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II

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COMMISSION

COMMISSION DECISION

of 8 July 1999

concerning the application of the United Kingdom of Great Britain and Northern Ireland for a transitional regime under Article 24 of Directive 96/92/EC of the European Parliament and of the Council concerning common rules for the internal market in electricity

(notified under document number C(1999) 1551/1)

(Only the English text is authentic)

(1999/791/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community,

Having regard to Directive 96/92/EC of the European Parliament and of the Council of 19 December 1996 concerning common rules for the internal market in electricity⁽¹⁾, and in particular Article 24 thereof,

Having informed the Member States of the application made by the United Kingdom of Great Britain and Northern Ireland,

Whereas:

(3) By letter of 16 October 1998, the United Kingdom Government submitted further information.

2. Structure of the electricity sector and the implementation of Directive 96/92/EC in Northern Ireland

(4) The present structure of the electricity sector in Northern Ireland stems from April 1992 when the electricity supply industry was restructured and privatised. The generation of electricity takes place mainly within four independent power producers organised as limited companies:

Ballylumford Power Ltd, now Premier Power Ltd

Belfast West Power Ltd

Coolkeeragh Power Ltd

Kilroot Power Ltd.

I. FACTS

1. Procedure

(1) On 30 January 1998, representatives of the Department of Trade and Industry in the United Kingdom gave an initial presentation on the content of the application for a transitional regime for Northern Ireland to the Commission.

(2) By letter of 18 February 1998, the United Kingdom Government applied for a transitional regime for Northern Ireland under Article 24 of the Directive.

(5) The total capacity of these plants is 2 063 MW. Two of the four generators produce more than 82% of this power. In addition, there are some small generators producing electricity from renewable energy sources.

(6) A separate company, Northern Ireland Electricity plc (NIE) is responsible for operating the transmission and the distribution network, for supply and for power procurement. NIE is, through its responsibility for power procurement, obliged to purchase all electricity generated by the main independent power stations. NIE is price regulated, while the producers are not.

⁽¹⁾ OJ L 27, 30.1.1997, p. 20.

(7) The electricity system of Northern Ireland is not connected to the system in the other parts of the United Kingdom and is linked to that of Ireland only through one interconnector. That 300 MW interconnector was restored in 1995 after 20 years of non-use and is providing spinning reserve for both systems. In the future, when trading systems in Northern Ireland and in Ireland develop, the use of the interconnector is expected to increase. A 250 MW interconnector to Scotland is also being planned.

(8) Directive 96/92/EC has still not being implemented in Northern Ireland. However, the intention is to introduce third party access based on published tariffs. The group of eligible customers will be defined as the largest customers required to meet the market opening in any year (see the minimum requirements for the market opening defined in Article 19(1) and (2) of Directive 96/92/EC).

3. The transitional regime notified by the United Kingdom Government

(9) The application, and this Decision, is limited to a transitional regime that concerns only the territory of Northern Ireland.

(10) The notification concerns the existence of power purchasing agreements between NIE and the abovementioned four main electricity generating companies which were put in place when the sector was restructured and privatised in 1992. Under those contracts, NIE is obliged to purchase its electricity requirements from the four generators. The payment consists of two elements: (i) an availability payment which is based on the availability and operating characteristics of the generating units and seeks to contribute to finance the fixed costs such as financing costs, salaries, return of investment; (ii) an energy payment which corresponds to the costs of purchasing and burning fuel and is calculated by reference to the contracted level of each generating unit, the thermal level, and the cost of fuel.

(11) The contracts expire between 2001 and 31 March 2024 at the latest. The contracts which have an expiry date beyond 2012 may, however, be cancelled as from 1 November 2010 if certain conditions are fulfilled.

(12) Problems may arise for NIE as the basis of the payment obligation of NIE to the generating companies remains unchanged under the existing power procurement obligations, even if the number of consumers supplied by NIE is reduced. As a high proportion of the payment from NIE to the generators is fixed, those costs will have to be recovered across a narrower customer base, which would mainly comprise non-eligible customers. The result would be an increase in the price of electricity for

those smaller customers. Those additional costs have been referred to as 'franchise customer excess costs'. Those costs should not only be borne by the captive customers but covered by all customers.

(13) The commitments in relation to the power purchasing agreements can be subdivided in the commitments set out below.

Stranded capacity

(14) With the implementation of Directive 96/92/EC, eligible customers will be able to choose their source of supply. If new authorised producers enter the market and they are able to sell the electricity to eligible customers, the capacity of the existing generating companies may exceed the demand for electricity in Northern Ireland. This situation may be influenced by the construction of an interconnector between Northern Ireland and Scotland as planned since 1991.

Excess costs linked to gas contract

(15) On 1 April 1992, a gas conversion agreement, which provides for the conversion of the oil-fired units at Ballylumford power plant to gas, was concluded between NIE and Ballylumford Power Ltd, now Premier Power Ltd. Most of the gas is bought under a form of a take-and-pay gas contract, 'Long-Term Interruptible 3'. That contract was concluded in 1992 and lasts until 2009 and contains prices which according to the notification are GBP 20 million per annum above prevailing market rates. The resultant costs are passed on to NIE under the power purchasing agreement.

Cost of gas pipeline

(16) The introduction of gas to Northern Ireland necessitated the construction of a gas pipeline from Twyholm, Scotland, across the North Channel to Islandmagee and the conversion of power station boilers from oil to gas. The costs involved were GBP 130 million for the pipeline and GBP 35 million for the conversion of the boilers.

Flue gas desulphurisation

(17) Finally, there may be costs which arise from possible future changes in environmental legislation such as the requirement to retro-fit flue gas desulphurisation equipment.

The extent of the stranded costs

electricity from NIE. The size of the CTC will be determined from that estimate.

- (18) The notification contains the following estimation of the stranded costs per annum (in GBP million):

Stranded capacity	0-25
Excess costs linked to gas contract	0-25
Cost of gas pipeline	0-14
Cost of flue gas desulphurisation	0-18
Total costs	0-82.

- (23) The CTC will be collected from all customers by the suppliers who will transfer it to NIE. It will be based on the electricity consumed in kWh and shown as a separate item on the customer's electricity bill.

- (24) At the end of each financial year, NIE will calculate the amount of overrecovery or underrecovery and the CTC for the following year will be corrected to ensure that the compensation does not exceed the franchise customer excess costs.

- (19) Such costs may occur until 2024 when the last power purchasing agreement expires. However, under the terms of the various licences issued to the generators and NIE, some of those agreements may be cancelled early in 2010, subject to certain conditions being fulfilled. The terms of the agreements may also be renegotiated with a view to reducing the overall stranded costs. The United Kingdom Government and the regulator stress in the notification that the stranded costs can only be accepted as eligible for compensation if such renegotiations have proven to be unsuccessful.

II. LEGAL ANALYSIS

1. **Legal basis: Article 24(1) and (2) of Directive 96/92/EC**

- (25) The United Kingdom Government notified an application for a transitional regime with respect to alleged commitments and guarantees of operation pursuant to Article 24 of Directive 96/92/EC.

Method of recovery

2. **Requirements of Article 24**

- (20) The notification has been drafted on the working assumption that any eligible stranded costs will be recovered through the introduction of a surcharge on the final electricity consumption. The United Kingdom Government, however, stresses that the possibility of sharing the costs between customers and the electricity industry must be considered carefully before any final decisions on the introduction of such a surcharge can be taken.

- (26) Article 24 of Directive 96/92/EC provides as follows:

'1. Those Member States in which commitments or guarantees of operation given before the entry into force of this Directive may not be honoured on account of the provisions of this Directive may apply for a transitional regime which may be granted to them by the Commission, taking into account, amongst other things, the size of the system concerned, the level of interconnection of the system and the structure of its electricity industry. The Commission shall inform the Member States of those applications before it takes a decision, taking into account respect for confidentiality. This decision shall be published in the *Official Journal of the European Communities*.

- (21) The working assumption envisages allowing NIE to recover the part of the stranded costs which cannot be recovered due to eligible customers not buying electricity from NIE by introducing a surcharge, a competitive transition charge (CTC), for the use of the electricity network. That amount is called franchise customer excess costs.

2. The transitional regime shall be of limited duration and shall be linked to expiry of the commitments or guarantees referred to in paragraph 1. The transitional regime may cover derogations from Chapters IV, VI and VII of this Directive. Applications for a transitional regime must be notified to the Commission no later than one year after the entry into force of this Directive.'

- (22) Three months before the end of each financial year NIE will prepare an estimate of franchise customer excess costs for the following financial year taking into account factors such as expected availability of generation subject to the power purchasing agreement, overall system demand and demand by eligible customers not buying

- (27) Article 24(1) and (2) of Directive 96/92/EC, in the light of the EC Treaty, thus require the following elements to be examined by the Commission, when considering any application for a transitional regime.
- (28) A. *Requirements concerning the nature of the commitments or guarantees of operation in question.*
- (1) The existence of a commitment or guarantee of operation must be proven.
 - (2) The commitment or guarantees of operation must have been given before 20 February 1997.
 - (3) A causal link between the entry into force of Directive 96/92/EC and the inability to respect the commitment must be established.
- (29) B. *Requirements concerning the measures proposed to achieve the objectives in question.*
- (1) The measures of the transitional regime must fall within the scope of derogations from Chapters IV, VI and VII of Directive 96/92/EC.
 - (2) The transitional regime must be of limited duration and linked to the expiry of the commitments or guarantees of operation in question.
 - (3) The transitional regime must apply the least restrictive measures reasonably necessary to achieve the objectives, which themselves must be legitimate. In deciding on these issues the Commission must take into account, amongst other things, the size of the system concerned, the level of interconnection of the system and the structure of its electricity industry.
- (32) The measures under consideration are based on a pure compensation scheme, that is a system of charges or levies implemented by a Member State in order to compensate for stranded costs caused by the application of Directive 96/92/EC.
- (33) The application of such levies in the present case do not require a derogation from Chapters IV, VI or VII of Directive 96/92/EC and cannot therefore be regarded as a transitional regime in the meaning of Article 24 thereof.
- (34) The fact that measures such as those under consideration in this case can result in very considerable distortions of the single market for electricity do not affect this conclusion. Indeed, the Commission recognises that the payment of such levies can result in economic consequences substantially similar to those resulting from a total or partial derogation from some of the obligations contained in Chapters IV, VI or VII of Directive 96/92/EC. However, such distortions by their very nature do not result from such a specific derogation as envisaged by that Directive. The transfer of a compensation payment to certain electricity producers, financed through a levy or charge on the consumers is, therefore, a measure which is not directly addressed by the Directive but one which needs to be examined pursuant to the rules on competition, and in particular Article 87(3)(c) of the EC Treaty. In this hypothesis, it is understood that measures of similar economic effect will be treated in a coherent manner, independently of the relevant procedure in each individual case.
- (35) In the light of the non-applicability of Article 24 of Directive 96/92/EC, it is not therefore necessary to assess the abovementioned further requirements A(1), (2), (3) and B(2) and (3).

3. Assessment of the United Kingdom transitional regime

- (30) In the present case, concerning the transitional regime as notified, it is not necessary to determine whether requirements A(1), (2), (3) or B(2), (3) are met, because the measures of the transitional regime do not require a derogation from Chapters IV, VI or VII of Directive 96/92/EC and thus do not meet requirement B(1).
- (31) As stated above, in order to constitute a transitional regime within the meaning of Article 24 of Directive 96/92/EC, the system chosen by the Member State must provide for a derogation from the requirements laid down by Chapters IV, VI or VII of Directive 96/92/EC.

4. Conclusion

- (36) The application for a transitional regime notified by the United Kingdom Government pursuant to Article 24 of Directive 96/92/EC has been assessed pursuant to Article 24(1) and (2) of that Directive. The Commission concludes that a transitional regime under Article 24 cannot and need not be approved in this respect, since the measures chosen do not constitute derogations from Chapters IV, VI and VII of the said Directive. The regime contains transfers of compensation payments to certain electricity producers, financed through a levy or charge on the consumers. Such measures are not directly addressed by Directive 96/92/EC but need to be examined pursuant to the rules on state aid, and in particular Article 87(3)(c) of the EC Treaty,

HAS DECIDED AS FOLLOWS:

Article 1

This Decision concerns the application of the United Kingdom for a transitional regime pursuant to Article 24 of Directive 96/92/EC, notified to the Commission on 18 February 1998 and completed on 16 October 1998. The notification concerns power purchasing agreements concluded between NIE and Ballylumford Power Ltd (now Premier Power Ltd), Belfast West Power Ltd, Coolkeeragh Power Ltd and Kilroot Power Ltd.

Article 2

The transitional regime notified by the United Kingdom Government contains no measures which would constitute

derogations from Chapters IV, VI or VII of Directive 96/92/EC, as defined by Article 24(2) thereof. Article 24 is, therefore, not applicable to the transitional regime notified by the United Kingdom Government.

Article 3

This decision is addressed to the United Kingdom of Great Britain and Northern Ireland.

Done at Brussels, 8 July 1999.

For the Commission

Christos PAPOUTSIS

Member of the Commission

COMMISSION DECISION

of 8 July 1999

concerning the application of France for a transitional regime under Article 24 of Directive 96/92/EC of the European Parliament and of the Council concerning common rules for the internal market in electricity

(notified under document number C(1999) 1551/2)

(Only the French text is authentic)

(1999/792/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

electricity, including imports and exports, is carried out by EDF.

Having regard to the Treaty establishing the European Community,

Having regard to Directive 96/92/EC of the European Parliament and of the Council of 19 December 1996 concerning common rules for the internal market in electricity⁽¹⁾, and in particular Article 24 thereof,

Having informed the Member States of the application submitted by France pursuant to Article 24(1) of Directive 96/92/EC,

Whereas:

**3. Liberalisation of the electricity market:
transposition of Directive 96/92/EC**

- (4) The new bill governing the electricity sector entitled 'Modernisation et développement du service public' (Modernisation and development of the public service) was given its first reading in Parliament in February 1999. The bill is expected to be voted on in September 1999.

- (5) The main focuses of the bill are as follows:

I. FACTS

1. Procedure

- (1) By letter of 19 February 1998 to the Commission, the French authorities applied to be covered by a transitional regime pursuant to Article 24 of Directive 96/92/EC.
- (2) Additional information from the French authorities concerning this application was received by the Commission on 4 November 1998.

2. Structure of the electricity sector in France

- (3) The electricity sector in France is characterised by the monopoly of *Électricité de France* (EDF) in the production, transmission and distribution of electricity. EDF is responsible for more than 90% of the production and distribution of electricity in France. All transmission of

— *eligible customers*: customers consuming more than 100 GWh per year will be eligible. This must represent the minimum required by the Directive, which is 26,48%. Distributors will be eligible only for their eligible customers,

— *new production installations*: France has opted for the authorisation procedure as part of a multiannual investment programme, with a subsidiary invitation to tender,

— *access to the network* by third parties will be governed on the basis of published transmission rates,

— EDF will remain a vertically integrated company. In order to comply with the Directive, its *accounts* for production, transmission, distribution and other activities will be separated. In addition, the *transmission network manager* will have to be independent in terms of the management of other activities not related to the transmission network,

— an independent electricity commission will be responsible for *regulating* the market. Its decision-making powers will be mainly limited to settling disputes.

⁽¹⁾ OJ L 27, 30.1.1997, p. 20.

4. *The transitional regime notified by the French authorities*

4.1. Introduction

(6) The French authorities have notified the following transitional measures in application of Article 24 of Directive 96/92/EC:

- contracts for purchasing the electricity produced by the 'peak' independent producers,
- commitments linked to the Superphénix fast breeder reactor,
- commitments linked to the financing of the special pension scheme for the employees of the electricity and gas industries.

(7) The transitional measure concerning the commitments linked to the financing of the special pension scheme for the employees of the electricity and gas industries was added to the notification by the letter of 4 November.

(8) This measure was not included in the initial notification of 19 February. The French authorities had, however, drawn attention to the problem of pensions in this notification, but did not include it because, in their view, Directive 96/92/EC did not cover social matters. Following the discussions on this aspect between the Commission and the Member States, the French authorities added this measure in the letter of 4 November.

4.2. Details of the measures notified

4.2.1. *Contracts for the purchase of the electricity produced by the 'peak' independent producers*

(a) Nature of the commitments

(9) EDF was under an obligation to buy the electricity produced during the peak-rate period by the small independent power stations — up to 8 MVA. This obligation stemmed from Decree No 55-662 of 1955, amended in 1994.

(10) The authorities removed the purchase obligation for new installations from January 1995. Any installation that had obtained the necessary authorisations before this date benefits from the favourable purchase conditions mentioned above.

(11) Remuneration conditions worsened considerably from 1993, but they were still enough to ensure that the operators of the small power stations continued to invest.

(12) In April 1997, a service contract between EDF and the French State provided for more substantial reductions in rates. New contracts known as 'dispatchable' contracts were concluded with the small 'peak' installations for a duration of 15 years, minus the period that had elapsed since the installations had been commissioned. The installations will be called solely on the basis of the needs of the electricity system. The remuneration comprises a fixed payment and remuneration for the energy supplied. An offer was made to any producers who did not wish to continue under these conditions to buy back their installations on the basis of the expenditure minus the income already received.

(13) The French authorities point out that EDF will no longer be able to bear the cost resulting from these contracts by means of its exclusive rights in the electricity sector.

(b) Amount of stranded costs

(14) The commitments resulting from 'dispatchable' contracts concluded between EDF and the independent producers concern installed power of 516 MW.

(15) The French authorities estimate that the commitment, limited to the foreseeable amounts to be paid in respect of the fixed payment under the contract, will be of the order of FRF 250 million (1997 value) per annum until the last contract expires in 2012.

(c) Recovery method

(16) EDF's costs would be financed by a fund supplied by a contribution payable by all users: suppliers, autoproducers and final customers who import or purchase electricity within the Community. The contribution would be based on the number of kWh supplied, purchased or produced. It would be divided up proportionally between the suppliers of eligible customers and the suppliers and non-eligible customers.

