</sup> Case No C 7/2005, paras. 13 and 17

<sup>124</sup> State Aid No. 675/2009, paras 1-2



the renovation of the Narva Power Plant as off 2016, Latvia will be faced with a shortage of electricity that might not be met by the available generation capacity.<sup>125</sup>

The shortage in supply will lead to that Latvia will increasingly rely on electricity imports. However, the possibility to import electricity is restricted due to limited interconnections with the neighbouring electricity markets. Latvia refers to that while the Baltic States are well interconnected with each other, there is a lack of interconnections with the other EU States, which leaves Latvia in an isolated position.<sup>126</sup> In addition, Latvia holds that demand management measures are insufficient to address the problems.

This leads the Latvian authorities to conclude that there is a need for the construction of additional generation capacity. Ideally, construction of new capacity should be left to the market players. However, Latvia puts forward a number of factors that are likely to discourage potential investors to make the necessary investments. Investors might be discouraged by the strong competition from possibly cheaper nuclear electricity, seasonal competition from hydropower during those times of the year when water levels are high or competition from the Russian or Belorussian generators that are able to produce electricity at a lower price. All these factors are likely to limit the profitability of any investment in new generation in Latvia.<sup>127</sup> On top of this, Latvia submits that demand side management measures would be insufficient to address the anticipated shortage in electricity supply. Therefore, the construction of new capacity is the only way to ensure that future needs will be sufficiently met.<sup>128</sup>

### **6.3.2 Description of the scheme**

The beneficiary to the scheme will be selected through a tender procedure. The grant will be offered to that undertaking that puts forward the cheapest offer, in other words the undertaking that requires the least amount of aid for building the power plant. An additional condition will be put on the applicants, namely that they will have to prove previous experience in the construction and operation of the power plant to be constructed. As no Baltic undertaking fulfils this criteria, the tender procedure will enable an undertaking from another Member State to enter the Latvian electricity market.<sup>129</sup>

The aid will be given to the undertaking chosen in the tender procedure in the form of a direct grant. The aid will be made subject to a number of conditions, such as a possible deduction should the undertaking not fulfil the condition of producing the minimum capacity agreed on in the tender. Further, a mechanism will be put in place in order to prevent

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<sup>125</sup> State Aid No. 675/2009, paras. 3-4

<sup>126</sup> State Aid No. 675/2009, paras. 5-6

<sup>127</sup> State Aid No. 675/2009, para. 7

<sup>128</sup> State Aid No. 675/2009, para. 8

<sup>129</sup> State Aid No. 675/2009, para. 10

overcompensation. The aid will be granted for a period of 10 years, from 2015 until 2025. The aid may be reduced or even terminated should the undertaking not produce the capacity agreed on in the tender.<sup>130</sup>

### **6.3.3 The Commission's assessment**

The Commission takes the view that the scheme proposed constitutes State aid as all the criteria in Article 107(1) TFEU are fulfilled. The decisive factor is that the measure will confer a competitive advantage on the undertaking winning the tender procedure. This excludes the application of Altmark. Therefore, the Commission has to assess whether the aid can be viewed as compatible with Article 107(3) TFEU. According to the Commission, in order to be compatible with Article 107(3) TFEU the aid needs to 1) *pursue an objective of common interest* and 2) *be necessary and proportionate*.<sup>131</sup>

#### **6.3.3.1 ...pursue an objective of common interest...**

The aid needs to be aimed at a well-defined objective of common interest. In this context, the Commission refers to the Security of Supply Directive, where it has been recognized by the EU that “*the guarantee of a high level of security of electricity supply is a key objective for the successful operation of the internal market*”.<sup>132</sup> The Commission adds that a secure supply of electricity is vital for the economy of the Member States, as well as the everyday life of European citizens. Ensuring that no break-down in electricity supply occurs in peak-demand periods or under certain weather conditions is necessary for the common interest. Therefore, security of electricity supply is a well-defined common interest.<sup>133</sup>