(17) No precise decision or method of calculation has been adopted so far. The French authorities presented the set of measures on a preliminary basis and subject to its examination by the French Parliament.

4.2.2. Commitments linked to the Superphénix power plant

- (25) The authorities presented the set of measures on a preliminary basis and subject to examination by the French Parliament.

(a) Nature of the commitments

- (18) Construction of the Superphénix fast breeder reactor began in 1976. Initial criticality took place in 1985. In 1994, the plant was transformed into a research facility.

4.2.3. Commitments linked to the financing of the special pension scheme

(a) Nature of the commitments

- (19) On 28 February 1997, the reactor was shut down. On 2 February 1998, the French Government decided that Superphénix would be permanently abandoned.

- (20) The NERSA company (51 % EDF, 33 % ENEL and 16 % SBK) was set up to build and run the power plant. SBK and ENEL ceased to be part of NERSA from 1 January 1998. EDF is responsible for all the expenditure involved in shutdown and decommissioning.

- (26) The national rules governing the employees of the electricity and gas industries establish a special pension scheme. The employers have made no reserve for these future commitments in the accounts.

(b) Amount of stranded costs

(b) Amount of stranded costs

- (21) The future expenditure to be met by EDF is estimated at around FRF 12,7 billion (1997 value) at the end of the 1998 financial year. This expenditure includes EDF's share for winding up NERSA, the resulting loss of equity and the back-end of the fuel cycle, and all expenditure for shutdown, post-operation and decommissioning of the power station.

- (27) The preservation of the staff rules will involve an additional cost, which will increase substantially from the year 2000. The French authorities point out that prior to liberalisation this additional cost could be covered by the exclusive rights of the employers on the electricity market. The authorities provide no calculation or estimate of this additional cost. They provide no information in the notification on future pensions or on any change in these staff rules in the new Electricity Act.

- (22) In the calculation, a loan granted by the Commissariat à l'Énergie atomique (Atomic Energy Commission) of FRF 2,1 billion has been deducted, on the assumption that reimbursement would not be necessary, as it was only payable in the event of sufficient availability of Superphénix.

(c) Recovery method

(c) Recovery method

- (23) EDF's costs would be financed from a fund made up of a contribution payable by all users: the suppliers, autoproducers and final customers who import or purchase electricity within the Community. The contribution would be based on the number of kWh supplied, purchased or produced. It would be divided up proportionally between the suppliers of eligible customers and the suppliers of non-eligible customers.

- (28) The method of recovery of this future expenditure is not indicated in the notification.

II. LEGAL ANALYSIS

1. Legal basis: Article 24(1) and (2) of Directive 96/92/EC

- (24) Owing to the fact that some of the payment dates are a long way off, and given possible developments in the areas of technology, safety, security and the environment, the estimates of future expenditure and the calculation of charges may be revised.

- (29) The French authorities applied to be granted a transitional regime with respect to alleged commitments and/or guarantees of operation pursuant to Article 24 of Directive 96/92/EC. However, no explicit derogation from the provisions of Chapters IV, VI or VII was requested.

2. *Requirements of Article 24(1) and (2) of Directive 96/92/EC*

(30) Under the terms of Article 24 of Directive 96/92/EC:

'1. Those Member States in which commitments or guarantees of operation given before the entry into force of this Directive may not be honoured on account of the provisions of this Directive may apply for a transitional regime which may be granted to them by the Commission, taking into account, amongst other things, the size of the system concerned, the level of interconnection of the system and the structure of its electricity industry. The Commission shall inform the Member States of those applications before it takes a decision, taking into account respect for confidentiality. This Decision shall be published in the *Official Journal of the European Communities*.

2. The transitional regime shall be of limited duration and shall be linked to expiry of the commitments or guarantees referred to in paragraph 1. The transitional regime may cover derogations from Chapters IV, VI and VII of this Directive. Applications for a transitional regime must be notified to the Commission no later than one year after the entry into force of this Directive.'

(31) Article 24(1) and (2) of Directive 96/92/EC (hereinafter referred to as 'the Directive'), in the light of the EC Treaty, thus require the following elements to be examined by the Commission when considering any application for a transitional regime.

A. *Requirements concerning the nature of the commitments or guarantees of operation in question*

- (1) The existence of a commitment or guarantee of operation must be proven.
- (2) The commitment or guarantee of operation must have been given before 20 February 1997.
- (3) A causal link between the entry into force of the Directive and the inability to honour the commitment must be established.

B. *Requirements concerning the measures proposed to achieve the objectives in question*

- (1) The measures of the transitional regime must fall within the scope of derogations from Chapters IV, VI and VII of the Directive.
- (2) The transitional regime must be of limited duration and linked to the expiry of the commitments or guarantees of operation in question.

(3) The transitional regime must apply the least restrictive measures reasonably necessary to achieve the objectives, which themselves must be legitimate. In deciding on these issues, the Commission must take into account, amongst other things, the size of the system concerned, the level of interconnection of the system and the structure of its electricity industry.

3. *Assessment of the French transitional regime*

3.1. 'Peak' producers

(32) In the present case of the transitional regime introduced by France concerning the commitments linked to the contracts for the purchase of the electricity produced by the 'peak' independent producers and those linked to the permanent shutdown of the Superphénix power plant, it is not necessary to determine whether the requirements A(1), (2), (3) or B(2), (3) have been met.

(33) This is because, as stated above, a transitional regime within the meaning of Article 24 of the Directive must provide for a derogation from the requirements laid down in Chapters IV, VI and VII thereof.

(34) The measures under consideration are based on a scheme of compensation or of levies and charges implemented by a Member State in order to offset stranded costs caused by the application of the Directive.

(35) The application of such levies does not require a derogation from the abovementioned chapters of the Directive and cannot therefore be regarded as a transitional regime within the meaning of Article 24 of the Directive.

(36) The measures in question do not come under the scope of the derogations from Chapters IV, VI and VII of the Directive and thus do not meet requirement B(1) above.

(37) The fact that measures such as those under consideration in this case can result in very considerable distortions of the internal market in electricity does not affect this conclusion.

(38) The Commission recognises that the payment of such levies can lead to economic consequences substantially similar to those resulting from a total or partial derogation from some of the obligations contained in Chapters IV, VI and VII of the Directive. However, such distortions, by their very nature, do not result from such a specific derogation as envisaged by the Directive.

- (39) The transfer of a compensation payment to certain electricity producers, financed through a levy or charge on the consumers is, therefore, a measure which is not directly addressed by the directive but one which needs to be examined pursuant to the rules on competition, and in particular Article 87(3)(c) of the EC Treaty. Under these circumstances, it is understood that measures of similar economic effect will be treated in a consistent manner, regardless of the relevant procedure in each individual case.
- (40) In the light of the non-applicability of Article 24 of the Directive, it is not necessary to assess requirements A(1), (2), (3) and B(2) and (3).

3.2. Superphénix

- (41) In the case of the transitional regime introduced by France concerning the commitments linked to the permanent shutdown of the Superphénix power plant, it is not necessary to determine whether requirements A(1), (2), (3) or B(2), (3) have been met.
- (42) This is because, as stated above, a transitional regime within the meaning of Article 24 must provide for a derogation from the requirements laid down by the Directive in its Chapters IV, VI and VII.
- (43) The measures under consideration are based on a compensation scheme or on charges and levies, implemented by a Member State in order to offset stranded costs caused by the application of the Directive.
- (44) The application of such levies does not require a derogation from the abovementioned chapters of the Directive and cannot therefore be regarded as a transitional regime within the meaning of Article 24 of the Directive.
- (45) The measures in question do not come under the scope of the derogations from Chapters IV, VI and VII of the Directive and thus do not meet requirement B(1).
- (46) The fact that measures such as those under consideration in this case can result in very considerable distortions of the internal market in electricity does not affect this conclusion.
- (47) The Commission recognises that the payment of such levies can lead to economic consequences substantially similar to those resulting from a total or partial derogation from some of the obligations contained in Chapters IV, VI or VII of the Directive. However, such distortions, by their very nature, do not result from such a specific derogation as envisaged by the Directive.

- (48) The transfer of a compensation payment to certain electricity producers, financed through a levy or charge on consumers, is therefore a measure which is not directly addressed by the Directive but on which needs to be examined pursuant to the relevant rules of the Treaties.
- (49) In the light of the non-applicability of Article 24 of the Directive, it is not necessary to assess requirements A(1), (2), (3) and B(2) and (3).

3.3. Commitments linked to the special pension scheme

- (50) The Commission takes the view that the information supplied by the French authorities concerning potential action to alleviate the difficulties of the special pension scheme for the employees of the electricity and gas industries is not sufficiently detailed to allow the commission to take a decision in accordance with Article 24(1) of Directive 96/92/EC,

HAS DECIDED AS FOLLOWS:

Article 1

This Decision concerns France's application for a transitional regime pursuant to Article 24 of Directive 96/92/EC, notified to the Commission on 19 February 1998 and supplemented on 4 November 1998. This notification concerns:

- (a) contracts for the purchase by *Électricité de France* (EDF) of the electricity produced by the 'peak' independent producers;
- (b) EDF's commitments linked to the Superphénix fast breeder reactor;
- (c) the commitments linked to the financing of the special pension scheme for employees of the electricity and gas industries.

Article 2

The transitional regime notified by France concerning the commitments entered into by EDF linked to the contracts for

the purchase of the electricity produced by the 'peak' independent producers, and the commitments entered into by EDF linked to the Superphénix fast breeder reactor, contains no measures which would constitute derogations from Chapters IV, VI or VII of Directive 96/92/EC, as defined by Article 24(2) thereof. Article 24 of Directive 96/92/EC is, therefore, not applicable to the transitional regime notified by the French authorities.

Article 3

The provisions concerning the commitments linked to the financing of the special pension scheme for the employees of

the electricity and gas industries are not approved by this Decision, in accordance with Article 24 of Directive 96/92/EC.

Article 4

This decision is addressed to the French Republic.

Done at Brussels, 8 July 1999.

For the Commission

Christos PAPOUTSIS

Member of the Commission

COMMISSION DECISION

of 8 July 1999

concerning the application of Luxembourg for a transitional regime under Article 24 of Directive 96/92/EC of the European Parliament and of the Council concerning common rules for the internal market in electricity

(notified under document number C(1999) 1551/3)

(Only the French text is authentic)

(1999/793/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community,

Having regard to Directive 96/92/EC of the European Parliament and of the Council of 19 December 1996 concerning common rules for the internal market in electricity⁽¹⁾, and in particular Article 24 thereof,

Having informed the Member States of the application of Luxembourg pursuant to Article 24(1) of Directive 96/92/EC,

Whereas:

for a system of regulated third party access. Eligible for network access are final consumers with more than 100 GWh yearly consumption, representing approximately 45 % of total national consumption.

- (5) The Luxembourg electricity supply market is shared between Cegedel, a majority State-owned company supplying 70 % of national consumption, and Sotel, a company owned by the heavy industry which supplies this industry as well as the railways, accounting for 30 % of national consumption. Since 1927 Cegedel has held a concession for distribution and exclusive public supply of electricity. Cegedel acts also as transmission system operator (TSO) and imports 92,8 % of its electricity needs from Germany on the basis of a long-term contract with RWE. The remaining 7 % is purchased from small private or public producers, mostly on the basis of hydropower and cogeneration.

I. FACTS

1. Procedure

- (1) By letter of 13 February 1998, the *Ministère de l'Energie du Grand-Duché de Luxembourg* notified to the Commission an application for a transitional regime according to Article 24 of Directive 96/92/EC.
- (2) By letter of 20 October 1998, the said Ministry submitted supplementary information to the Commission.
- (3) On 15 December 1998, a bilateral meeting between representatives of the said Ministry and the Commission took place.

2. The electricity sector and implementation of Directive 96/92/EC in Luxembourg

- (4) Luxembourg has not yet implemented Directive 96/92/EC. The draft law of 16 December 1998 provides

3. The transitional regime notified by the government of Luxembourg

- (6) The application notified by Luxembourg consists of several elements, referring to Article 24(1) as well as to Article 24(3) of Directive 96/92/EC.

3.1. Article 24(1) of Directive 96/92/EC

- (7) Luxembourg considers that the power procurement agreement between Cegedel and RWE (the actual contract parties being the Luxembourg State, *Société Électrique de l'Our SA* and *RWE AG*), initially concluded on 30 April 1963, several times amended and expiring on 31 December 2000, is to be regarded as a commitment within the meaning of Article 24(1) of Directive 96/92/EC. The contract contains an exclusive supply clause in favour of RWE. Cegedel, on the other hand, supplies large industrial consumers above 100 GWh yearly consumption, which will be eligible within the meaning of Directive 96/92/EC as of 19 February 1999. If these eligible customers were to choose a supplier other than Cegedel, RWE could review

⁽¹⁾ OJ L 27, 30.1.1997, p. 20.

its present supply tariffs to Cegedel. In order to protect the position of Cegedel, the Government of Luxembourg requests a transitional regime until 31 December 2000, the expiry date of the power procurement contract. The notification is not specific about the measures under the transitional regime.

3.2. Article 24(3) of Directive 96/92/EC

- (8) With respect to the small size of the Luxembourg system and the fact that Article 24(3) of Directive 96/92/EC specifically mentions Luxembourg, the Government of Luxembourg requests:

(a) derogation from Article 14(3) of Directive 96/92/EC, which states: 'They shall include a balance sheet and a profit and loss account for each activity in notes to their accounts.' Luxembourg requests that the balance sheet and profit and loss account for each of the activities to be separated (generation, transmission, distribution, non-electricity activities) need not be included in the notes to the published annual accounts, but only in the internal accounts;

(b) restrictive interpretation of Article 20(1) of Directive 96/92/EC '(i) independent producers and autoproducers to negotiate access to the system so as to supply their own premises and subsidiaries in the same Member State or in another Member State by means of the interconnected system'. Luxembourg requests that the definition of 'subsidiary' be based on Council Directive 83/349/EEC⁽²⁾, most recently amended by Directive 90/605/EEC⁽³⁾, which requires a minimum share of 50% to be held by the parent company, and that this access right be limited to situations where the autoproducer generates a surplus of electricity, and the supply of establishments and subsidiaries is limited to this surplus production.

II. LEGAL ANALYSIS

1. Legal basis: Article 24 of Directive 96/92/EC

- (9) The government of Luxembourg notified an application according to Article 24 of Directive 96/92/EC. The notification contains two parts which need to be assessed separately:

- an application for a transitional regime within the meaning of Article 24(1) and (2),
- an application for derogations for small isolated systems within the meaning of Article 24(3).

2. The transitional regime for the power procurement contract

2.1. The requirements of Article 24(1) and (2) of Directive 96/92/EC

- (10) Article 24 of Directive 96/92/EC states the following:

'1. Those Member States in which commitments or guarantees of operation given before the entry into force of this Directive may not be honoured on account of the provisions of this Directive may apply for a transitional regime which may be granted to them by the Commission, taking into account, amongst other things, the size of the system concerned, the level of interconnection of the system and the structure of its electricity industry. The Commission shall inform the Member States of those applications before it takes a decision, taking into account respect for confidentiality. This Decision shall be published in the *Official Journal of the European Communities*.

2. The transitional regime shall be of limited duration and shall be linked to expiry of the commitments or guarantees referred to in paragraph 1. The transitional regime may cover derogations from Chapters IV, VI and VII of this Directive. Applications for a transitional regime must be notified to the Commission no later than one year after the entry into force of this Directive.'

- (11) Article 24(1) and (2) of Directive 96/92/EC, in the light of the EC Treaty, thus requires all of the following elements to be examined by the Commission when considering any application for a transitional regime.

A. Requirements concerning the nature of the commitments or guarantees of operation in question

- (1) The existence of a commitment or guarantee of operation must be proven.
- (2) The commitment or guarantees of operation must have been given before 20 February 1997.
- (3) A causal link between the entry into force of the Directive and the inability to honour the commitment must be established.

B. Requirements concerning the measures proposed to achieve the objectives in question

- (1) The measures of the transitional regime must fall within the scope of derogations from Chapters IV, VI and VII of the Directive.

⁽²⁾ OJ L 193, 18.7.1983, p. 1.

⁽³⁾ OJ L 317, 16.11.1990, p. 60.

- (2) The transitional regime must be of limited duration and linked to the expiry of the commitments or guarantees of operation in question.
- (3) The transitional regime must apply the least restrictive measures reasonably necessary to achieve the objectives, which themselves must be legitimate. In deciding on these issues the Commission must take into account, amongst other things, the size of the system concerned, the level of interconnection of the system and the structure of its electricity industry.

2.2. Assessment of the Luxembourg transitional regime

A. Requirements concerning the nature of the commitments or guarantees of operation in question

- (12) With its notification, Luxembourg enclosed a copy of the power procurement contract in question. The contract parties are, on the purchasing side, the Luxembourg State, represented by Cegedel, and, on the selling side, RWE AG as well as the Luxembourg-based SEO SA. The contract was initially concluded in 1963 and has been renewed and amended several times. On 22 October 1990, an amendment was signed, Section 6 of which stipulated 31 December 2000 as the new expiry date.
- (13) In the light of these facts, the Commission considers the requirements A(1) and (2) to be fulfilled in the present case.
- (14) With regard to requirement A(3), it is necessary that the Member State is able to sufficiently demonstrate that the commitment in question would impose a specific burden or stranded cost, which is caused by the implementation of the Directive and which puts the obliged party in a position that makes it factually or economically impossible to honour or fulfil the commitment in question. This would be the case if the power procurement contract were of the take-or-pay type, stipulating a fixed quantity which as to be paid for by the buyer irrespective of whether or not he can resell this quantity at a selling price which covers the purchase price. In such a situation, stranded costs may occur and justify, if they reach an unacceptable burden, the application of a transitional regime.
- (15) However, the contract in question contains no such take-or-pay clauses, i.e. there are no long-term minimum quantities to be accepted by the purchaser. The contract is flexible, as the quantity of electricity (MWh) actually purchased/consumed is determined retrospectively. Also, the contract offers flexible terms to adapt capacity payments (MW) at relatively short intervals. Generally, the prices are indexed through formulas referring to coal prices and labour costs. Additionally, Section 9.2 of the contract contains an explicit general renegotiation right for either party if economic circumstances change significantly.
- (16) Consequently, in the event that eligible consumers currently supplied by Cegedel were to shift to another supplier, Cegedel could adapt its purchases from RWE. Thus, there is no danger that Cegedel could be in a position where it would have to take and pay for electricity from RWE which it cannot sell on to its customers.
- (17) It is true that the loss of customers may well lead to a situation where Cegedel loses market share. This may even result in lower profit margins as a result of fixed overheads or the loss of quantity discount offered by RWE. However, this is considered a normal commercial risk, which is indeed a consequence of the introduction of competition through Directive 96/92/EC, but not a stranded cost covered by Article 24 of this Directive.
- (18) The Luxembourg Government puts forward the exclusivity clause of the power procurement contract as an argument. RWE has an exclusive right to supply electricity for the public supply system in Luxembourg, with the exception of Cegedel autoproduction from hydropower or CHP as well as limited surplus feed-in from industrial autoproduction.
- (19) However, it is important to clearly differentiate between such an exclusivity clause and a take-or-pay clause as described above. Only take-or-pay clauses are able to produce stranded costs falling into the scope of Article 24 of the Directive. The fact that the exclusivity clause reduces the procurement choice of Cegedel does not constitute a commitment which cannot be honoured on the grounds that Cegedel might lose eligible customers. The fact that the quantity purchased from RWE might decrease is not in opposition to the exclusivity clause.
- (20) Nevertheless, the present Decision does not prejudice the compatibility of this or similar exclusivity clauses with the competition rules of the EU Treaty, in particular after liberalisation of the electricity market through implementation of Directive 96/92/EC. Furthermore, this Decision does not prejudice whether the right of distributors (Cegedel) to act as eligible customer for quantities consumed by eligible customers within their distribution system, as stipulated by Article 19(3) of Directive 96/92/EC might be in opposition to such an exclusivity clause.

(21) Concluding, the Commission considers that the contract in question is not of a nature to cause stranded costs for Cegedel, which can adapt its purchase quantities to the quantities actually sold by itself to its customers. Thus, there is no sufficient evidence that the entry into force of the Directive might render Cegedel unable to honor its commitments as required by Article 24(1) of Directive 96/92/EC.

B. Requirements concerning the measures proposed to achieve the objectives in question

(22) The notification contains a request for a transitional regime until 31 December 2000. However, the notification does not specify which measures the transitional regime would contain or apply. No requests for derogations from Chapters IV, VI and VII of Directive 96/92/EC are included with the notification.

(23) In the light of the above conclusion that requirement A(3) is clearly not met by the transitional regime according to Article 24(1) of the Directive, it is not necessary to further access the requirements concerning the measures of the notified regime.

(24) The notification does not indicate whether Luxembourg is planning any financial support mechanism to compensate the electricity undertakings involved. If such a financial support system were contemplated, it would need to be notified pursuant to Articles 87 and 88 of the EC Treaty.

3. Derogations on the grounds of the small size of the Luxembourg system

3.1. The requirements of Article 24(3) of Directive 96/92/EC

(25) Article 24(3) of Directive 96/92/EC states that: 'Member States which can demonstrate, after Directive 96/92/EC has been brought into force, that there are substantial problems for the operation of their small isolated systems, may apply for derogations from the relevant provisions of Chapters IV, V, VI, VII, which may be granted to them by the Commission. The latter shall inform the Member States of those applications prior to taking a decision, taking into account respect for confidentiality. This decision shall be published in the *Official Journal of the European Communities*. This paragraph shall also be applicable to Luxembourg.'

(26) This provision therefore requires the following elements to be examined by the Commission when considering any application for a transitional regime in such cases.

(1) This provision of Directive 96/92/EC is in principle applicable only to small isolated systems. Article 2(23) of Directive 96/92/EC defines a small isolated system as 'any system with consumption of less than 2 500 GWh in the year 1996, where less than 5% of annual consumption is obtained through interconnection with other systems.' Luxembourg is explicitly mentioned as an exception.

(2) The measures have to fall within the scope of derogations from Chapter IV, V, VI and VII of the Directive.

(3) Member States have to show, after entry into force of the Directive, that there are substantial problems for the operation of their small isolated systems.

(4) In deciding on each application, the Commission is applying the proportionality test, which means that the proposed approach must be the least restrictive to trade and competition reasonably necessary to achieve the objectives in question, which themselves must be legitimate.

3.2. Assessment of the requested derogations

3.2.1. Specificity of Luxembourg

(27) In the case of Luxembourg it is not necessary to assess whether it is a small isolated system according to the definition of Article 2(23) of Directive 96/92/EC, as Article 24(3) of the said Directive specifically and explicitly mentions its applicability to Luxembourg.

3.2.2. Derogation from Article 14 of Directive 96/92/EC

(28) Article 14(3), second sentence, states that: 'They (the integrated electricity undertakings) shall include a balance sheet and a profit and loss account for each activity in notes to their accounts.'

(29) Luxembourg requests that the balance sheet and profit and loss account for each of the activities to be separated (generation, transmission, distribution, non-electricity activities) need not be included in the notes to the published annual accounts, but only in the internal accounts.

(30) Luxembourg argues as follows. First, the small dimensions of the Cegedel system, and in particular of its transmission system, would make publication of

separate accounts for transmission and distribution an unnecessary administrative burden. Secondly, as Cegedel depends on one supplier for 90 % of its electricity needs, namely on the import contract with RWE, the electricity procurement costs of this contract should not become publicly known. This could have a negative impact on the bargaining position of Cegedel vis-à-vis competitors, who would only have to divulge the combined average costs of their electricity procurement. Third, the fact that all non-electricity activities are already outside the Cegedel accounts in a separate legal entity can justify Cegedel not being required to publish unbundled accounts.

- (31) As potential 'substantial problems' within the meaning of Article 24(3) of Directive 96/92/EC, two issues can be identified.
- (32) The first issue is the alleged administrative burden for Cegedel, if it had to publish its unbundled accounts. However, the publication requirement under Article 14 of Directive 96/92/EC does not apply to the specific separate accounts but only to the yearly balance sheet and the profit and loss account. The overall (bundled) annual accounts have to be published in any case. Also the unbundling of the ongoing internal accounting has to be ensured in any case. The proper separation of the ongoing internal accounting is definitely the principal administrative burden for the electricity companies. The mere inclusion of the corresponding balance sheet and profit and loss statement in the notes to the annual accounts, which have to be published in any case, is not considered to be a significant additional administrative burden.
- (33) The second issue is the alleged competitive disadvantage resulting from the possibility that the cost of the specific electricity procurement of Cegedel from RWE could become transparent.
- (34) Assuming that it is a legitimate objective of Luxembourg to avoid these procurement costs becoming transparent, it has to be assessed whether the proposed measures are the least restrictive measures reasonably necessary to achieve this objective.
- (35) One of the main purposes of the vertical separation between generation, transmission and distribution, which is achieved through a transparent unbundling of accounts combined with the unbundling of management of the transmission system operator based on Article 7(6) of Directive 96/92/EC, is to ensure non-discriminatory access to the transmission and distribution system as well as correct calculation and verification of the transmission fees which have to be paid by third parties for access to the system.
- (36) The transmission system and the transparency of the costs of the transmission system play a key role for the functioning of the internal market in electricity, particularly as the transmission system is used for transit and cross-border trade in electricity between Member States.
- (37) Therefore, of the four activities which need to be separated, namely generation, transmission, distribution and non-electricity activities, the transparency of transmission activity would appear to be the most significant.
- (38) The Commission considers that at least the yearly balance sheet and the profit and loss account for transmission activity should be published in the notes to the overall annual accounts. The separate inclusion of the balance sheet and profit and loss account for generation activity as well as for distribution activity could be suspended for a limited period of time, in order to allow Luxembourg to achieve the objective of protecting the cost data concerning the dominant procurement contract. This should be no less achievable if all activities except transmission are included in a combined balance sheet and profit and loss account.
- (39) As there is no time limitation to apply for derogations under Article 24(3) of Directive 96/92/EC, it appears reasonable to grant a derogation for a limited period until 31 December 2001. The Luxembourg Government has the possibility to request an extension of the derogation if considered necessary.
- (40) Concluding the assessment of requirements (2), (3) and (4), the following should be noted:
- (1) the requested measure does constitute a derogation from Chapter VI of the Directive;
 - (2) it is accepted that the consequences for the competitive position of Cegedel, if the specific procurement costs of one dominant supply source became public, represent a substantial problem within the meaning of Article 24(3) of Directive 96/92/EC;
 - (3) the objective of avoiding the transparency of this specific procurement cost is considered to be legitimate. However, Luxembourg has to apply the least restrictive measures reasonably necessary to achieve this objective. With regard to the importance of transparency concerning transmission activity in the context of intra-Community electricity trade, the publication of the balance sheet and the profit and loss account for transmission activity has to be maintained.

3.2.3. Interpretation of Article 20 of Directive 96/92/EC

- (41) Concerning this element of the Luxembourg notification according to Article 24 of Directive 96/92/EC, no specific regime or derogation is applied for. The notification is more a request for interpretation, and not an application for a derogation on the basis of Article 24(3) of the Directive. Thus, it cannot be element of a Commission Decision pursuant to Article 24.

(a) an application for a transitional regime pursuant to Article 24(1) and (2) of Directive 96/92/EC;

(b) an application for a derogation from Article 14(3) of Directive 96/92/EC pursuant to Article 24(3).

Article 2

Based on Article 24(1) and (2) of Directive 96/92/EC, a transitional regime in relation to the contract between the Luxembourg State, Société Électrique de l'Our SA and RWE AG, initially concluded on 30 April 1963 and amended on 22 October 1990, cannot be granted.

Article 3

Based on Article 24(3) of Directive 96/92/EC, a derogation from Article 14(3) is granted in so far as:

4. Conclusion

- (42) Luxembourg's application under Article 24 of Directive 96/92/EC contains three elements.

- (43) First, the request for a transitional regime on the basis of a power procurement contract. The Commission concludes that there is no sufficient evidence that the entry into force of Directive 96/92/EC might render Cegedel unable to honour its commitments as required by Article 24(1) of the Directive. Furthermore, the notification does not specify any concrete measures. Therefore, no transitional regime can be granted.

- (44) Secondly, a derogation from Article 14(3) of Directive 96/92/EC on the basis of Article 24(3) thereof. The Commission concludes that the derogation is granted in so far as Luxembourg may suspend the publication of separate balance sheets and profit and loss accounts for the generation and distribution activities of Cegedel until 31 December 2001. The publication of the separate balance sheet and profit and loss account for transmission activity has to be maintained.

- (45) Thirdly, the notification contains a request for interpretation of Article 20 of Directive 96/92/EC, which has to be dealt with outside the scope of the present Decision,

(1) Luxembourg may suspend the requirement for Cegedel to publish separate balance sheets and profit and loss accounts for generation and distribution activities in the notes to the annual accounts until 31 December 2001;

(2) Luxembourg shall ensure that the publication of the separate balance sheet and profit and loss account for the transmission activity of Cegedel is maintained.

Article 4

This decision is addressed to Luxembourg.

HAS DECIDED AS FOLLOWS:

Article 1

The present Decision concerns the following applications notified by Luxembourg to the Commission in its letters of 13 February 1998 and 20 October 1998:

Done at Brussels, 8 July 1999.

For the Commission

Christos PAPOUTSIS

Member of the Commission

COMMISSION DECISION

of 8 July 1999

concerning the German application for a transitional regime under Article 24 of Directive 96/92/EC of the European Parliament and of the Council concerning common rules for the internal market in electricity

(notified under document number C(1999) 1551/4)

(Only the German text is authentic)

(1999/794/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community,

Having regard to Directive 96/92/EC of the European Parliament and of the Council of 19 December 1996 concerning common rules for the internal market in electricity (hereinafter 'the Directive')⁽¹⁾, and in particular Article 24 thereof,

Having informed the Member States of the German application,

Whereas:

zur Neuregelung des Energiewirtschaftsrechts', which was published in the *Bundesgesetzblatt* on 28 April 1998⁽²⁾ and entered into force on the following day.

(4) On 14 July 1998, Commission representatives undertook a fact-finding mission to the *Bundesministerium für Wirtschaft* in Bonn. The Ministry confirmed that it regarded the application of 12 February 1998 as final and that, apart from the protection clause for lignite contained in the application, there were no other transitional regimes for which the Government would envisage support or aid schemes. The Commission requested additional information concerning the development of the lignite sector in the new *Länder* as well as on the contractual situation between the parties concerned, which is the basis of the commitments in accordance with Article 24(1) of the Directive.

(5) By letter of 11 September 1998, the Ministry submitted this additional information.

(6) Additionally, and in the agreement with the *Bundesministerium für Wirtschaft*, there was direct contact between the Commission and the company primarily concerned, Vereinigte Energiewerke AG (VEAG). VEAG set out its position in a letter to the Commission dated 28 January 1999. On 12 February 1999, a meeting between VEAG and the Commission took place in Brussels. By fax of 23 March 1999, VEAG submitted a report commissioned from chartered accountants evaluating the need for the lignite protection clause.

I. FACTS

1. Procedure

- (1) By letter of 30 July 1997, the German *Bundesministerium für Wirtschaft* (Ministry of Economic Affairs) asked the Commission to comment on, among other issues, the introduction into the German 'Gesetz zur Neuregelung des Energiewirtschaftsrechts' (Energy Act), of a protection clause for lignite-based electricity production.
- (2) By letter of 22 September 1997, the Commission replied that a protection clause including a possible refusal of system access would be a derogation from the access right under the terms of Article 17 of the Directive and could not therefore be based on Article 8(4) of the Directive, but would need to be applied for in accordance with the procedure set out in Article 24 of the Directive (transitional regime).
- (3) By letter of 12 February 1998, the German Ministry of Economic Affairs applied for a transitional regime in accordance with Article 24 of the Directive in relation to the provisions of Article 4(3) (new *Länder*) of the 'Gesetz

2. Structure and development of the electricity sector in the new *Länder*

- (7) Electricity transmission in the new *Länder* is carried out by VEAG. VEAG is also the largest electricity producer in the new *Länder*, accounting for approximately 60 % of total electricity production. VEAG produces 92 % of its electricity generation on the basis of lignite. Electricity distribution is organised by 15 regional distribution companies (in which VEAG or its shareholders often

⁽¹⁾ OJ L 27, 30.1.1997, p. 20.

⁽²⁾ BGBl. I, p. 730.

own shares). In addition, several municipalities own local electricity distribution companies, which also own generating facilities. Thus the structure of the electricity network in the new *Länder* consists of up to three levels, as in other parts of Germany: (1) VEAG's high-voltage grid; (2) the regional distribution companies' medium-voltage grids; (3) the municipal distribution companies' low-voltage or medium-voltage grids.

purchased 54,3 million for electricity production. Before reunification in 1989, East German lignite mines produced 300 million tonnes. Since then, output capacity has been gradually reduced to the current level.

- (8) In the period between the German economic and monetary union (1 July 1990) and political reunification (3 October 1990), the 'Stromvertrag' (power supply contract) was concluded on 22 August 1990 between the then German Democratic Republic and the *Treuhandanstalt* (Government trust for privatising East German property established by an Act of 17 June 1990) on the one side and Bayernwerk AG, PreussenElektra AG and RWE Energie AG on the other). The contract sets out the structure of the electricity sector in the new *Länder* following reunification. It provides for the sale of former East German power plants and transmission lines to VEAG, a joint venture company founded on 12 December 1990 by the *Treuhandanstalt*. VEAG was 75% owned by the three largest West German electricity companies, RWE Energie AG (26,25%), PreussenElektra AG (26,25%) and Bayernwerk AG (22,5%). The remaining 25% was held by four other German transmission system operators via the holding company EBH GmbH.
 - (9) As an integral part of the purchase agreement with the *Treuhandanstalt*, VEAG (or more precisely in 1990 its three main subsequent shareholders) committed itself to maintaining lignite-based electricity generation and to investing large amounts in modernising existing plants and bringing them into line with higher environmental standards. These commitments by VEAG were confirmed in a parallel contract concluded on 27 August 1990 between the consortium of Bayernwerk AG, PreussenElektra AG and RWE Energie AG (shareholders in VEAG) and the regional electricity companies. This contract was subsequently confirmed in a series of 20-year bilateral contracts between VEAG and the regional electricity companies. These contracts require the regional distributors to purchase 70% of their electricity consumption (i.e. the electricity sold by them) over 20 years from VEAG at a price based on full costs, with the distributors passing on any resulting higher costs to final customers.
- (11) Lignite mining in the new *Länder* is carried out by two major companies. Mibrag (Mitteldeutsche Braunkohle) was privatised in 1993 and sold to an Anglo-American consortium (PowerGen, NRJ Energy and Morrison Knudsen). Laubag (Lausitzer Braunkohle) was sold to a German consortium, 55% of which is owned by Rheinbraun AG/RWE, 30% by PreussenElektra AG and 15% by Bayernwerke AG. Thus, Laubag and VEAG are linked via common shareholders.
 - (12) In 1989, 138 800 employees were working in the lignite mining sector and 30 499 in the electricity production sector. Since then, employment has declined dramatically to a current level of 16 400 in the lignite mining sector and 8 163 in electricity production with VEAG. Thus, together with an additional 5 000 employees depending indirectly on lignite mining and electricity production, a total of 30 000 employees currently depend on the lignite sector.
 - (13) Since 1990, VEAG has invested DM 13 000 million in modernising lignite power plants. DM 2 000 million have been invested in lignite mining. VEAG's total investment plan amounts to DM 20 000 million, running until 2001.
 - (14) At the fact-finding meeting on 14 July 1998, the German Ministry of Economic Affairs drew the following conclusions from the above figures:
 - a further decrease in the use of lignite in electricity production would call into question the future of lignite mining as a whole,
 - a key consideration as to why German energy policy needs to protect lignite is long-term security of supply. German energy policy has to weigh increasing dependency on imported natural gas against the disadvantages of existing indigenous fuels such as lignite.