Having established that security of supply is an objective of common interest, the Commission goes on to investigate whether there is an actual risk to that security of supply. The Commission concludes that Latvia has managed to show risks to its security of supply. Primarily, Latvia managed to show that demand will not be met by future available supplies, mainly due to seasonal fluctuations affecting generation, such as low water levels and low temperatures. Further, Latvia managed to show that this excess demand will not be covered by imports, due to lack of interconnections with the other Member States and thus the isolation of the Latvian electricity market. Neither is it possible to cover the excess demand through electricity imports from Russia/Belorussia, since these interconnections are often loaded to the maximum.<sup>134</sup>

Very much related to the obligation to show a risk to security of supply, is the need to demonstrate that the market is unable to provide security of electricity supply. For this purpose, Latvia refers to several potential

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<sup>130</sup> State Aid No. 675/2009, paras. 11-13

<sup>131</sup> State Aid No. 675/2009, para. 21

<sup>132</sup> Recital 1 of the Security of Supply Directive

<sup>133</sup> State Aid No. 675/2009, para. 22

<sup>134</sup> State Aid No. 675/2009, paras. 23-28

obstacles that discourage investors from investing in new capacity. These are competition from cheap nuclear electricity that will be provided by a newly built nuclear power plant, competition from cheap hydropower during certain times of the years or potential competition from Russian or Belarusian electricity. These circumstances lead the Commission to conclude that the market itself is unable to generate the levels of electricity required to ensure a secure supply simply because there is not enough incentive for market players to invest in new capacity.<sup>135</sup>

### **6.3.3.2 ...necessary and proportionate...**

In addition to the requirement discussed above, namely that the State aid, in order to be compatible with EU law, needs to pursue an objective of common interest, the Commission holds that this objective needs to be pursued in a necessary and proportionate manner.

Therefore, the proposed scheme proposed needs to be an appropriate instrument to achieve security of supply, in other words, no other less distortive instruments are available to achieve the result. The Commission here proposes measures in order to improve energy efficiency or measures to manage demand as instruments that are regarded as less distortive. The Commission then concludes that these measures would not be sufficient to secure supply on the Latvian market.<sup>136</sup>

Additionally, the aid needs to provide enough incentive for the recipient in order to change their behaviour on the market. The Commission earlier established that the market players face no incentive to invest in new capacity due to fears of not being able to get a return on their investment. The Commission finds that the aid is suitable to influence the recipient to build new capacity.<sup>137</sup>

Lastly, the Commission states that the State aid measure needs to be proportional, that is, the selection process needs to be non-discriminatory and transparent. Here, the Commission concludes that the proposed scheme complies with relevant EU legislation on public tender, such as that the participants are not discriminated based on their place of establishment. Further, Latvia has shown that the aid granted will be kept to a minimum, where the undertaking that offers the lowest price will be chosen in the public tender procedure and with the possibility to reduce or terminate the aid.<sup>138</sup>

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<sup>135</sup> State Aid No. 675/2009, paras. 31-37

<sup>136</sup> State Aid No. 675/2009, paras. 38-39

<sup>137</sup> State Aid No. 675/2009, para. 42

<sup>138</sup> State Aid No. 675/2009, paras. 43-46

## 6.4 Spain

### 6.4.1 Background

In May 2010 Spain notified to the Commission a scheme for public service compensation granted to indigenous coal power plants.<sup>139</sup> The scheme has been designed with the objective to ensure security of energy supply. Spain observes several potential threats to security of supply on the Spanish energy market.

First, Spain refers to the increase in electricity production originating from renewable sources. This increase in use of renewable sources inevitably leads to a lower demand for electricity generated from coal power plants. One problem is that lower demand limits the revenues of the undertakings providing electricity generated from coal-fired plants, weakens their economic situation and might lead to their closure. Another problem is that the capacity for generation out of renewable resources is highly dependent on weather conditions and is therefore unreliable.<sup>140</sup> Second, Spain reminds of the isolation of the Spanish market from other electricity markets of Europe due to a lack of interconnections, making import and export difficult.

These factors combined make it possible for Spain to conclude that there is a need to support the existing coal plants, in order to ensure security of supply as these plants can guarantee a stability of generation.<sup>141</sup>

### 6.4.2 Description of the scheme

The scheme is based on a preferential dispatch mechanism for indigenous power plants. A preferential dispatch mechanism is designed in such a way that it gives priority to certain undertakings producing electricity above other undertakings when it comes making their electricity available for sale on the market. More precisely, ten power plants running on indigenous coal are selected and are subjected to the obligation to produce certain quantities of electricity out of indigenous coal. The volume of electricity that each of these plants has to produce will be determined on a yearly basis. Further, a weekly *operating plan* is drawn up for each of these coal plants, determining the weekly production. The electricity produced will then be offered on the market by the respective undertaking.<sup>142</sup>

The preferential treatment is activated when it comes to putting the generated electricity for sale on the market. Two alternatives are possible.

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<sup>139</sup> State Aid No 178/2010

<sup>140</sup> State Aid No 178/2010, paras. 16-20

<sup>141</sup> State Aid No 178/2010, paras. 16-20

<sup>142</sup> State Aid No 178/2010, paras. 35-37

First, the coal power plant can put the electricity produced on the market and succeed in selling it. If it is possible to sell the electricity originating from the indigenous coal power plants on the market, there is no need to take recourse to the preferential dispatch mechanism.

Second, the coal power plant might *not* succeed in selling the electricity produced, due to the price being too high or the coal power plant not being able to provide the amounts of electricity required. In this case, the preferential dispatch mechanism will be activated. The mechanism will give priority to the coal power plant to sell the amount of electricity specified in the weekly *operating plan*. This in turn will mean that competing generators not falling under the scheme will be “displaced”. In other words, they will not be allowed to sell their electricity on the market that specific day.<sup>143</sup>

### **6.4.3 The Commission’s assessment**

In the Spanish Decision, a number of third parties submitted comments, where they question the validity of Spain’s arguments related to the notified measure being regarded as a SGEI in the field of security of supply.<sup>144</sup> More precisely, the third parties hold that Spain is obliged to identify a specific and imminent threat to the security of electricity supply.<sup>145</sup> In the light of the comments submitted by third parties, the Commission considers it necessary to verify whether Spain has made a manifest error of assessment when concluding that the scheme in question constitutes a SGEI.<sup>146</sup> Therefore, the Commission begins its assessment of the notified measure by ascertaining the presence of a genuine SGEI.

Having concluded that Spain has not made a manifest error of assessment when determining that the notified measure is a SGEI, the Commission continues to determine whether the notified measure is to be considered as State aid. The Commission promptly concludes that the fourth Altmark condition is not fulfilled and that the criteria in Article 107(1) TFEU are fulfilled. Based on this the Commission concludes that the measure in question is to be considered as State aid.<sup>147</sup> Finally, the Commission assesses whether the State aid can be justified.

#### **6.4.3.1 Presence of a SGEI**

The Commission refers to previous Commission practice, case law of the Court and Protocol No (26) that all recognize the wide discretion enjoyed by national authorities in defining and organizing SGEI.<sup>148</sup> The Commission then refers to Article 11(4) of the Second Electricity Directive, that allows Member States to take measures ensuring the continued exploitation of indigenous fuels by setting up a preferential dispatch mechanism, with the

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<sup>143</sup> State Aid No 178/2010, paras. 38-41

<sup>144</sup> State Aid No 178/2010, paras. 90-91

<sup>145</sup> State Aid No 178/2010, para. 87

<sup>146</sup> State Aid No 178/2010, para. 91

<sup>147</sup> State Aid No 178/2010, paras. 106-111

<sup>148</sup> State Aid No 178/2010, paras. 77-81

objective of securing electricity supply. Further, Article 3(2) of the same Directive gives the Member States to impose PSO on undertakings in order to ensure security of supply. These two provisions combined provide the basis to impose PSO in the form of a preferential dispatch mechanism, for the purposes of security of supply.

Further, the Commission dismisses the argument that Spain is obliged to identify an imminent and specific threat to security of supply. On the contrary, the Commission lays down that Article 11(4) does not require the existence of specific and imminent risks. Further, the Commission again refers to the wide discretion afforded to the Member States in determining what should be regarded as a SGEI.<sup>149</sup>

The Commission establishes that Spain has not made a manifest error when determining that the notified scheme is a SGEI, based on the following facts. The Commission refers to the two threats to security of supply, as identified by Spain; the increase in production from renewable sources which competes with coal power plants and can result in their closure, and the isolation of Spain for the EU electricity market due to lacking interconnections which prevents imports of electricity.