3. Development of the lignite mining sector

- (10) In 1997, VEAG produced 46,6 TWh of electricity from lignite, which accounts for approximately 60% of the total of 77,5 TWh of electricity produced in the new *Länder*. The remaining 40% is generated via municipal generators, autoproduction and generation by independent power producers (IPP). Lignite output in 1997 was 73,8 million tonnes, of which VEAG

4. The opening of the German electricity market to competition: implementation of Directive 96/92/EC

- (15) The German 'Gesetz zur Neuregelung des Energiewirtschaftsrechts' entered into force on 29 April 1998. It implements Directive 96/92/EC by opting for a

contract-based third party access system with a parallel single buyer option for distributors until 2005. The Act provides for an immediate 100% opening-up of the market: there is no eligibility threshold, all final consumers and distributors are, *de jure*, eligible customers.

- (16) Thus, under the liberalised system introduced by the new German Act, all eligible customers in the new *Länder* (all final consumers and all distributors) can contract for supplies from outside the VEAG system. However, in order to deal with the situation that would result if many consumers transferred their demand to competing suppliers, thus making it increasingly difficult if not impossible for VEAG to sell its lignite-based electricity, Article 4(3) of the Act provides for a transitional regime.

5. The transitional regime notified by the German Government

- (17) The notification of 12 February 1998 and the complementary information of 11 September 1998 define the following transitional regime.
- (18) The basis of the transitional regime is the VEAG investment programme for the construction and modernisation of lignite-based power plants with a financial volume of DM 20 000 million, which will be terminated around 2000. The programme is part of VEAG's commitment under the contract of 22 August 1990 between the then German Democratic Republic and the Treuhandanstalt on the one hand and Bayernwerk AG, PreussenElektra AG and RWE Energie AG (later VEAG) on the other. The programme must also be seen in the light of the 20-year commitment under the terms of the contract of 27 August 1990 between the consortium of Bayernwerk AG, PreussenElektra AG and RWE Energie AG (later VEAG) and the regional electricity companies, as well as the related series of bilateral contracts between VEAG and the regional electricity companies.
- (19) The proposed transitional regime provides for the possibility of refusing network access to eligible customers, in so far as the requirements as defined in Article 4(3) of the 'Gesetz zur Neuregelung des Energiewirtschaftsrechts' are fulfilled:

'(1) When assessing whether refusal to permit access to the system to supply customers in Berlin, Brandenburg, Mecklenburg-Western Pomerania, Saxony, Saxony-Anhalt and Thuringia with electricity pursuant to Article 1 (6) and (7) is impermissible or represents abuse, discrimination or unfair impediment as defined in Section 22, paragraph 2 and Section 26, paragraph 2 of the Act against restraints of competition, particular

attention shall be given to the need for a sufficiently high level of power generation from lignite from these *Länder*.

(2) The Federal Ministry for Economic Affairs shall report to the German Bundestag in 2002 on the impact of this provision on power generation from lignite and on the electricity price trend in the *Länder* listed in paragraph 1. In so far as this arrangement is not extended until 31 December 2005 on the basis of that report, this transitional provision shall expire on 31 December 2003.'

- (20) Thus, in principle, all clients in the new *Länder* as well as in the remainder of Germany are eligible. However, if a significant number of such clients choose to purchase from new suppliers, the distributors tied to the 70% purchase obligation from VEAG may lose sales, thereby purchasing less electricity from VEAG. In such circumstances, VEAG itself would lose market share, making it difficult in turn to maintain lignite purchases and resultant electricity generation. If this occurs, VEAG and, according to the wording of the law, the distributors may decide to refuse network access to eligible customers, requiring customers *de facto* to purchase more expensive, lignite-based electricity supplied by VEAG. Any such refusal is potentially subject to the control of the *Bundeskartellamt*, which will decide whether the refusal was reasonable and necessary in order to meet the need to maintain lignite production.

II. LEGAL ANALYSIS

1. Legal basis: Article 24 of Directive 96/92/EC

- (21) The German notification of 12 February explicitly applies for a transitional regime pursuant to Article 24 of the Directive. It also, however, contains a declaration that the German Government considers the regime laid down in Article 4(3) of the German Act is already covered by Article 8(4) of Directive 96/92/EC. Originally, in the memorandum to the draft Act of March 1997, the Government justified this provision on the grounds of Article 8(4) of the Directive (dispatching priority for indigenous fuel sources to cover up to 15% of consumption). This approach was also taken in the official application of 12 February 1998 for the transitional regime in accordance with Article 24 of the Directive.
- (22) However, Article 8(4) of the Directive does not apply to the scheme as notified.

(23) Article 8(4) of the Directive states:

'A Member State may, for reasons of security of supply, direct that priority be given to the dispatch of generating installations using indigenous primary energy fuel sources, to an extent not exceeding in any calendar year 15% of the overall primary energy necessary to produce the electricity consumed in the Member State concerned.'

(24) Although electricity from lignite in the new *Länder* represents less than 15% of electricity production in Germany as a whole, it represents approximately 60-70% of electricity production in the new *Länder*. This high percentage is not spread over the whole of Germany under a pure dispatching obligation in accordance with Article 8(4) of the Directive, but is locally protected by potentially refusing access to customers wishing to make use of the possibility of purchasing elsewhere, via network access, an essential requirement of the Directive defined in its Chapter VII.

(25) The provision for priority treatment under Article 8(4) under no circumstances justifies refusal of an application for network access or transmission. Article 8(4) is explicitly limited to making provision for a maximum of 15% to be purchased from plants using indigenous fuels. Article 8(4), as well as Article 8(3), have to be seen as special provisions in the context of the general merit order principle as laid down in Article 8(2). The present mechanism — potentially refusing access to the network for bilateral purchasing contacts between eligible clients and producers — clearly falls outside the scope of this provision.

2. The requirements of Article 24

(26) Article 24 (1) and (2) of Directive 96/92/EC require the following elements to be examined by the Commission in the light of the EC Treaty when considering any application for a transitional regime.

2.1. Requirements concerning the nature of the commitments or guarantees of operation in question

(27) (1) The existence of a commitment or guarantee of operation must be proven.

(2) The commitment or guarantee of operation must have been given before 20 February 1997.

(3) A causal link between the entry into force of the Directive and the inability to honour the commitment must be established.

2.2. Requirements concerning the measures proposed in order to achieve the objectives in question

(28) (1) The measures of the transitional regime must fall within the scope of derogations from Chapters IV, VI and VII of the Directive.

(2) The transitional regime must be of limited duration and linked to the expiry of the commitments or guarantees of operation in question.

(3) The transitional regime must apply the least restrictive measures reasonably necessary to achieve the objectives, which themselves must be legitimate. In deciding on these issues the Commission must take into account, amongst other things, the size of the system concerned, the level of interconnection of the system and the structure of the electricity industry in the Member State in question.

3. Assessment of the German transitional regime

3.1. Requirements concerning the nature of the commitments or guarantees of operation in question

(29) The information contained in this Decision concerning the legal and contractual situation at the time of German reunification in 1990 is based upon the description of the relevant contracts provided by the German Ministry of Economic Affairs by letter of 11 September 1998. Two sets of contracts are mentioned therein:

(i) the contract of 22 August 1990 between the German Democratic Republic and the Treuhandanstalt on the one hand and Bayernwerk AG, PreussenElektra AG and RWE Energie AG on the other;

(ii) the contract of 27 August 1990 between the consortium of Bayernwerk AG, PreussenElektra AG and RWE Energie AG (later VEAG) and the regional electricity companies, as well as the series of subsequent bilateral contracts between VEAG and the regional electricity companies.

(30) The central commitment within the meaning of Article 24(1) is the investment commitment by Bayernwerk AG, PreussenElektra AG and RWE Energie AG, represented in

VEAG, based on the *Stromvertrag* of 22 August 1990. VEAG not only took over production and transmission facilities but, as part of the contract package, committed itself to a DM 20 000 million investment programme to modernise the lignite sector.

- (31) This investment commitment was based on a long-term guaranteed minimum delivery of electricity and a corresponding amortisation of the investment. To this end, the central *Stromvertrag* is complemented by 20-year power purchase agreements with downstream distributors.

- (32) This in 1990, VEAG undertook the investment commitment on the basis of the guaranteed 20-year electricity purchase agreements, which themselves were ultimately based on, or guaranteed by, the monopoly supply of captive consumers, which was the situation prior to liberalisation of the German electricity market in April 1998.

- (33) The German Government considers that this investment commitment may not be honoured under the liberalised system if not protected until 2003 with the clause relating to potential refusal of access. This is because of the concern that lignite-sourced electricity will be more expensive than electricity from other sources, particularly due to the very heavy investment obligations on VEAG arising from modernisation requirements. If this is correct, and VEAG is unable to make the necessary improvements in efficiency to compete at market prices, purchases from distributors linked to VEAG by the 70% purchasing obligation will decrease as eligible customers source elsewhere, leading to falling sales by VEAG. Under these circumstances it does appear correct that, with regard to VEAG, a commitment or guarantee of operation had been entered into prior to the entry into force of the Directive, and that fulfilment of this commitment is endangered by the entry into force thereof.

- (34) The Commission therefore considers that:
 - (1) a commitment or guarantee within the meaning of Article 24(1) of the Directive exists;
 - (2) such commitments or guarantees of operation were given prior to the entry into force of the Directive;
 - (3) the necessary causal connection between the inability to fulfil the commitment and the entry into force of the Directive has been sufficiently established for the VEAG commitment arising from

the investment in lignite production capacity. It can be assumed that in 1990 Bayernwerk AG, PreussenElektra AG and RWE Energie AG would not have undertaken the lignite investment commitment if there had been no guaranteed delivery, ultimately based at that time on a captive market. It can further be assumed that 100% liberalisation, defining all categories of customer as eligible customers within the meaning of the Directive, might well lead to a situation where VEAG may not be in a position to complete its DM 20 000 million investment programme, which will not be completed until 2000, if no transitional regime is established.

3.2. Requirements concerning the measures proposed to achieve the objectives in question

- (35) 1. *The measures in question fall within the scope of derogations from Chapters IV, VI and VII of Directive 96/92/EC.*

- (36) The German transitional regime refers exclusively to the protection clause of Article 4(3) of the Energy Act. It gives transmission system operators the right to deny network access on a case-by-case basis in order to guarantee sufficient delivery of electricity from lignite-fired power plants. Refusal of access on the grounds of guaranteeing sufficient delivery of electricity from lignite-fired power plants is not covered by Article 17(5) of Directive 96/92/EC, which only refers to the lack of necessary transmission or distribution capacity and duly substantiated reasons with regard to notified public service obligations as defined in Article 3 of the Directive. Germany has not notified any public service obligations under Article 3 of the Directive.

- (37) Consequently, the German transitional regime represents a derogation from Article 17(5) in Chapter VII of the Directive. Such a derogation falls under the measures mentioned in Article 24(2). Article 24 is therefore applicable.

- (38) 2. *The transitional regime is of limited duration and is linked to the expiry of the commitments or guarantees of operation in question.*

- (39) The German transitional regime is of limited duration, namely until 31 December 2003. The Act provides for the possibility of an extension until 31 December 2005, depending on the outcome of a report which the Ministry must present to the Bundestag in 2002

regarding the impact of the transitional regime on power generation from lignite and electricity price trends in the new *Länder*.

(40) The Commission therefore considers this Decision regarding a transitional regime to be valid until 31 December 2003. Should Germany decide in 2002 to extend the transitional regime until 31 December 2005, this additional period would at that stage have to be the subject of a complementary application to the Commission requesting an extension of the transitional regime.

(41) Whilst the Commission is not at present considering extending the derogation from the Directive granted by this Decision, such an eventuality is not completely excluded. It would be difficult to envisage such an extension as being compatible with the Directive were it to be long term in nature, for example extended beyond 2005. However, it is not necessary to address this issue at present.

(42) 3. *The transitional regime has to apply the least restrictive measures necessary to achieve the legitimate objectives, taking into account, amongst other things, the size of the system concerned, the level of interconnection of the system and the structure of the electricity industry in the Member State concerned.*

3.1. Legitimate objectives

(43) The objective pursued by the scheme in question is to permit VEAG to honour the lignite investment commitments entered into and to meet the legitimate expectations related to these commitments. As a background element, Germany further justifies the objective of the transitional regime with two additional arguments. Firstly, the specific economic situation of the new *Länder* and the need for a socially and environmentally acceptable restructuring of the energy sector in this region. A further decrease in the use of lignite for electricity production would call into question lignite mining activities as a whole. Secondly, Germany argues that the measures are necessary in terms of long term security of supply. The continued use of electricity produced from lignite is part of overall German energy policy which attempts to weigh increasing dependency on imported natural gas against the environmental and cost disadvantages of existing indigenous fuels such as lignite.

(44) On the basis of these three considerations the Commission considers the objectives pursued by Germany to be legitimate.

3.2. The least restrictive measures taking into account, amongst other things, the size of the system concerned, the level of interconnection of the system and the structure of the electricity industry in the Member State concerned

(45) Under the new German Energy Act, all eligible customers (all final consumers and all distributors) may contract supplies from outside the VEAG system. Article 4(3) of the German Act is designed to provide a potential limit to purchases of electricity from outside the VEAG system where this would result in severe difficulties in continuing to operate lignite-fired power plants.

(46) In practice, such an occurrence cannot be excluded. According to the German Government, the electricity produced by VEAG on the basis of lignite is not only more expensive than electricity provided from other sources such as natural gas, but even more expensive than lignite-based electricity from the western *Länder*. The uncompetitive situation of east German lignite has been explained by the amortisation of the high investments in modernisation. As most of these costs are fixed, a significant fall in VEAG electricity sales would increase the cost burden on remaining customers.

(47) If VEAG lost significant sales due to eligible customers purchasing elsewhere, this would, as mentioned above, endanger its lignite-based electricity production and its ability to fulfil its investment and modernisation commitments. The transitional regime would enable it to refuse these eligible customers access to its transmission network. These eligible customers would therefore be obliged to continue to purchase more expensive, lignite-based electricity from VEAG.

(48) The Commission considers that Germany has sufficiently demonstrated that the transitional regime is a possible measure to achieve the objectives in question. However, the practice in other Member States shows that there are alternative solutions for stranded cost problems. Therefore, specific attention must be given to the question of whether the German transitional regime applies the least restrictive measures possible in order to achieve the objectives in question.

(49) The German Government considers that, in the light of the particular circumstances in question, the current solution is less restrictive to trade and competition than the alternative, namely statutory quotas for lignite, possibly financed by a levy on all electricity consumption in Germany. This is due to the temporary nature of the support scheme, and in fact that it is

not possible to determine whether protection will in fact be necessary. The proposal states only that the *Bundeskartellamt*, when judging disputes over refusal of access, must consider the lignite issue among other arguments, notably capacity restraints. According to the government, this is only likely in rare cases to lead to a refusal of access and would only exist in principle until 2003. Furthermore, this approach has the advantage that it would not affect the contracts between VEAG and the regional distributors. Under these circumstances, it is argued, the present approach taken by the German Government ensures that market distortion will occur only if, and in so far as, necessary.

(50) In the light of the specific circumstances of the case, and in particular (i) the limited area concerned in comparison to the size of the entire German system, (ii) the lack of certainty that any protection will in fact be necessary, and (iii) the strictly limited timescale, the Commission considers that such a scheme is indeed a reasonable method of achieving the objectives in question. It is not possible to demonstrate that other schemes, such as those based on levies, would be less restrictive of trade and competition than the transitional regime as notified, given the very special circumstances under consideration here.

(51) However, two caveats are necessary in this respect regarding certain details of the transitional regime as notified: firstly, the possibility for regional transmission/distribution system operators to refuse network access pursuant to this scheme, and secondly the need to ensure that clearly defined, non-discriminatory, transparent and verifiable criteria exist regarding the right to refuse access.

3.2.1. *The possibility for regional transmission/distribution system operators to refuse network access*

(52) The wording of Article 4(3) of the German Act does not specifically restrict to VEAG the right to refuse network access. It would also, subject to ex-post approval by the *Bundeskartellamt*, allow regional transmission/distribution system operators to implement the clause and to deny access to their networks. However, in fact only VEAG is substantially affected through its investment commitment in electricity production. The regional electricity companies are neither producing electricity from lignite nor ([...])(*); their only obligation is to

procure 70% of their sales from VEAG). Under these circumstances, it does not appear necessary to allow the regional transmission/distribution companies to refuse network access on the grounds of the need to ensure adequate production from lignite.

(53) Firstly, the regional distribution/transmission companies are not in a position to determine whether falling demand from their customers for electricity, resulting in reduced purchases from VEAG, will actually endanger continuing production by VEAG of electricity from lignite. Only VEAG, which can take into account purchases by all distributors and individual eligible customers, can determine this. Secondly, as the distributors have no direct or commercial interest in lignite production, any need that they might experience to restrict access to their networks might be based more on commercial considerations than on the need to maintain lignite production. This, combined with the impossibility for regional distribution/transmission companies to determine in practice whether falling sales on their part would prejudice VEAG's overall lignite-based production, makes it inappropriate to permit regional distribution/transmission companies to refuse access on these grounds. Consequently, only VEAG, entitled on the basis of a commitment within the meaning of Article 24(1) of the Directive, should be in a position to invoke the protection clause.

(54) Moreover, it would significantly compromise the market position of eligible customers if they had to face not one potential access dispute settlement with the transmission system operator, but possibly two, one on the level of the distribution network and the other on the level of the transmission network.