The Commission notes that the data provided by Spain indeed confirms a reduction in production of electricity by indigenous power plants. Further, Spain has managed to show a fall in demand of electricity. These two factors lead the Commission to conclude that Spain's argument that there is a risk that indigenous power plants may be closed due to their insufficient profitability is valid.<sup>150</sup>

A solution to this expected risks to security of electricity supply would be to either increase import of electricity or to ensure investment in new power plants. The Commission here establishes that Spain has managed to show that interconnection levels will remain insufficient and import will not be a reliable source of electricity. Further, the investment in new power plants will be able to contribute towards security of electricity supply only in the long run and will thus not solve the short-term concerns that Spain is facing.<sup>151</sup>

All the above taken into account leads the Commission to conclude that back-up generation capacities are required in order to mitigate the risks to security of electricity supply. Therefore the Commission concludes that Spain has not made a manifest error in its justifications of the scheme.<sup>152</sup>

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<sup>149</sup> State Aid No 178/2010, para. 87

<sup>150</sup> State Aid No 178/2010, paras. 92-93

<sup>151</sup> State Aid No 178/2010, paras. 95-96

<sup>152</sup> State Aid No 178/2010, para 101

### 6.4.3.2 Compatibility of the State aid

The Commission's assessment is based on the SGEI Framework, described above in *Section 5.2.2*.

The first condition is formulated in paragraphs 9 and 10 of the SGEI Framework and requires the presence of a genuine SGEI. In the Section immediately above, I have outlined the Commission's argument when it lays down that the obligations imposed on the coal power plants indeed constitute a SGEI relating to security of supply. Therefore, the first condition of the SGEI Framework is fulfilled.

The second condition requires an instrument specifying the PSO and the methods for calculating compensation, according to paragraphs 11-13 of the SGEI Framework. The Commission here finds that the Spanish Royal Decree specifies the precise nature of the PSO, lists the coal power plants concerned, defines a clear method for calculating compensation *ex ante*, as well as enabling the compensation to be adjusted *ex post*, thus preventing overcompensation.<sup>153</sup> Therefore, also the second condition is fulfilled.

The third condition refers to the amount of compensation, more precisely which costs that can be included when establishing the size of the compensation. The costs to be taken into account are, according to Point 16 of the SGEI Framework, only the costs incurred in producing the electricity for the purposes of fulfilling the PSO. These costs include variable production costs, an appropriate contribution to fixed costs, an adequate return on the own capital assigned to SGEI, fuel costs, operation and maintenance costs, investment costs and so forth. Any other costs incurred by the undertaking are to be excluded. The Commission finds that the Spanish Royal Decree fulfils these criteria.<sup>154</sup>

The fourth and last condition, outlined in paragraphs 20-23 of the SGEI Framework, requires mechanisms to be put in place in order to identify and repay overcompensation. The Commission concludes that the annual review of costs laid down in the Spanish Royal Decree is sufficient in this respect.<sup>155</sup>

With all the above stated taken into account, the Commission concludes that the notified public service compensation fulfils the criteria laid down in the SGEI Framework. Therefore, the aid is to be considered compatible with Article 106(2) TFEU.<sup>156</sup>

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<sup>153</sup> State Aid No 178/2010, para. 132

<sup>154</sup> State Aid No 178/2010, paras. 136-143

<sup>155</sup> State Aid No 178/2010, para. 147

<sup>156</sup> State Aid No 178/2010, para. 148

# 7 Analysis

## 7.1 Introduction

Before going into the details of the four State aid decisions subject of this thesis, the following can be said. All four of the State aid measures were found compatible with the EU competition rules and the internal market. However, although all the State aid measures were approved, the Commissions line of argumentation and points of focus were different. In two of the Decisions, namely Ireland and Slovenia, the Commission used the conditions laid down by the Court in Altmark, and found that the notified measure should not be classified as State aid. In the Decisions concerning Latvia and Spain the Commission found that the notified measure was to be considered as State aid, but that the State aid could be justified and thus was compatible with the EU law.

I will argue that there are two levels of Commission control of the notified measures. The first level of control is used in situations where the Commission appraises the State measure according to the criteria set up in Altmark. These situations often coincide with Member States using Article 11(4) of the Second Electricity Directives as a ground for the State measure. I will show that in these cases, the extent or degree of review by the Commission is limited. The Commission repeatedly approves the notified measures without questioning the motives of the Member State, the necessity of the measure or the compatibility of the measure with the EU approach towards security of supply.

The second level of control comes into play when the Commission finds that the notified measure constitutes State aid. This calls into question whether the notified measure can be justified, with reference to the exceptions to the State aid prohibition in Articles 106(2) or 107 TFEU. In these cases, the Commission scrutiny is stricter as the Member State is obliged to demonstrate the presence of a SGEI, show a risk to security of supply as well as show that no other less restrictive measures are sufficient to remedy the risks to security of supply. In this context, I will discuss the justifying arguments put forward by the Member State and whether the Commission assessment of these justifying arguments is in line with the EU approach to security of supply.

## 7.2 The first level of control – no State aid

The Slovenian and Irish decisions are similar in the way that the Commission in these cases refers to Altmark and concludes that the notified measures are not to be regarded as State aid and should therefore not fall under the prohibition of Article 107 TFEU.



The first Altmark condition requires the presence of a SGEI that results in a clearly defined PSO that the undertaking in question has been entrusted with. With the intention to fulfil this condition and show the presence of a SGEI, Slovenia simply refers to Article 11(4) of the Second Electricity Directive (now Article 15(3) of the Third Electricity Directive) in conjunction with Article 3(2) of the same Directive. As described in *Section 4.3.1*, these provisions give the right to a Member State to impose on undertakings PSO that relate to security of supply as well as the right to give priority to the dispatch of generators using indigenous sources for energy production. In other words, Slovenia's approach is to prove the existence of a SGEI simply by referring to secondary legislation that gives the right to Member States to take measures to ensure security of supply.

The Commission accepts this and states that the mentioned provisions indeed provide a basis for PSO in the field of security of supply. Based on this and without further assessment of the scheme, the Commission concludes that the Trbovlje Power Plant has clearly defined PSO's to discharge.

The Slovenian decision can be contrasted with the Commission's assessment in the Irish Decision, which was delivered five years previously. For Ireland, it was not sufficient solely to refer to Article 3(2) of the Second Electricity Directive in order for the first Altmark condition to be fulfilled. Ireland also had to show that no other, less restrictive measures could deliver security of supply, and thus that the PSO were necessary. In the Irish Decision, the Commission formulated a two-step test that was meant to assess whether the legitimate objective to ensure security of supply could be achieved with different means whose effect on competition and trade between the Member States would be different. The Commission laid down that; 1) the priority should be to control growth in demand, and should these measures not be sufficient, 2) focus should be put on developing new interconnection infrastructure or increasing the capacity of existing interconnections.

From the above stated it is possible to conclude that Article 11(4) of the Second Electricity Directive is of great importance. In the Slovenian Decision, the Commission accepts Slovenia's reference to Article 11(4) of the Second Electricity Directive and simply confirms that the Slovenian measure is to be accepted as a SGEI in the field of security of supply. The Commission does not assess whether Slovenia has made an attempt to safeguard security of supply by managing demand or making use of interconnections in order to import electricity from other Member States, should this be needed.

In the Irish Decision, Article 11(4) of the Second Electricity Directive is not applicable. Here the relevant provision is instead Article 3(2) of the mentioned Directive. Based on my reasoning above, it can be deduced that the Commission in this case will evaluate the Irish measure more closely. This is also the case. The Commission finds it essential to determine

whether the Irish measure is in fact *necessary* in order to ensure security of supply. In other words, Ireland is required to justify the necessity of the measure. Thus, here the Commission control is stricter. It is not sufficient for Ireland merely to claim that the measure is necessary in order to safeguard security of supply, without providing arguments as to why the particular measure is necessary.

### **7.3 The second level of control – State aid but justified**

In contrast to the Irish and Slovenian Decisions, the Commission concludes that the Latvian and Spanish measures constitute State aid. The Commission therefore moves on to assess whether this State aid can be justified. Here, the Commission control involves more steps, and this makes the evaluation of the State aid different from the evaluation in the Irish and Slovenian cases.