(55) A further issue raised by Germany in this respect concerns purchases by distributors of electricity originating from outside the new *Länder*, which would involve only the low and medium-voltage grid. VEAG would not be aware of these 'imports', and would not therefore be able to take them into account in planning future lignite-based production levels based on likely 'domestic' demand. If such 'imports' via the low/medium-voltage grid reached a certain level, the distributors' sales would be reduced. Consequently, the amounts bought by them from VEAG would also fall, thus reducing VEAG's sales. The Commission has tested this argument, but does not regard it, *per se*, as justification for allowing the distribution/transmission companies to refuse network access in the medium term on the grounds of the need to protect lignite. Firstly, given the fact that these 'imports' can only be via the low/medium-voltage grid, it cannot be taken for granted

(*) Business secret.

that such flows will acquire any quantitative significance. Secondly, this issue can be resolved in a manner less restrictive of trade and competition than the possibility of refusing network access at regional level.

- (56) Germany can, for example, establish a procedure whereby regional companies are obliged to inform VEAG of transmission contracts concluded at the level of the regional network operators which could indirectly affect VEAG's lignite-based electricity production. This would enable VEAG to include these cases in its overall planning and thus submit it as evidence when claiming refusal of access. However, in order to give Germany the opportunity to determine whether such additional measures are required, in order to enable VEAG to fulfil its lignite-based production obligations and to ensure that regional distributors have an appropriate period of time to adapt prior to the introduction of this additional market pressure, the Commission considers it appropriate to bring this condition into force with suspensory effect (cf. 3.2.3 below).

3.2.2. *Clearly defined, non-discriminatory, transparent and verifiable criteria*

- (57) The Commission regards refusal of network access as a severe measure which is directly opposed to one of the main objectives of the Directive, namely to permit competition for electricity supply by introducing network access. In this light, it is important that any application of the lignite protection clause be exercised restrictively and according to clearly defined, non-discriminatory, transparent and verifiable criteria. The Commission considers that the wording of Article 4(3) of the German Act does not satisfactorily fulfil these criteria. Therefore, the Commission considers it necessary to ensure that several conditions are met within the scope of the regulatory procedures and dispute settlement mechanisms in question. Such conditions are:

- (58) (1) that a refusal of access will only take place on a case-by-case basis, that there will therefore be no a priori or systematic refusal, and that in every case of refusal detailed reasons will be given by VEAG as to the need to refuse transmission to ensure an adequate level of lignite generation;
- (59) (2) a minimum opening-up of the market must also be guaranteed in the new *Länder* so that a network access system can develop in practice, albeit on the basis of the transitional regime at a pace below the minimum market opening requirements of the Directive. Thus, it must be guaranteed that a minimum segment of eligible customers must have the unrestricted right to change supplier in spite of the legitimate interests of VEAG.

- (60) There is a risk that, in the absence of such a caveat, little competition would develop in the new *Länder* during the period in question and that, in particular, VEAG might face insufficient pressure to increase efficiency and lower prices. At present, approximately 60% of electricity generation is by VEAG and 40% by municipal producers and autoproduction. It is to be expected that, if even limited numbers of eligible clients decide to purchase elsewhere, this will inevitably, and probably immediately, put pressure — albeit limited — on VEAG's lignite-based production. To meet this challenge it would need to increase efficiency and competitiveness, or risk losing market share. However, rather than cutting costs and reducing prices, in the absence of a minimum number of unequivocal eligible customers VEAG may adopt a policy of systematically refusing any request for network access in order to maintain its market share and, indirectly, lignite production. The possibility of such a policy by VEAG is supported by the conclusions of the report evaluating the need for the lignite protection clause commissioned by VEAG from chartered accountants PWC Deutsche Revision (see below).

- (61) (3) Although the German Government argued that a minimum opening-up of the market and market practice would be ensured by the case-by-case approach of the German Article 4(3) of the lignite clause, the Commission considers that Article 4(3) firstly provides insufficient guarantees in this respect, and secondly does not comply with the requirement for clear and verifiable criteria, which are necessary to differentiate clearly between those network access applications which are admissible and those which are to be refused. These concerns have already been stressed by the Commission in the letter to the Ministry of Economic Affairs of 22 September 1997. Such clear and verifiable criteria must be specified in order to enable customers to predict whether they will be able to exercise their right to network access. This will avoid potential discriminatory application of the clause arising from excessive discretion in the case-by-case assessment of refusals of access.

- (62) It seems appropriate that, when weighing the justification of a refusal of access against the right of eligible customers to choose their supplier, account must be taken of whether the eligible customer is itself a party to long-term purchasing commitments, e.g. in the case of distributors committed to taking 70% of their electricity from VEAG, in which case particular attention may be given to the interest in ensuring sufficient sales of lignite-based electricity, or whether the eligible customer is a final consumer without specific long-term purchase commitment, in which case particular attention may be given to access to competitive electricity prices. In this context, it is important to note that VEAG and the regional distribution companies are in many cases affiliated or associated companies, or companies belonging to the same shareholders. With regard to the need for major industrial final consumers to have access to competitive electricity prices, Article 19(3) of the

Directive lays down that, despite a certain discretion for Member States in defining customer segments for achieving a minimum opening-up of the market, 'all final consumers consuming more than 100 GWh per year (on a consumption site basis and including autoproduction) must be included' in the category of eligible customers. Thus the Commission considers that at least this customer segment⁽³⁾ should have a clear guarantee that their potential requests for market access will not be refused on the basis of Article 4(3) of the German Act.

- (63) This would be transparent and would avoid any potential discrimination. In this way, an appropriate balance can be struck between the need to provide adequate and effective protection for lignite production in Germany and the need to ensure that competitive forces — the basic aim of the Directive — nonetheless play an important role in ensuring that all companies increase efficiency and lower prices.

3.2.3. Entry into force of this Decision

- (64) In order to permit:

- preparation of suitable and appropriate measures as necessary in order to ensure that electricity sales to eligible customers, via the regional distributors' low/medium-voltage grid only, do not bypass VEAG's lignite-based electricity production obligation, and to enable the regional distributors to prepare for the introduction of such competition,
- VEAG to adapt to the new situation with regard to customers consuming more than 100 GWh annually,

it appears reasonable to ensure a suitable period of time prior to the entry into force of the conditions set out in 3.2.1 and 3.2.2(3).

⁽³⁾ Although no official data have been presented, the Commission received oral information from VEAG as well as from electricity consumers (VIK) indicating that the category of final consumers consuming more than 100 GWh/year in the new *Länder* represents 15-20 companies with a consumption share of approximately 15-16%. Inaccuracies stem in particular from the difficulties of assessing autoproduction and defining the consumption site.

- (65) It should be noted that the circumstances leading to the choice by the German Government of this transitional regime, as well as the objectives pursued by it, are specific and not characteristic of the other schemes notified to the Commission pursuant to Article 24 of the Directive. In particular, this regime results from the significant reconstruction of the electricity sector in the new *Länder* following reunification, and the resulting very major and localised regional and employment problems. Under these circumstances it is particularly important in this case that an appropriate balance is struck between the need for VEAG to be placed under a reasonable degree of competitive pressure and the need to ensure that VEAG can meet its investment and lignite-based electricity production obligations. This Decision is therefore, in terms of its nature and objectives, extremely specific in comparison with transitional regimes accepted or examined in other Member States. The other schemes relate to the need or aim to maintain the viability or competitiveness of individual undertakings, not the reconstruction and major modernisation of an entire regional electricity sector.

- (66) In this light, the Commission considers it appropriate to provide for an interim period of two years between publication of this Decision and the entry into force of the conditions set out in Article 2(2) and (3) below. This period will provide VEAG and the regional distributors with the necessary time to take corresponding measures to meet any additional competitive pressure resulting from this Decision.

3.2.4. Additional considerations

- (67) 1. In order to limit the possible impact of this Decision, and in particular the conditions set out in 3.2.1 and 3.2.2(3), to the competitiveness and viability of VEAG, a review of the Decision is scheduled for two years after its adoption. The basis for such a review must be a report by the German Government on its experience with the application of Article 4(3) of the German Act and the application of the additional Condition (3) of this Decision. If the proportion of final customers which have actually transferred to an electricity supplier not producing on the basis of lignite from the new *Länder* is substantial and endangers the viability of VEAG, the Commission will review this Decision, and in particular, if appropriate, Condition (3).
- (68) 2. In order to ensure sufficient transparency, the Commission also considers it necessary to ensure close monitoring of the application and interpretation of Article 4(3) of German Act. Thus the Commission must be notified of any decision by a German arbitration or

regulatory body which conditionally or unconditionally approves a refusal of network access on the basis of Article 4(3) of the German Act.

3.2.5. *Appreciation of the arguments of VEAG*

(69) In order to support its arguments expressed by letter of 28 January 1999 and during a meeting between VEAG and the Commission on 12 February in Brussels, VEAG submitted a report commissioned from the chartered accountants PWC Deutsche Revision evaluating the need for the lignite protection clause.

(70) In its letter of 28 January 1999, VEAG argues that any loss of sales whatsoever would be unsustainable. The lignite protection clause in Article 4(3) of the German Act should therefore be applied in full without any restrictions.

(71) The accountants' report calculates target quantities for electricity sales in order to cover VEAG's full costs (p. 24). This calculation is based on data from VEAG's medium-term cost planning of VEAG and cannot therefore be directly compared with data from the published annual accounts. The cost base for calculating the target quantities includes capital costs of [...] % (*) and a margin for a return on equity of [...] % (*) p.a. ([...] % (*) state obligation plus [...] % (*) risk premium), assuming [...] % (*) equity capital.

(72) A comparison between the calculated target quantities for electricity sales and actual electricity sales for 1998, and estimated electricity sales planned by VEAG for 2003 gives the following results: in 1998, actual sales exceeded calculated target quantities by [...] % (*). In 2003, however, target quantities are [...] % (*) higher than planned sales. This leads to the conclusion that future operations will not fully cover costs (p. 27).

(73) The report subsequently examines two scenarios up to 2003. Scenario 1 assumes full application of the lignite protection clause in Article 4(3) of the German Act in VEAG's favour. It concludes that, except for 2000, all years will show a surplus, peaking in 2002, showing a sales margin of [...] % (*) which translates into a return on equity of [...] % (*). Thus it is shown that the abovementioned quantitative gap of [...] % (*) (2003) results in a decreased return on equity from the expected [...] % (*) to [...] % (*) (2002, comparable figure for 2003 not available).

(74) The report also examines a Scenario 2, assuming that consumers representing [...] % (*) of VEAG turnover change to a different supplier. The assumption of [...] % (*) is derived from a [...] % (*) market segment of total electricity production in the new *Länder* ([...] % (*) TWh) which is assumed to be lost exclusively from VEAG turnover. This scenario concludes that VEAG's viability will be threatened, although there is no detailed analysis of realistic plant operation, nor are revenues from sales to alternative customers or on spot markets taken into account.

(75) The Commission concludes as follows:

(76) a) the report does not provide for a detailed analysis of VEAG's cost structure according to fixed and variable costs to make it possible to assess short-term marginal costs; nor does it provide any cash-flow analysis in order to assess VEAG's liquidity. This according to the data provided, the short and medium-term viability of VEAG cannot be considered to be directly threatened;

(77) b) the report's conclusions are based on the objective of maintaining full cost coverage including a profit margin ([...] % (*) ROE). As this target is not achieved, even if the lignite protection clause is fully applied in VEAG's favour (resulting in [...] % (*) ROE), the rather pragmatic conclusion is that no restriction on the application of the lignite protection clause would be sustainable;

(78) c) The data provided show that the full-cost accounting approach chosen includes a number of safety nets before VEAG's viability would be seriously called into question:

— [...] % (*) profit margin included in the calculations,

— undisclosed potential margin included in the contract to procure lignite from the related company Laubag⁽⁴⁾,

— [...] % (*) equity capital,

— revenues from surplus electricity sales to alternative customers or on spot markets would have to be included when calculating the effect of customer losses;

⁽⁴⁾ According to the report (p. 17), until [...] % (*) VEAG purchased lignite mainly from Laubag, a company which is related through common shareholders, at [...] % (*), and after [...] % (*) according to a price-quantity schedule [...] % (*). Neither Laubag's cost structure nor the current profit margin have been disclosed and analysed.

- (79) d) Scenario 2, assuming a [...] % (*) loss of sales, is based on assumptions which cannot be compared with the potential effects of the conditions referred to in 3.2.2 of this Decision.
- (80) e) In contrast to the position expressed by the German Government, namely that the lignite protection clause would apply on a case-by-case basis, thereby allowing a degree of market opening, the position expressed by VEAG and supported by the accountants' report makes it clear that VEAG would strive for a systematic refusal of access to all direct and indirect VEAG customers over the full period of application of the clause.

- (81) In summary, the Commission recognises VEAG's legitimate concern to maintain sufficient sales in order to ensure the specific economies of scale for lignite-based electricity production. Thus the Commission developed the conditions in 3.2.2 with regard to these concerns, albeit weighed against the equally legitimate needs of electricity consumers. The possibilities for review described above are a further safeguard for the competitiveness and viability of VEAG.

4. Conclusions

- (82) The transitional regime was applied for by letter of 12 February 1998. Thus the application is in accordance with the deadline laid down in Article 24(2).
- (83) The transitional regime is based on investment commitments arising from a series of contracts concluded in 1990 between the former German Democratic Republic, the Treuhandanstalt, Bayernwerk AG, PreussenElektra AG, RWE Energie AG and the regional electricity companies. The nature of VEAG's investment commitment meets all the criteria of Article 24(1) of the Directive.
- (84) As regards the measures proposed, the transitional regime is a derogation from Chapter VII of Directive 96/92/EC, namely refusal of network access, which in principle falls within the scope of Article 24(2) of the Directive. The proposed transitional regime is of limited duration and linked to the expiry of the commitments or guarantees of operation in question. The requirement that the transitional regime applies the least restrictive measures necessary to achieve the legitimate objectives is in principle fulfilled, albeit with two limitations, namely the need to clarify its scope, which is to be limited to the network of the lignite-based electricity-producing company, and clarification of the wording of the German transitional regime, which is not sufficiently clearly defined in order to ensure non-discriminatory, transparent and verifiable application.

- (85) The Commission therefore concludes that a number of conditions must be fulfilled in order to ensure the adequate predictability and transparency of the German transitional regime. The conditions can be implemented either through an amendment of the law or through adequate application of provisions or practices on the part of the authority responsible for implementing Article 4(3) of the German Act,

HAS DECIDED AS FOLLOWS:

Article 1

Article 4(3) (new *Länder*) of the German 'Gesetz zur Neuordnung des Energiewirtschaftsrechts' (Energy Act), published in the *Bundesgesetzblatt* on 28 April 1998, p. 730, which is the single subject of the application for a transitional regime in accordance with Article 24 of Directive 96/92/EC, notified to the Commission on 12 February 1998, shall be considered to be based on a commitment or guarantee of operation within the meaning of Article 24(1) of the Directive.

In the abovementioned case, the commitment within the meaning of Article 24(1) of Directive 96/92/EC is the contract concluded on 22 August 1990 between the German Democratic Republic and the Treuhandanstalt on the one hand and Bayernwerk AG, PreussenElektra AG and RWE Energie AG on the other.

Article 2

In accordance with Article 24(2) of Directive 96/92/EC, Germany shall be entitled to derogate from Article 17 and thus from Chapter VII by applying Article 4(3) (new *Länder*) of the Energy Act as a transitional regime limited until 31 December 2003, under the following conditions.

- (1) Germany shall ensure that the right to network access also remains the general norm in the new *Länder*, and that every refusal of network access is considered an exception which must be duly substantiated on a case-by-case basis.
- (2) Requests for network access may only be refused where they involve the Vereinigte Energiewerke AG (VEAG) transmission network. Regional transmission and distribution system operators may not apply the provisions of the transitional regime. This condition shall be applied not later than two years following publication of this Decision.
- (3) A minimum proportion of final electricity consumption must also remain open to competition in the new *Länder*. Therefore, at least those final consumers consuming more than 100 GWh per year (on a consumption site basis and

including autoproduction) within the meaning of Article 19(3) of Directive 96/92/EC shall not be refused network access on the basis of Article 4(3) of the Energy Act. This condition shall be applied not later than two years following publication of this Decision.

Article 3

1. Germany shall submit to the Commission, within three years of the adoption of this Decision, a report on the actual use of network access by final customers in the new *Länder*. Should this report conclude that the proportion of final consumers who have actually changed to an electricity supplier not producing on the basis of lignite from the new *Länder* is substantial and endangers the viability of VEAG, the Commission shall review this Decision.

2. Germany shall notify to the Commission every refusal of network access in accordance with Article 4(3) of the Energy Act immediately following unconditional or conditional

approval of such refusal at first instance (*Landeskartellbehörde* or *Bundeskartellamt*).

3. Germany shall notify to the Commission any change in relation to the Energy Act which may directly or indirectly affect the application of this transitional regime.

Article 4

This decision is addressed to the Federal Republic of Germany.

Done at Brussels, 8 July 1999.

For the Commission
Christos PAPOUTSIS
Member of the Commission

COMMISSION DECISION

of 8 July 1999

concerning the Austrian application for a transitional regime under Article 24 of Directive 96/92/EC of the European Parliament and of the Council concerning common rules for the internal market in electricity

(notified under document number C(1999) 1551/5)

(Only the German text is authentic)

(1999/795/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community,

Having regard to Directive 96/92/EC of the European Parliament and of the Council of 19 December 1996 concerning common rules for the internal market in electricity⁽¹⁾, (hereinafter 'the Directive'), and in particular Article 24 thereof,

Having informed the Member States of the Austrian application,

Whereas:

I. FACTS

1. Procedure

- (1) By letter of 11 February 1998, the Austrian Bundesministerium für wirtschaftliche Angelegenheiten notified to the Commission an application for a transitional regime pursuant to Article 24 of Directive 96/92/EC.
- (2) On 23 March 1998, the Commission's representatives undertook a fact finding mission to Vienna and met with the Austrian Bundesministerium für wirtschaftliche Angelegenheiten as well as with representatives of consumers (social partners) and the electricity industry.
- (3) By letter of 15 October 1998, the Austrian Bundesministerium für wirtschaftliche Angelegenheiten submitted to the Commission complementary information, in particular the final report of the independent accountants and lawyers commissioned by the Austrian Government to determine the anticipated level of compensatory payments arising from the transitional regime in question. On the basis of this report, the application for a transitional regime has been

reduced by the Austrian Government to a stranded cost amount of ATS 8,7 billion from the ATS 35,6 billion contained in the initial notification.