In both of the Decisions, the Commission initiates by investigating whether the measures relate to a SGEI. In both of the Decisions, the Commission lays down that security of supply is an objective of common interest, based on references made to security of supply in secondary legislation as well as the importance of a secure supply of electricity for the economy of the Member States and the everyday life of citizens. Further, in the Spanish Decision, the Commission emphasises the wide discretion of the Member States to define SGEI. Thus, so far, the assessment is not different from the Irish and Slovenian Decisions.

The differences between the Decisions are detected only when looking at the next step in the assessment. After having established that security of supply is to be regarded as a SGEI, the next step is to establish whether there is a risk to security of supply, or to put it differently, whether the State aid is necessary in order to ensure security of supply. Here, the both Member States are required to show that the available supplies of electricity are not likely to meet the demand. Latvia did this by referring to the planned closure of several power plants, seasonal variations in generation capacity and lack of interconnections to the EU market. Spain did the same by referring to the decrease in demand for electricity leading to the possible closure of the coal power plants as well as a lack of interconnections.

Related to the obligation to show a risk to security of electricity supply is the requirement that no other measures are sufficient to mitigate the risks. For Latvia, the requirement was to show a market failure, in other words, an inability of the market to remedy the risks to security of supply. For Spain, the formulation is somewhat different. Spain is required to show that no other measures are sufficient to repair the risks to security of supply. However, in essence, these two requirements have the same effect.

It is at this stage that the greatest difference between the Decisions emerges. The Slovenian Decision is to be placed on one end of the spectrum. The Commission lays down that an application of Article 11(4) of the Second Electricity Directive in conjunction with Article 3(2) of the same Directive provides a basis for a Member State to impose PSO on undertakings and to compensate the undertaking for the performance of these PSO. Having established this, the Commission does not exercise further scrutiny of the measure. The Latvian and Spanish Decisions are to be found on the opposite end, where the Commission requires the States to show a risk to security of supply, as well as proof that the market is not able to mitigate these risks and that other, less restrictive measures are insufficient. The Irish case falls somewhere between these two extremes. The Commission recognizes security of supply as an objective of common interest by referring to Article 3(2) of the Second Electricity Directive. Still, the Commission recalls that there are limitations in EU law in terms of measures Member States are allowed to take to ensure security of supply. Consequently, Ireland is required to take measures to control growth of demand and to improve or develop interconnections, before resorting to more restrictive measures.

## **7.4 Conclusions on the scope of Commission control**

The account above makes it possible to distinguish a number of trends in the Commission control of the notified measures.

As can be read out of the Slovenian Decision, a Member State is not required to justify why a specific measure should be considered as a SGEI. On the contrary, the measure concerned is recognized as a SGEI simply by falling within the scope of application of Article 11(4). In the Spanish decision the Commission confirms this interpretation, when it states that a Member State is not obliged to identify a specific and imminent threat to security of electricity supply, in order to be able to rely on Article 11(4), since the provision does not mention this. This proves the strength of the provision and the wide discretion granted to the Member States when defining the measures necessary in order to ensure security of electricity supply.

Therefore, a Member State wishing to grant compensation to an undertaking that has been entrusted with the performance of PSO's in the field of security of supply is free to do so without to much interference from the Commission, if the Member State in question bases such a measure on Article 11(4) of the Second Electricity Directive. In this case the Commission will simply accept the Member States' assessment that the measure should be considered as a SGEI and that it is necessary to ensure security of supply.

This shows that security of supply has been granted a special status in EU law, as measures to ensure security of supply have been internalized in the

EU legal order. According to the Commission, there is a gradual substitution of the national dimension of security of supply by a common dimension. The Commission has on several occasions stated that security of supply is to be regarded as an essential public service objective. Further, according to Article 194 TFEU, the EU energy policy is aimed at ensuring security of supply in the Union. The successful attainment of these objectives implies the need for assessing the State measures in the light of criteria likely to serve the interests of security of supply at a EU level.

I have shown that this is not the case. Member States have very much retained the right to define what measures that are to be classified as SGEI in the field of security of supply. The analysis of the measures shows that the State measures are still very much limited national interests. Thus, the Member States have remained key players when it comes to providing short-term security of supply in the EU.<sup>157</sup>

On the one hand, it is understandable that Member should be allowed to take measures when a threat to a secure supply of electricity is anticipated. Energy supply is politically a very sensitive subject.<sup>158</sup> A secure supply of electricity is regarded as a service of particular importance, whose provision needs to be ensured even in cases where the market is unable to do so. In addition, matters related to energy are of high strategic importance for the national economies.<sup>159</sup>

On the other hand, it is questionable how this wide discretion awarded to the Member States is beneficial to the common EU approach on security of supply that the Commission has been trying to develop since the publication of the Green Paper on a European Strategy for the security of energy supply in 2000.<sup>160</sup> In order to overcome supply problems, the Commission emphasises coherence. A coherent and coordinated approach that looks beyond the interests of the individual Member States and takes the interest of the EU as a whole into account is necessary.<sup>161</sup> The question is therefore whether the measures taken by the Member States and approved by the Commission contribute towards the common EU approach for security of supply.

I argue that this is not the case and that the Commission's Decisions call for critical remarks on several grounds. I will below present the impact of the Decisions on the EU approach to security of supply, which as outlined in *Section 4.2* consists of the creation of a genuinely integrated internal market in energy and measures to manage demand.

The Commission has repeatedly pointed out that it views demand management to be an essential part in any security of supply policy. Indeed,

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<sup>157</sup> Glachant, 2008, p.14

<sup>158</sup> Glachant, 2008, p. 13

<sup>159</sup> Nowak, 2010, p. 27

<sup>160</sup> The substance of this Green Paper is discussed in Section 4.2

<sup>161</sup> Nowak, 2010, p. 35

the impact of energy efficiency on security of supply can be considerable.<sup>162</sup> It should be mentioned that the Commission does examine whether the Member States have taken measures on the demand management side. In the Irish Decision the Commission lays down that Ireland is obliged to take steps to control the growth of demand before resorting to other more restrictive measures. However, while stating that demand management should be the first step, the Commission does not assess whether Ireland in fact has taken any steps to manage demand. Thus, there is a failure of the Commission to implement the EU approach to security of supply on this particular point. Also in the Latvian Decision, a reference to demand management is made. Latvia contends that measures to control demand, such as energy efficiency measures in public housing, are in place, but that these measures are insufficient to address the problems to Latvian security of supply. The Commission agrees with Latvia.

In the Irish and Latvian Decisions, the Commission seems to follow the strategy outlined in the Green Paper stating that demand side management should be central in the EU approach towards security of supply. However, two shortcomings of the Commission approach are worth to mention. First, the Commission recognizes the importance of measures to manage demand, but does not shed light on according to what criteria it should be assessed whether a Member State actually has taken sufficient measures to manage demand. The result of this shortcoming is apparent in the Irish and Latvian Decisions, namely that the Commission seems to simply accept, without further scrutiny, a Member State declaration that measures to control demand have been taken. The second shortcoming is related to the fact that measures to control demand usually require substantial planning and investment in new technology, better infrastructure and so forth and are likely to produce a result only in the long run. Therefore, these measures are not suitable to address the short-term risks to security of supply.

In addition to demand side management, the creation of a genuinely integrated energy market is an essential part of the EU approach to security of supply. A fundamental element here is the sought-for increase in trade between the Member States. An increase in trade necessitates the existence of sufficient interconnections so that electricity can be distributed across borders.

Interconnections are mentioned in the Decisions in two different ways. In the Irish Decision, the Commission states that security of supply can be guaranteed simply by developing new interconnections between the Member States or by increasing the capacity of the existing interconnections. Better interconnections between the concerned Member State and other Member States would make it possible to share reserve capacity and would therefore reduce the need to take measures on the supply side for individual Member States. In other words, in addition to demand side management, the Commission requires the Member States to develop

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<sup>162</sup> Glachant, 2008, p. 15

new interconnection infrastructure or increase the use of existing interconnections, before resorting to other measures.

However, at the same time as better interconnections between the Member States are presented as a solution to EU supply problems, a lack of interconnections and the resulting isolation of the national electricity market is used as a justification by the Member States for State intervention.

In the Decisions concerning Ireland, Spain and Latvia, a reference is made to the geographical location, which leads to isolation from the other Member States and the Common market. The consequences of this isolation is that, in an event of disruption of electricity supply, it is not possible for these Member States to rely on imported electricity.