2. The Austrian electricity sector and implementation of Directive 96/92/EC

- (4) Austria is implementing Directive 96/92/EC by the Elektrizitätswirtschafts- und Organisationsgesetz (hereinafter 'ElWOG'), which was published on 18 August 1998 and entered into force on 19 February 1999, as well as complementary laws for the nine Länder. The ElWOG provides for a market opening starting with approximately 27% in February 1999 and increasing to approximately 50% in 2003. Accordingly, in the first phase final customers with more than 40 GWh yearly consumption as well as distributors, which also operate transmission systems, will be eligible. From February 2000, final customers above 20 GWh/a will be eligible, as well as all distributors above 40 GWh/a. Finally, in February 2003, all final customers and all distributors above 9 GWh/a will be eligible. Austria has opted for a system of regulated network access.
- (5) Österreichische Elektrizitätswirtschafts AG (Verbundgesellschaft) is the main transmission system operator. Through its legally separated subsidiaries, it is also Austria's main electricity producing company. Most of the nine regional electricity companies are not only distributors but also producers; some of them are also transmission system operators.

3. The transitional regime notified by the Austrian Government

3.1. Introduction

- (6) Austria has notified two schemes pursuant to Article 24 of Directive 96/92/EC.

⁽¹⁾ OJ L 27, 30.1.1997, p. 20.

- (7) *Guarantees of operation given to electricity generation plants* based on the legal authorisation procedure for power plants prior to liberalisation. Authorisations for certain types of power plants were granted only if a corresponding electricity demand had been assessed ('Bedarfsprüfung'). Those power plants that received authorisation benefited from a guarantee of operation and guarantee of cost amortisation. The stranded cost regime in this respect seeks to compensate certain generating plants from the loss of income that can be expected from the lower prices resulting from the introduction of competition.
- (8) The final notification of 15 October 1998 limits the plants eligible to the transitional regime to three hydropower plants: Freudenau, Mittlere Salzach and Kraftwerkskette Obere Drau, all operated by subsidiaries of *Verbundgesellschaft*.
- (9) *Long-term procurement contract for indigenous lignite* for the 'Voitsberg' power plant. The contract was concluded in 1977 between the lignite mine GKB and the power plant operator ÖDK, a subsidiary of *Verbundgesellschaft*. Additionally, the power plant benefits from a legal guarantee of operation of up to 3% of the yearly domestic electricity consumption. The stranded cost regime thus seeks to compensate this generating plant (i) for its long-term obligation to purchase lignite above world coal/lignite prices, and (ii) for the loss of income regarding the expected lower prices resulting from the introduction of competition with respect to the legal guarantee of operation.

3.2. Details of the guarantees of operation given to electricity generation plants and the lignite procurement contract

- (10) The proposed method is defined in recital 69 of the ElWOG. It provides for operating aid to compensate stranded costs in relation to the abovementioned commitments and guarantees of operation. On 11 February 1998, Austria preliminarily notified a total amount of stranded cost of ATS 35,58 billion (approximately EUR 2,5 billion). Based on a subsequent assessment of the stranded costs through independent accountants and lawyers, a final notification was submitted on 15 October 1998, which reduced the total stranded cost amount to ATS 8,7 billion (approximately EUR 0,6 billion) which consists of a maximum of ATS 6,27 billion for the three hydropower plants and ATS 2,43 billion for the lignite-fired power plant. The transitional regime is limited until 2009.

(11) Calculation method

In a first step the stranded costs were calculated for each power plant as the discounted difference between

guaranteed cost coverage and expected market price for electricity taking into account the real market opening per company. In a second step, the degree to which the viability of the consolidated operating companies would be affected was assessed.

(12) Compensation method

With respect to the three hydropower plants, the transitional regime envisages the grant of operating aid, on an annual basis, in the light of developments in market prices for electricity, and the consequent effect this has on the viability of the hydro plants in question. With respect to the lignite fuelled plant, a fixed compensation payment is envisaged.

(13) Recovery method

The transitional regime envisages that the payments will be financed by the imposition of a levy per kWh of electricity purchased by eligible customers. Captive customers pay their proportional part within the regulated electricity tariff. The funds are collected by the network operators (via a charge on transmission) and administrated by the Ministry of Economic Affairs).

II. LEGAL ANALYSIS

1. Legal basis: Article 24(1) and (2) of Directive 96/92/EC

- (14) The Austrian Government notified an application for a transitional regime with respect to alleged commitments and guarantees of operation pursuant to Article 24 of the Directive.

2. Requirements of Article 24

- (15) Article 24 of Directive 96/92/EC states the following:

'1. Those Member States in which commitments or guarantees of operation given before the entry into force of this Directive may not be honoured on account of the provisions of this Directive may apply for a transitional regime which may be granted to them by the Commission, taking into account, amongst other things, the size of the system concerned, the level of interconnection of the system and the structure of its electricity industry. The Commission shall inform the Member States of those applications before it takes a decision, taking into account respect for confidentiality. This Decision shall be published in the *Official Journal of the European Communities*.

2. The transitional regime shall be of limited duration and shall be linked to expiry of the commitments or guarantees referred to in paragraph 1. The transitional regime may cover derogations from Chapters IV, VI and VII of this Directive. Applications for a transitional regime must be notified to the Commission no later than one year after the entry into force of this Directive.'

- (16) Article 24(1) and (2) of Directive 96/92/EC, in the light of the EC Treaty, thus require the following elements to be examined by the Commission when considering any application for a transitional regime.
- A. *Requirements concerning the nature of the commitments or guarantees of operation in question*
- (17) (1) The existence of a commitment or guarantee of operation must be proven.
- (2) The commitment or guarantees of operation must have been given before 20 February 1997.
- (3) A causal link between the entry into force of the Directive and the inability to honour the commitment must be established.
- B. *Requirements concerning the measures proposed to achieve the objectives in question*
- (18) (1) The measures of the transitional regime must fall within the scope of derogations from Chapters IV, VI and VII of the Directive.
- (2) The transitional regime must be of limited duration and linked to the expiry of the commitments or guarantees of operation in question.
- (3) The transitional regime must apply the least restrictive measures reasonably necessary to achieve the objectives, which themselves must be legitimate. In deciding on these issues the Commission must take into account, amongst other things, the size of the system concerned, the level of interconnection of the system and the structure of its electricity industry.
- (20) As stated above, in order to constitute a transitional regime within the meaning of Article 24, the system chosen by the Member State must provide for a derogation from Chapter IV, VI or VII of Directive 96/92/EC.
- (21) The measures in question are based on a pure compensation scheme, i.e. a system of charges or levies implemented by a Member State in order to compensate stranded costs caused by the application of Directive 96/92/EC. The application of such levies in the present case does not require a derogation from the abovementioned chapters of the Directive and cannot therefore be regarded as a transitional regime in the meaning of Article 24 of the Directive.
- (22) The fact that measures such as those in question in this case can result in very considerable distortions of the single market for electricity do not affect this conclusion. Indeed, the Commission recognises that the payment of such levies can result in economic consequences substantially similar to those resulting from a total or partial derogation from some of the obligations contained in Chapters IV, VI or VII of the Directive. However, such distortions by their very nature do not result from such a specific derogation as envisaged by the Directive. The transfer of a compensation payment to certain electricity producers, financed through a levy or charge on consumers is, therefore, a measure which is not directly addressed by the Directive but one which needs to be examined pursuant to the rules on competition, and in particular Article 87(3)(c) of the EC Treaty. Under these circumstances, it is understood that measures of similar economic effect will be treated in a consistent manner, regardless of the relevant procedure in each individual case.
- (23) In the light of the non-applicability of Article 24 of the Directive, it is not necessary to assess the further requirements A(1), (2), (3) and B(2) and (3).

4. Conclusions

3. Assessment of the Austrian transitional regime

- (19) In the present case, concerning the transitional regime as notified, it is not necessary to determine whether requirements A(1), (2), (3) or B(2), (3) are met, because the measures of the transitional regime in question do not require a derogation from Chapter IV, VI or VII of Directive 96/92/EC and thus do not meet requirement B(1).
- (24) The transitional regime notified by the Austrian Government pursuant to Article 24 of Directive 96/92/EC has been assessed pursuant to Article 24(1) and (2). The Commission concludes that a transitional regime according to Article 24 cannot and need not be approved to the extent that the measures chosen do not constitute derogations from Chapters IV, VI and VII of the Directive. The regime contains transfers of compensation payments to certain electricity producers, financed through a levy or charge on consumers. Such measures are not directly addressed by the Directive but

need to be examined pursuant to the rules on State aid, and in particular Article 87(3)(c) of the EC Treaty,

Article 2

The transitional regime notified by Austria contains no measures which would constitute derogations from Chapters IV, VI or VII of Directive 96/92/EC, as defined by Article 24(2). Article 24 is therefore not applicable to the transitional regime notified by the Austrian Government.

HAS DECIDED AS FOLLOWS:

Article 1

The present Decision concerns the Austrian application for a transitional regime pursuant to article 24 of Directive 96/92/EC, notified to the Commission on 11 February 1998 and finalised on 15 October 1998. This notification concerns.

- guarantees of operation given to three hydropower plants,
- a long-term procurement contract and a guarantee of operation given to one lignite plant.

Article 3

This decision is addressed to the Republic of Austria.

Done at Brussels, 8 July 1999.

For the Commission
Christos PAPOUTSIS
Member of the Commission

COMMISSION DECISION

of 8 July 1999

concerning the application of the Netherlands for a transitional regime under Article 24 of Directive 96/92/EC of the European Parliament and of the Council concerning common rules for the internal market in electricity

(notified under document number C(1999) 1551/6)

(Only the Dutch text is authentic)

(1999/796/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community,

Having regard to Directive 96/92/EC of the European Parliament and of the Council of 19 December 1996 concerning common rules for the internal market in electricity⁽¹⁾, and in particular Article 24 thereof,

Having informed the Member States of the application made by the Netherlands,

Whereas:

2. Structure and development of the electricity sector in the Netherlands

(a) Generation

- (3) There are four electricity producers in the Netherlands:

EPON — NV Elektriciteits-Productiemaatschappij Oost-Noord-Nederland

EPZ — NV Elektriciteits-Productiemaatschappij Zuid-Nederland

EZH — NV Elektriciteitsbedrijf Zuid-Holland

UNA — NV Energieproductiebedrijf UNA.

They generate around 70% of domestic electricity demand. The remaining 30% is imported (around 13%) or supplied by independent producers or autoproducers.

I. FACTS

1. Procedure

- (1) By letter of 20 February 1998, the Dutch Permanent Representation sent its provisional notification of transitional regimes under Article 24 of Directive 96/92/EC to the Commission. On 29 May, the Commission's services undertook a fact-finding mission to the *Ministerie van Economische Zaken* in The Hague. The Commission asked for additional information regarding some elements of the notification, which it received by letter of 22 June.

- (2) By letter of 16 October, the Dutch Permanent Representation sent further information regarding the notification of transitional regimes.

- (4) The four production companies coordinate their activities to a certain extent through SEP (Samenwerkende Elektriciteits-Productiebedrijven NV), owner of the national high-voltage grid and the legal person responsible for all electricity imports until 1 January 1999. SEP is responsible for the management of Dodewaard nuclear power plant (currently being decommissioned) and of Demkolec, a coal gasification plant, and for the international commitments referred to in point 4.1, recital 12. The four production companies and SEP are parties to a cooperation agreement (Overeenkomst van Samenwerking, hereinafter 'OvS').

- (5) The production companies are in turn owned as follows:

EPON — distribution companies

EPZ — distribution companies

⁽¹⁾ OJ L 27, 30.1.1997, p. 20.

EZH — province, larger cities in the region, municipalities and a distribution company

UNA — two provinces and the cities of Utrecht and Amsterdam.

(b) Transmission

- (6) Until January 1999, electricity transmission was carried out by SEP, owner of the high-voltage grid and the sole importer of electricity.
- (7) TenneT, an independent agency which is owned by SEP and in which the State intends to have a majority stake, has been responsible for transmission since 1999.

(c) Distribution

- (8) There are 23 electricity distribution companies. These are publicly owned (provinces, cities and municipalities).

3. *Liberalisation of the Dutch electricity market: implementation of Directive 96/92/EC*

- (9) The Dutch Electricity Act 1998 entered into force on 1 August 1998. A supplementary law modifies the Electricity Act 1998 and deals mainly with details regarding access to the network and supply to captive customers. The supplementary law was adopted on 1 June 1999.
- (10) The Dutch Government has opted for a gradual opening up of the electricity market. Since 1 January 1999, one third of customers have been eligible and another third will become eligible in 2002. As of 2007, all Dutch electricity customers will be free in their purchase of electricity. The supplementary law provides for regulated third party access to the grid. Since 1 January 1999, the importation of electricity has been free for eligible customers and for distributors for their eligible customers, subject, however, to a reciprocity requirement.
- (11) The transmission system operator, TenneT, is, as mentioned above, separated legally from generation and supply and has been operational since 1 January 1999. The State intends to have a majority stake in the transmission system operator.

4. *The transitional regime notified by the Dutch Government*

4.1. Introduction

- (12) The Dutch Government has notified the following transitional measures pursuant to Article 24 of Directive 96/92/EC.

- 1. *District heating*: recovery of the losses on some district heating projects until the last contract expires in 2021.
- 2. *Demkolec*: recovery of the extra costs of construction and operation of Demkolec, a demonstration of coal gasification plant at Buggenum.
- 3. *Protocol*: a protocol agreement has been concluded between Dutch generators and distributors, under which the generators agree to sell, and the distributors agree to purchase, all the output of the generators (representing 70% of the present sales of the distributors) up to and including 2000. In the event that this voluntary agreement is cancelled, for commercial or legal reasons, the Minister reserves the right to impose it, or similar provisions, by law.
- 4. *International commitments*: recovery of possible losses from the following contracts:
 - power procurement contracts between SEP and EdF, Preussen Elektra and Statkraft,
 - investment obligations of SEP to Statnett for the NorNed cable,
 - a gas take-or-pay contract between SEP and StatOil.

- (13) The international commitments mentioned above were added to the Dutch notification letter of 16 October 1998. They were not referred to in the initial notification of 20 February 1998.

- (14) In the initial notification two further schemes were mentioned:

- *delay of privatisation of the electricity sector*. Until the end of 2001, the express agreement of the Minister will be necessary for any sales of shares outside the circle of present shareholders,
- the phasing in of *corporation tax* keeping pace with the liberalisation process.

- (15) However, these two schemes were withdrawn from the final notification. This is because of information provided by the Commission's services during the abovementioned meeting of 29 May. The Commission noted that these issues could not be regarded as derogations from Directive 96/92/EC and could therefore not be considered under Article 24 of the Directive. The Commission reserves the right to examine these issues according to other provisions of Community law.

4.2. Details of the notified schemes

4.2.1. District heating projects

(a) The commitment

- (16) In 1990, the production companies took over a fuel price guarantee from the distributors for the purpose of district heating. Consumers are given a guarantee that they will not pay more than users of gas heating. Nine of these district-heating projects, involving three production companies, are running at a loss; these projects are mentioned. The contracts all date from before February 1997. In the areas in question, district heating is not competitive, chiefly because of the level of capital investment and thus amortisation. The contracts are a result of government policy, dating back to 1979, to promote district heating for environmental reasons.

(b) The extent of the stranded costs

- (17) The losses have been calculated by accounting firm Coopers Lybrand at between NLG 1,628 and 2 billion, depending on fluctuations in the gas price.

(c) Method of recovery

- (18) Article 77a of the Electricity Act 1998 provides for the recovery of stranded costs resulting from district heating projects by means of a surcharge on the electricity transport tariff.
- (19) The Dutch authorities intend to put in place a recovery scheme which will run for twenty years. Financing will be to a maximum of NLG 2 billion, to be recovered from a surcharge on the electricity transport tariff. The scheme has four beneficiaries: producers EZH, EPZ, UNA and EPON or their legal successors, which are party to

the contracts for district heating with fuel price guarantee.

- (20) Yearly accounting controls are imposed on the beneficiaries. The Commission can have access to the accounts, if it so requests.

4.2.2. Demkolec

(a) The commitment

- (21) The construction and operation of the demonstration coal gasification plant, Demkolec, required very substantial, and exceptional, investment in research, development and the demonstration of environment-related technology. This investment has not yet been written off. The extra costs cannot be recuperated through the national basic tariff for electricity after liberalisation. The Government decided to build Demkolec in order to diversify supply and for environmental reasons.

(b) The extent of the stranded costs

- (22) Coopers Lybrand has calculated the extra investment in Demkolec that has not yet been written off at NLG 458,4 million. The calculation was based on the net value on 1 January 2001 of the difference between the costs of Demkolec and a modern gas-fired plant with a cost price of NLG 0,07/kWh.

The calculation takes account of the Commission-approved subsidy to Demkolec of NLG 18,3 million. It remains, however, to be verified whether the preferential loan granted by the European Investment Bank has been accounted for in this calculation. The Dutch authorities have notified a maximum of NLG 550 million guilders as a transitional scheme for the Demkolec plant.

(c) Method of recovery

- (23) Article 77a of the Electricity Act 1998 provides for the recovery of the stranded costs of building and running the demonstration coal gasification plant 'Demkolec' by means of a surcharge on the electricity transport tariff.
- (24) The Dutch authorities intend to introduce a recovery scheme to be financed by a levy on the transport tariff which will run for two years. The maximum of NLG 550 million will be reimbursed to the sole beneficiary, SEP.