In the Irish Decision, the Commission considers the specific geographical situation of Ireland and concludes that the geographical situation of some Member States makes it impossible to connect these Member States to the rest of Europe, in an economically rational way. According to this reasoning, it is possible to draw the conclusion that the security of supply on the Irish electricity market can be ensured solely via national measures, leaving very little room for measures on a European level. Thus, to some extent, the Irish electricity market will always remain somewhat isolated from the rest of Europe.

Also in the Latvian Decision a reference was made to isolation of Latvia. Latvia's isolation is dependent on several factors. First, there are limited or no interconnections to Finland, Sweden and Poland. Second, the plans to construct and improve interconnections are still subject to negotiations with the concerned Member States and will not be materialized in the near future. Third, there are interconnections with Russia and Belorussia, but these interconnections are already subject to a risk of congestion and will not be able to carry additional capacity to Latvia in times of supply shortage in Latvia. Even if these interconnections could carry additional capacity to Latvia, Latvia argues that this is unlikely to happen, as the Russian and Belorussian markets often experience shortages in winter months and are therefore unlikely to export any electricity to Latvia.

Furthermore, also the Spanish Decision deals isolation of the Spanish electricity market, and just like in the Latvian Decision, the isolation is due to a lack of interconnections between the Spanish electricity market and the electricity markets of the neighbouring Member States.

From the account above, it is possible to distinguish different types of isolation. The isolation of the Irish market is based on Ireland's geographical situation. It is difficult to integrate the Irish electricity market with the rest of Europe in an economically rational way and therefore it is necessary to approve the Irish measure to finance PSO related to generation of additional capacity. In contrast, the isolation of the Latvian and the Spanish markets seems to result from, not the geographical situation of

those States, but on a lack of interconnections with other Member States and with third States. This makes it impossible for Latvia and Spain to rely on imported electricity in a time of shortages on the Latvian market.

It is necessary to comment upon the insufficient interconnections between the Member States and the lack of trade between Member States that this results in. As I have pointed out before, the focus of the Commission has ever since the initial liberalization of the electricity market been to develop the interconnections between the Member States in order to ensure that electricity shortages in one Member State can be balanced with the surplus generation on another Member State. In this way, a secure supply of electricity would be safeguarded on a EU level.

However, in the Decisions described above it is clear that the now existing interconnections are not sufficient to enable trade for the purposes of supplying those Member States that face a shortage of electricity supply. This leads the concerned Member States having to resort to measures aimed at securing electricity supply at a national level with solely the national interest in mind. Therefore, by approving the proposed measures, the Commission reinforces the trend of Member States taking measures with purely a national interest in mind. The Commission Decisions will do little when it comes to increasing the level of interconnections. On the contrary, undertakings wishing to embark on investing in interconnections will be faced with a competitive disadvantage compared to those undertakings that have been granted aid as a result of the Commission Decisions. Thus, the aid granted to the various undertakings will reinforce the existing national electricity markets, since it is aimed essentially at ensuring security of supply at a national level, where every Member State ultimately is responsible for ensuring its own security of supply. The EU dimension is at this stage non-existent.

## 8 Conclusion

The purpose of this thesis has been to analyze a number of Commission Decisions on State aid in the light of the common EU approach to security of supply.

I have been able to conclude the following. Member States have a wide discretion when it comes to defining and organizing SGEI in general, and security of supply in particular. This discretion is however subject to control by the Commission and the Court.

There are two levels of Commission control. The first level of control comes into play when Member States refer to what is now Articles 3(2) and 15(3) of the Third Electricity Directive. At this stage the Commission's review is limited. The Commission recognizes the right afforded by these provisions to the Member States to take measures to ensure security of supply and concludes that these measures are not to be regarded as State aid.

The second level of control is relevant in those situations when the notified measures constitute State aid. As State aid measures have an anticompetitive effect and can be detrimental to the internal market in electricity, the Commission control is stricter. Thus, the Member States have to show the existence of a SGEI, the necessity of the measure and that other, less restrictive measures are insufficient.

However, I have shown that even in the cases where the Commission control is strict, the Commission will recognize the justifications put forward by the Member States. This reinforces the image of security of supply still belonging to the national domain, where each Member State ultimately is responsible for its own security of supply. Further, I have shown that the national measures are likely to interfere with the common EU approach to security of supply that the Commission has been in the process of developing in the last decade.



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