4.2.3. *Protocol*(a) *The commitment*

- (25) Producers and distributors are bound by a Protocol which runs from 1997 until the end of 2000. The distributors have agreed to buy all the electricity produced by the four generators (covering 70% of distributors' needs under the pre-liberalisation regime). The Protocol regulates costs, prices and tariffs for the period of 1997 to 2000. The reason why the Government is supporting the maintenance of this Protocol is to allow the Dutch producers to recover part of any stranded costs resulting from the fact that the generating capacity is no longer competitive at the lower prices resulting from liberalisation. In order to cover these costs, therefore, the Protocol effectively guarantees that these companies receive significant and continued market share and sales levels.

(b) *The extent of the stranded costs*

- (26) It is impossible at this stage to determine what financial consequences the repeal of the Protocol would have for producers.

(c) *Method of recovery*

- (27) In the event that the Protocol is annulled, for whatever reason, the Minister for Economic Affairs retains the right and legal mandate to impose the agreement, or one similar, by law. However, it is not clear (a) when or if this is likely to occur or (b) precisely which measures would be adopted if the Minister exercised this possibility. It is therefore unclear what form any imposition by the Minister of an agreement between producers and distributors might take.

4.2.4. *International commitments*(a) *The commitments*

- (28) (i) The EDF electricity import contract. The initial contract dates from 1989. The most recent amendment dates from April 1998 and obliges SEP to take at least 65% of 600 MW until 31 March 2000[...](*).

(ii) Preussen Elektra electricity import contract dating back to 1989. Annual off-take commitment by SEP of 1 500 GWh until 31 December 2005.

(iii) NorNed cable contract, dating back to 31 January 1994. SEP is committed to pay 50% of cable construction costs and has to off-take 2,16 TWh/a from Statnet. The cable has to be operational on 1 October 2001 and the contract runs until 2016.

(iv) Gas take-or-pay contract between SEP and StatOil dating back to 1989.

(b) *The extent of the stranded costs*

- (29) The extent of the costs will depend on the fluctuations in electricity and gas prices on the market. If prices on the Dutch market fall to NLG 0,07/kWh, SEP (through the OvS, the production companies for their proportional part) is responsible for the loss on these import contracts, to a total of NLG 3,1 billion. In these circumstances, no government intervention will take place.

- (30) However, once the market price for electricity falls below NLG 0,07/kWh, the authorities take over more of the costs of additional losses on these contracts resulting from further falls in the electricity price. The government contribution to the loss is progressive and is linked to a contribution from the production companies to cover the loss. At a price of NLG 0,05/kWh, the Government would pay an estimated NLG [...](*) billion to SEP, while the production companies would contribute NLG [...](*) billion.

- (31) On top of this progressive government contribution, if prices fall to below NLG 0,055/kWh, the Government will contribute more. The initial loss of NLG [...](*) billion, taken on by the producers when the market price falls to NLG 0,07/kWh, will be paid in full by the authorities once the market price has dropped to NLG 0,055/kWh. Thus at a price of NLG 0,05/kWh, the authorities would pay a total of NLG [...](*) billion (the initial [...](*) billion loss plus the [...](*) billion additional loss), while the production companies would pay NLG [...](*) billion.

- (32) The total amounts mentioned in this paragraph are maximum amounts of the Net Present Value which are adjusted annually.

- (33) Use of the NorNed cable will be free for the Statnet import contract. TenneT will not receive payment for

(*) Business secret.

the use of this transport facility. It is not clear whether SEP can use this cable free of charge for export to Norway.

(c) Method of recovery

- (34) The Dutch authorities intend to impose a surcharge on the transport tariff which will recover the losses on the power and gas purchase contracts and finance the laying of the Dutch part of the NorNed cable. The recovery scheme will run until the last contract runs out, which is in 2026. The beneficiary of the scheme is SEP.

II. LEGAL ANALYSIS

1. Legal basis: Article 24(1) and (2) of Directive 96/92/EC

- (35) The Dutch Government notified an application for a transitional regime with respect to alleged commitments and guarantees of operation pursuant to Article 24 of Directive 96/92/EC.

2. Requirements of Article 24(1) and (2)

Article 24 of Directive 96/92/EC provides as follows:

'1. Those Member States in which commitments or guarantees of operation given before the entry into force of this Directive may not be honoured on account of the provisions of this Directive may apply for a transitional regime which may be granted to them by the Commission, taking into account, amongst other things, the size of the system concerned, the level of interconnection of the system and the structure of its electricity industry. The Commission shall inform the Member States of those applications before it takes a decision, taking into account respect for confidentiality. This Decision shall be published in the *Official Journal of the European Communities*.

2. The transitional regime shall be of limited duration and shall be linked to expiry of the commitments or guarantees referred to in paragraph 1. The transitional regime may cover derogations from Chapters IV, VI and VII of this Directive. Applications for a transitional regime must be notified to the Commission no later than one year after the entry into force of this Directive.'

- (36) Article 24(1) and (2) of the Directive, in the light of the EC Treaty, thus require the following elements to be examined by the Commission, when considering any application for a transitional regime.

A. Requirements concerning the nature of the commitments or guarantees of operation in question

- (37) (1) The existence of a commitment or guarantee of operation has to be proven.
- (2) The commitment or guarantees of operation must have been given before 20 February 1997.
- (3) A causal link between the entry into force of Directive 96/92/EC and the inability to honour the commitment must be established.

B. Requirements concerning the measures proposed to achieve the objectives in question

- (38) (1) The measures of the transitional regime must fall within the scope of derogations from Chapters IV, VI and VII of Directive 96/92/EC.
- (2) The transitional regime must be of limited duration and linked to the expiry of the relevant commitments or guarantees of operation in question.
- (3) The transitional regime must apply the least restrictive measures reasonably necessary to achieve the objectives, which themselves must be legitimate. In deciding on these issues the Commission must take into account, amongst other things, the size of the system concerned, the level of interconnection of the system and the structure of its electricity industry.

3. Assessment of the Dutch transitional regime

3.1. District heating, and Demkolec

- (39) In the present case, concerning the transitional regime with respect to district heating and Demkolec, as notified by the Dutch Government, it is not necessary to determine whether requirements A(1), (2), (3) or B(2), (3) are met, because the measures in question do not require a derogation from Chapters IV, VI or VII of Directive 96/92/EC and thus do not meet requirement B(1) above.
- (40) As stated above, in order to constitute a transitional regime within the meaning of Article 24 of Directive 96/92/EC, the regime chosen by the Member State must provide for a derogation from the requirements laid down by Chapters IV, VI or VII of Directive 96/92/EC.
- (41) The measures under consideration are based on a pure compensation scheme, i.e. a system of charges or levies

implemented by a Member State in order to compensate for stranded costs caused by the application of Directive 96/92/EC. The application of such levies in the present case does not require a derogation from the abovementioned chapters of the Directive and cannot therefore be regarded as a transitional regime within the meaning of Article 24 thereof.

- (42) The fact that measures such as those under consideration in this case can result in very considerable distortions of the single market for electricity does not affect this conclusion. The Commission recognises that the payment of such levies can result in economic consequences substantially similar to those resulting from a total or partial derogation from some of the obligations contained in Chapters IV, VI or VII of Directive 96/92/EC. However, such distortions by their very nature do not result from such a specific derogation as envisaged by that Directive. The transfer of a compensation payment to certain electricity producers, financed through a levy or charge on the consumers is, therefore, a measure which is not directly addressed by the Directive but one which needs to be examined pursuant to the rules on competition, and in particular Article 87(3)(c) of the EC Treaty. Under these circumstances, it is understood that measures of similar economic effect will be treated in a consistent manner, regardless of the relevant procedure in each individual case.

- (43) In the light of the non-applicability of Article 24 of the Directive, it is not therefore necessary to assess the abovementioned further requirements A(1), (2), (3) and B(2) and (3).

3.2. International commitments

- (44) Article 24(2) of Directive 96/92/EC includes the following provision: 'Applications for a transitional regime must be notified to the Commission no later than one year after the entry into force of this Directive'. This deadline passed on 20 February 1998. In the present case, no mention of the proposed transitional regime with respect to international commitments was made in the original notification dated 20 February 1998. They cannot therefore be examined for approval pursuant to Article 24 of Directive 96/92/EC. However, even if this transitional regime had been notified to the Commission within the deadline provided for in Article 24(2), it would not fall within the scope of Article 24(1), as no derogation from the requirements of Chapters IV, VI and VII of Directive 96/92/EC result from the scheme.

3.3. Protocol

- (45) The Commission considers that, at present, the details of any possible action by the Netherlands in this respect are not yet sufficiently precise to permit the Commission to take a decision pursuant to Article 24(1) of Directive 96/92/EC. Thus, the possible imposition of such an agreement should be the subject of supplementary information provided to the Commission under Article 24 as soon as it is clear what form this measure will take. The Commission will then be able to judge whether the scheme constitutes a derogation from Chapters IV, VI and VII of Directive 96/92/EC and, if so, whether and to what extent it is compatible with the requirements of the Directive,

HAS DECIDED AS FOLLOWS:

Article 1

This Decision concerns the application of the Netherlands for a transitional regime pursuant to Article 24 of Directive 96/92/EC, notified to the Commission on 20 February 1998 and completed on 16 October 1998. This notification concerns:

- (a) commitments undertaken with respect to the Demkolec demonstration coal gasification plant at Buggenum;
- (b) commitments entered into by production companies regarding the price charged for district heating;
- (c) international purchasing commitments entered into by SEP;
- (d) a Protocol agreement concluded between Dutch producers and distributors in 1997.

Article 2

The transitional regime notified by the Netherlands with respect to commitments entered into by production companies regarding the price charged for district heating and commitments undertaken with respect to the Demkolec demonstration coal gasification plant at Buggenum contains no measures which would constitute derogations from Chapters IV, VI or VII of Directive 96/92/EC, as defined by Article 24(2) thereof. Article 24 is, therefore, not applicable to the transitional regime notified by the Dutch Government.

Article 3

Article 76 of the Dutch Electricity Act concerning the Protocol is not approved pursuant to Article 24 of Directive 96/92/EC. The Commission should receive supplementary information pursuant to Article 24 in the event of recourse to this provision.

Article 4

The scheme for the recovery of losses on international commitments contained in the letter of 16 October 1998 cannot be considered under Article 24 of Directive 96/92/EC,

because this scheme was notified to the Commission more than one year after the entry into force of the Directive.

Article 5

The decision is addressed to the Kingdom of the Netherlands.

Done at Brussels, 8 July 1999.

For the Commission

Christos PAPOUTSIS

Member of the Commission

COMMISSION DECISION

of 8 July 1999

concerning the application of the Spanish Government for a transitional regime under Article 24 of Directive 96/92/EC of the European Parliament and of the Council concerning common rules for the internal market in electricity

(notified under document number C(1999) 1551/7)

(Only the Spanish text is authentic)

(1999/797/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community,

Having regard to Directive 96/92/EC of the European Parliament and of the Council of 19 December 1996 concerning common rules for the internal market in electricity⁽¹⁾, and in particular Article 24 thereof,

Having informed the Member States of the application made by the Spanish Government,

Whereas:

I. FACTS

1. Procedure

- (1) By letter of 18 February 1998, the Spanish Ministry of Industry and Energy notified the Commission of an application for a transitional regime pursuant to Article 24 of Directive 96/92/EC. The application referred to the Spanish Electricity Sector Act No 54/1997, notified under Article 27 of the Directive by letter of 20 January, and in particular to two provisions thereof: (1) the provisions on costs of transition to competition (hereinafter 'CTC'), and (2) the provision concerning the systems on the islands and outside the Iberian peninsula.
- (2) On 3 June 1998, the Commission's services undertook a fact-finding mission to Madrid and met with officials from both the Ministry of Industry and Energy and the *Comisión Nacional del Sistema Eléctrico* (CNSE).
- (3) By letter of 16 October 1998, the Spanish Ministry of Industry and Energy submitted complementary information to the Commission.

- (4) By letter of 28 January 1999, the Spanish Government notified the transitional regime (which had been notified pursuant to Article 24 of the Directive) with certain modifications, in accordance with Article 88 of the EC Treaty. This notification is not the subject of this Decision but is being dealt with in a parallel procedure under Article 88 of the EC Treaty.

2. *The Spanish electricity sector and the implementation of Directive 96/92/EC*

- (5) Spain implemented Directive 96/92/EC with the Act No 54/1997 of 27 November 1997, which entered into force on 1 January 1998. This Act introduces regulated network access for all customers with a consumption of more than 15 GWh per year. This represents approximately 30% of total consumption by the end of 1998⁽²⁾. The Act, together with amendments which entered into force on 1 January 1999, already provides for further progressive market opening steps which will lead to 100% market opening in 2007.
- (6) Furthermore, the Spanish Act introduced the functions of independent system operator and independent market operator, which are separated in legal and ownership terms from other electricity companies (no shareholder may hold more than 10% of these bodies, the sum of shareholders operating in the electricity sector may not exceed 40%). Royal Decree 2019/1997 designated Red Eléctrica de España, SA (REE) as system operator and Compañía Operadora del Mercado Español de Electricidad, SA (OMEL) as market operator.
- (7) The market operator (OMEL) manages the coordination of supply and demand on the spot market. All producers generating more than 50 MW are obliged to regularly submit offers on the spot market, and are also allowed to sell their electricity under bilateral contracts. All distributors, suppliers and eligible customers may act as buyers on the spot market. Thus, eligible customers currently have three possibilities: (1) remaining with their supplier/distributor at regulated supply tariffs, (2) purchasing directly on the spot market, and (3)

⁽¹⁾ OJ L 27, 30.1.1997, p. 20.

⁽²⁾ Directive 96/92/EC requires a minimum market opening of 26,48% as of 19 February 1999.

purchasing on the basis of a bilateral contract with a specific producer or supplier.

- (8) The main electricity generating companies, which also carry out distribution and supply activities, are Endesa, Iberdrola SA, Unión Eléctrica Fenosa SA and Hidroeléctrica del Cantábrico SA. These are all privately owned.

3. The transitional regimes notified by the Spanish Government

3.1. Introduction

- (9) Spain has notified two schemes pursuant to Article 24 of the Directive:

1. 'CTC' regime (Costes de transición a la competencia)

The CTC regime is defined in the sixth transitional provision of Spanish Act No 54/1997, amended as of 1 January 1999 by Act No 50/1998 of 30 December 1998. It is based on guarantees given by the Spanish State to all electricity generating plants under Royal Decrees 40/1994 and 1538/1987, which governed electricity tariffication prior to liberalisation. The system guaranteed cost coverage for electricity generating plants built in Spain by allowing the electricity tariff to be calculated on the basis of each individual power plant according to standardised cost accounting methods. The new Act No 54/1997 establishes a transitional regime referred to as 'costs of transition to competition' (CTC), with a view to partly compensating the electricity generating companies for the loss of income resulting from the difference between the guaranteed electricity tariff existing hitherto and the anticipated price of electricity in the liberalised market.

2. Systems on the islands and outside the Iberian peninsula

For the operation of these systems, the companies (Unelco (Canary Islands), GESA (Balearic Islands) and Endesa (Ceuta and Melilla)) will be exempted until 31 December 2000 from some of the market rules that govern the mainland electricity market. These exemptions are defined in the 15th transitional provision of Act No 54/1997 and in amendments to this Act under the 17th additional provision of Act No 34/1998 on the hydrocarbons sector. In addition, Act No 54/1997 provides for the comparatively higher cost of electricity production and distribution in these systems to be redistributed through a special levy on the mainland electricity tariffs and transmission charges.

3.2. Details of the 'CTC' regime

(10) Objectives

The objective of the CTC regime is to compensate Spanish electricity generating companies, over a maximum period of ten years, for the expected decrease in the electricity price on the wholesale market resulting from the introduction of competition. For the purposes of the CTC regime, it has been estimated that the price of electricity may fall to 6 ESP/kWh. The maximum compensation, calculated *ex ante*, has been set at ESP 1 988 billion (approximately EUR 12 billion). The main portion, i.e. ESP 1 693 billion or 85%, is intended to cover the loss of income of the 11 generating companies resulting from lower prices due to the introduction of competition. A smaller portion, i.e. ESP 295 billion or 15% is intended to cover a fixed premium of one peseta per kWh of electricity produced from indigenous coal.

(11) Calculation method

The individual cost schedules of each plant were independently and individually audited in the course of the previous tariff setting exercises. Starting from this cost base, the average yearly hours of operation per technology have been determined. The 'technology compensation' is then calculated as the discounted difference between the standardised production costs and the assumed market price of six pesetas per kWh. The discount rate used is 5%. The resulting difference amounted to ESP 2 508 billion⁽³⁾. This amount was then reduced by 32,5% or ESP 815 billion in order to take into account possible productivity gains. The result was the abovementioned ESP 1 693 billion, to which was added the coal compensation of ESP 295 billion. The stranded costs are compensated by payments to the owners of each generating plant on a yearly basis.

(12) Compensation method

Approximately 50% of the total CTC technology compensation is to be paid to the nuclear sector, 31% to the conventional thermal sector, and 19% to the hydroelectric sector. The *ex ante* calculation of ESP 1 988 billion sets the maximum amount of compensation. The actual yearly compensation is calculated on the basis of the actual trend in spot-market prices. If the market price remains higher than the assumed six pesetas per kWh, the compensation payments will be reduced proportionally. If the market price falls below the

⁽³⁾ It should be noted that in the notification of 28 January pursuant to Article 88 of the Treaty, the original difference between standardised production cost and assumed market price was ESP 3 074 billion, which had been reduced by ESP 565 billion.

estimated six pesetas per kWh, the yearly compensation will be increased, but not the total compensation. This means that the transitional period would end before the scheduled ten years, namely when the maximum compensation amount has been used up.

(13) Recovery method

The cost of the CTC regime is recovered annually by means of regulated tariffs and transmission charges. The respective amounts are collected by the distribution companies and transferred to the production companies under the supervision of the regulator (CNSE).

The amendment to the Electricity Act that came into force on 1 January 1999 modified the compensation and recovery method in so far as it introduced a fixed 4,5% tariff component, which is earmarked for the compensation payments to the electricity companies. This would prepare for the possibility of a later securitisation of ESP 1 000 billion of compensation payments by the receiving companies. This possibility has been introduced in exchange for a further reduction of approximately ESP 250 billion in the overall CTC payments. The remaining amount of approximately ESP 320 billion will be compensated in accordance with the original method described above. This modification does not affect the ESP 295 billion of compensation for indigenously-produced coal, which will be recovered through the tariffs at a rate of one peseta per kWh.

3.3. Details of the systems on the islands and outside the Iberian peninsula

- (14) The notification does not include a request for specific derogations from the Directive. The financial support, which redistributes the higher electricity costs of these isolated systems to the overall Spanish system, is recovered in a similar way to that described above for the CTC regime.

II. LEGAL ANALYSIS

1. Legal basis: Article 24 of Directive 96/92/EC

- (15) The Spanish Government notified an application in accordance with Article 24 of Directive 96/92/EC. The notification contains two parts which need to be assessed separately:

— an application for a transitional regime within the meaning of Article 24(1) and (2),

— an application for derogations for small isolated systems within the meaning of Article 24(3).

2. The 'CTC' regime

2.1. The requirements of Article 24(1) and (2)

- (16) Article 24 of Directive 96/92/EC states the following:

'1. Those Member States in which commitments or guarantees of operation given before the entry into force of this Directive may not be honoured on account of the provisions of this Directive may apply for a transitional regime which may be granted to them by the Commission, taking into account, amongst other things, the size of the system concerned, the level of interconnection of the system and the structure of its electricity industry. The Commission shall inform the Member States of those applications before it takes a decision, taking into account respect for confidentiality. This Decision shall be published in the *Official Journal of the European Communities*.

2. The transitional regime shall be of limited duration and shall be linked to expiry of the commitments or guarantees referred to in paragraph 1. The transitional regime may cover derogations from Chapters IV, VI and VII of this Directive. Applications for a transitional regime must be notified to the Commission no later than one year after the entry into force of this Directive.'

Article 24(1) and (2) of the Directive, in the light of the EC Treaty, thus requires all of the following elements to be examined by the Commission when considering any application for a transitional regime.

- (17) A. *Requirements concerning the nature of the commitments or guarantees of operation in question*

(1) The existence of a commitment or guarantee of operation must be proven.

(2) The commitment or guarantees of operation must have been given before 20 February 1997.

(3) A causal link between the entry into force of the Directive and the inability to respect the commitment must be established.

- (18) B. *Requirements concerning the measures proposed to achieve the objectives in question*

(1) The measures of the transitional regime must fall within the scope of derogations from Chapters IV, VI and VII of Directive 96/92/EC.

(2) The transitional regime must be of limited duration and linked to the expiry of the commitments or guarantees of operation in question.

(3) The transitional regime must apply the least restrictive measures reasonably necessary to achieve the objectives, which themselves must be legitimate. In deciding on these issues the Commission must take into account, amongst other things, the size of the system concerned, the level of interconnection of the system and the structure of its electricity industry.

2.2.3. Assessment of the 'CTC' regime

(19) In the present case, concerning the CTC regime as notified, it is not necessary to determine whether requirements A(1), (2), (3) or B(2), (3) of recitals (17) and (18) respectively are met because the measures of the transitional regime do not require a derogation from Chapters IV, VI and VII of Directive 96/92/EC and thus do not meet requirement B(1).

(20) As stated above, in order to constitute a transitional regime within the meaning of Article 24 of Directive 96/92/EC, the system chosen by the Member State must provide for a derogation from the requirements laid down in Chapters IV, VI or VII of Directive 96/92/EC.

(21) The measures under consideration are based on a pure compensation scheme, i.e. a system of charges or levies implemented by a Member State in order to compensate for stranded costs caused by the application of Directive 96/92/EC. The application of such levies in the present case does not require a derogation from Chapters IV, VI or VII of Directive 96/92/EC and cannot therefore be regarded as a transitional regime within the meaning of Article 24 thereof.

(22) The fact that measures such as those under consideration in this case can result in very considerable distortions of the single market for electricity does not affect this conclusion. Indeed, the Commission recognises that the payment of such levies can result in economic consequences substantially similar to those resulting from a total or partial derogation from some of the obligations contained in Chapters IV, VI or VII of Directive 96/92/EC. However, such distortions by their very nature do not result from such a specific derogation as envisaged by that Directive. The transfer of a compensation payment to certain electricity producers, financed through a levy or charge on the consumers, is therefore a measure which is not directly addressed by the Directive but one which needs to be examined pursuant to the rules on competition, and in particular Article 87(3)(c) of the EC Treaty. Under these circumstances, it is understood that measures of similar

economic effect will be treated in a consistent manner, regardless of the relevant procedure in each individual case.

(23) However, notwithstanding this and despite the fact that in the notification of 18 February 1998 the Spanish Government itself expressed a doubt as to whether it was necessary to apply for transitional regime under Article 24 of Directive 96/92/EC because 'although the CTC corresponds to what is described in Article 24(1), it is not deemed to come within the scope of Article 24(2) as the new Spanish legislation transposing this part of the Directive does not contravene Chapters IV, VI and VII', the Spanish Government argued in the complementary information provided to the Commission by letter of 16 October 1998 that the Spanish CTC regime would, indeed, represent a derogation from Article 8 in Chapter IV of the Directive.

(24) It is argued that the Spanish price regulation before liberalisation (Royal Decree 1583/1987) constitutes a guarantee for the operation and full amortisation of each single power plant. After liberalisation, the market operates under a merit order system according to Article 8 of the Directive, which does not guarantee the dispatching for plant operation at prices guaranteed by Royal Decree 1583/1987. In its letter of 16 October 1998, the Spanish Government concludes that 'the absence of these stranded costs (CTC regime) would lead to a different merit order compared to the one resulting from the current competitive generation market'. ('la ausencia de estos costes hundidos (costes de transición a la competencia) darían lugar a una precedencia económica diferente a la que está resultando en el actual mercado competitivo de generación.')

(25) In other words, Spain contends that the introduction of the CTC payments permits the recipients to use these funds to sell electricity at lower prices than would be the case in the absence of such a transitional regime. This, in turn, will lead to a modification of the merit order based simply on economic criteria, which is the basis of the requirement in Article 8 of Directive 96/92/EC.

(26) Thus, according to the Spanish authorities, the compensation payments of the CTC regime put the plant operators in the same position as if they still had a guarantee of dispatch at cost amortising prices and as if Article 8(2) of Directive 96/92/EC did not apply. In this way, the CTC regime allowed Spain to opt for an early market opening schedule and a simultaneous reduction of electricity tariffs for captive consumers, instead of a delayed market opening, which could have been the result if Spain had opted for a derogation from Chapter VII under Article 24 of the Directive.

(27) However, the Commission considers that this type of compensation, which aims at 'neutralising' in economic terms and for a limited time the effects of applying the provisions of the Directive, cannot be regarded as a 'derogation' from the Directive within the meaning of Article 24. The Spanish system, based on an

independent market operator and a transparent spot market, clearly implements and conforms with the requirements in Article 8 of the Directive. The CTC regime does not constitute a specific derogation from Article 8. What is relevant here is the nature of the notified measure rather than its purpose or aim. By its very nature, the transfer of a compensation payment to certain electricity producers, financed through a levy or charge on the consumers is, as mentioned above, a measure which is not directly addressed by the Directive but one which needs to be examined under the rules on competition, and in particular Article 87(3)(c) of the Treaty.

- (28) In the light of the non-applicability of Article 24 of Directive 96/92/EC, it is not necessary to assess the abovementioned further requirements (2) and (3) of recital (18).

3. The regime for systems on the islands and outside the Iberian peninsula

3.1. The requirements in Article 24(3) of Directive 96/92/EC

- (29) Article 24(3) of the Directive states the following: 'Member States which can demonstrate, after the Directive has been brought into force, that there are substantial problems for the operation of their small isolated systems, may apply for derogations from the relevant provisions of Chapters IV, V, VI, VII, which may be granted to them by the Commission. The latter shall inform the Member States of those applications prior to taking a decision, taking into account respect for confidentiality. This Decision shall be published in the *Official Journal of the European Communities*. This paragraph shall also be applicable to Luxembourg'.
- (30) This provision therefore requires the following elements to be examined by the Commission when considering any application for a transitional regime in such cases.
- (1) Article 24(3) is in principle applicable only to small isolated systems. Article 2(23) of the Directive defines a small isolated system as 'any system with consumption of less than 2 500 GWh in the year 1996, where less than 5 % of annual consumption is obtained through interconnection with other systems'.
 - (2) Member States have to show, after the Directive comes into force, that there are substantial problems for the operation of their small isolated systems.
 - (3) The measures have to fall within the scope of derogations from Chapters IV, V, VI and VII of the Directive.

- (4) In deciding on each application, the Commission applies the proportionality test, which means that the proposed approach must be the least restrictive to trade and competition reasonably necessary to achieve the objectives in question, which themselves must be legitimate.

3.2. Assessment of the Spanish application

- (31) By analogy with the above assessment of the CTC regime, also concerning the regime for systems on the islands and outside the Iberian peninsula, it is not necessary to determine whether requirements (1), (2) and (4) are met, because the measures of the transitional regime in question do not fall within the scope of derogations from Chapters IV, VI and VII of Directive 96/92/EC and thus do not meet requirement (3) of the recital above.
- (32) The Spanish notification itself does not apply for any specific derogation from the Directive. Since the regime for the systems on the islands and outside the Iberian peninsula represents financial support for these systems that is recovered through a levy or charge on electricity consumption, the abovementioned arguments apply by analogy. Thus, such a regime needs to be examined under the rules on State aid, and in particular Article 87(3)(c) of the Treaty. Under these circumstances, as mentioned in point 2.2.3, it is understood that measures of similar economic effect will be treated in a consistent manner, regardless of the relevant procedure in each individual case.
- (33) If, in the future, a derogation under Article 24(3) of Directive 96/92/EC became necessary in order to avoid an infringement of Chapters IV, V, VI or VII with regard to specific rules for the electricity systems on the islands and outside the Iberian peninsula, the Spanish Government could submit an appropriate application at any time as the application deadline specified in Article 24(2) does not apply with respect to Article 24(3).

4. Conclusion

- (34) The Spanish application pursuant to Article 24 of Directive 96/92/EC has two elements.

First, the CTC regime, which has been assessed on the basis of Article 24(1) and (2) of the Directive, and, second, the regime for the systems on the islands and outside the Iberian peninsula, which has been assessed on the basis of Article 24(3) of the Directive.

- (35) The Commission concludes in both cases that a transitional regime pursuant to Article 24 cannot and need not be approved as the measures chosen do not

constitute derogations from Chapters IV, V (only in respect of Article 24(3)), VI and VII of the Directive.

Article 2

- (36) Finally, it has been recognised that both the CTC regime as well as the regime for the systems on the islands and outside the Iberian peninsula systems involve transfers of compensation payments to certain electricity producers, financed through a levy or charge on the consumers. Such measures are not directly addressed by the Directive but need to be examined pursuant to the rules on State aid, and in particular Article 87(3)(c) of the Treaty,

The transitional regime of the 'Costes de transición a la competencia', defined in the sixth transitional provision of Spanish Electricity Sector Act No 54/1997 of 27 November 1997, contains no measures which would constitute derogations from Chapters IV, VI or VII of Directive 96/92/EC, as referred to in Article 24(2) of the Directive. Article 24 of the Directive is therefore not applicable to this part of the transitional regime notified by the Spanish Government.

Article 3

HAS DECIDED AS FOLLOWS:

The transitional regime of the 'Sistemas insulares y extrapeninsulares', as notified by the Spanish Government, contains no measures which would constitute derogations from Chapters IV, V, VI or VII of Directive 96/92/EC, as referred to in Article 24(3) of the Directive. Article 24 of the Directive is therefore not applicable to this part of the transitional regime notified by the Spanish Government.

Article 1

The present Decision concerns the application of the Spanish Government for a transitional regime pursuant to Article 24 of Directive 96/92/EC, notified to the Commission on 18 February 1998. This notification concerns:

Article 4

This decision is addressed to Spain.

- (a) the 'Costes de transición a la competencia', defined in the sixth transitional provision of Spanish Electricity Sector Act No 54/1997 of 27 November 1997,
- (b) the 'Sistemas insulares y extrapeninsulares', defined in the 15th transitional provision of Spanish Electricity Sector Act No 54/1997 of 27 November 1997.

Done at Brussels, 8 July 1999.

For the Commission
Christos PAPOUTSIS
Member of the Commission

COMMISSION DECISION**of 8 July 1999****concerning the Danish application for a transitional regime under Article 24 of Directive 96/92/EC of the European Parliament and of the Council concerning common rules for the internal market in electricity***(notified under document number C(1999) 1551/8)***(Only the Danish text is authentic)**

(1999/798/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

2. Structure and development of the electricity sector in Denmark

Having regard to the Treaty establishing the European Community,

Having regard to Directive 96/92/EC of the European Parliament and of the Council of 19 December 1996 concerning common rules for the internal market in electricity⁽¹⁾, and in particular Article 24 thereof,

Having informed the Member States of the application submitted by Denmark,

Whereas:

I. FACTS**1. Procedure**

- (1) By letter of 19 February 1998, the Danish Ministry of Environment and Energy (*Miljø- og Energiministeriet*) applied for a transitional regime pursuant to Article 24 of the Directive.
- (2) On 25 June 1998, a meeting between the Commission and representatives from the Danish Ministry of Environment and Energy was held in Brussels to discuss the application. The Ministry was asked to provide more detailed information.
- (3) By letter of 16 October 1998, the Ministry submitted this information.

- (4) In 1997, there were 111 companies in the Danish electricity industry. 46 of the companies are directly owned and run by municipalities, 43 are organised as consumer owned cooperatives, nine are partnerships, 11 are private foundations and two are joint stock companies.
- (5) The transmission network in Denmark is divided into two separate vertically integrated systems. Eltra (separate legal entity and separate management and governing board) operates a network which covers the western part of Denmark (Jutland and Funen) and is linked to the UCPTE net and Elkraft System (organised within Elkraft but has separate management) operates a network which covers the eastern part and is linked to the Nordel net. The distribution companies are responsible for the sale of electricity to the consumers, and for the planning, operation and maintenance of the low and medium-voltage grid.
- (6) The generation of electricity is undertaken by eight companies which are owned by the distribution companies. The generation of electricity and the sale of electricity to the distribution companies are coordinated by Elsam (in the Eltra area) and by Elkraft.
- (7) There are three electricity undertakings which are producers as well as distributors: Københavns Belysningsvæsen (the municipality of Copenhagen), Østkraft on the island of Bornholm, and the municipality of Randers.
- (8) The electricity is mainly produced in combination with heat production. Coal is the predominant fuel in these plants; however, natural gas is growing in importance. Traditional power plants producing only electricity have been phased out in recent years. In addition, renewable energy sources such as biomass and wind power are becoming more important in electricity production. It is

⁽¹⁾ OJ L 27, 30.1.1997, p. 20.

the policy of Denmark that this development should continue.

- (9) Historically, Denmark has been a net importer of electricity, but since 1995 it has had a surplus which has been exported.

3. *The Electricity Supply Act and the Electricity Market Directive*

- (10) The Danish electricity market is regulated through the Electricity Supply Act (ESA), which entered into force in 1977. Since then it has undergone several amendments, but the structure remains unchanged.
- (11) The transition towards a more market-based system commenced with the adoption of an amendment to the ESA by Parliament in May 1996. The purpose of the amendment was to introduce competition in Denmark while at the same time ensuring that the electricity industry would have to fulfil a number of public service obligations relating to environmental protection, security of supply and consumer protection. The amendment entered into force on 1 January 1998 after the approval of certain elements of the Bill by the Commission on 3 December 1997 (State-aid procedure) ⁽²⁾.
- (12) Since 1 January 1998, distribution companies with an annual supply of electricity above 100 GWh and final consumers with an annual electricity consumption above 100 GWh per consumption site have been considered as eligible customers. The Danish electricity market is characterised by having only a few large electricity consumers. In fact, only seven consumers exceed the 100 GWh threshold and their market share equals about 5% of total consumption in Denmark. By including distributors the potential market involved indirectly increases to about 90% of the market.
- (13) Denmark has opted for negotiated third party access in the present legislation. In practice, however, Eltra and Elkraft System have introduced third party access based on published tariffs for access to the transmission networks. The distribution network is still characterised by negotiated third party access.
- (14) There are still a number of outstanding issues of detail to be covered by new legislation in order to fully comply with the Directive. The Danish Government is preparing legislation which, *inter alia*, covers these remaining issues.

4. *The transitional regime notified by the Danish Government*

4.1. *Introduction*

- (15) The Danish Government has notified transitional regimes for three types of commitments:
- (1) Take-or-pay gas contracts
- (2) Closure of power plants
- (3) Pension obligations.

4.2. *Take-or-pay gas contracts*

The commitment

- (16) Two Danish undertakings, Elkraft AmbA and I/S Elsam have concluded three take-or-pay gas contracts with Dansas A/S.
- 1991 — contract, which runs from 1996 until 2020 and requires Elkraft to take a minimum of [...] (*) million Nm³ per annum,
- 1994 — contract, which runs from 1996 until 2020 and requires Elsam to take a minimum of [...] (*) million Nm³ per annum,
- 1995 — contract, which runs from 2001 until 2010 and requires Elsam to take a minimum of [...] (*) million Nm³ per annum and Elkraft to take a minimum of [...] (*) million Nm³ per annum.
- (17) The gas price is [...] (*).
- (18) The contracts include a clause which [...] (*).
- (19) The contracts are [...] (*).
- (20) The gas is destined for use at four central combined heat and power plants which are partly covered by a 'CHP guarantee' which exists in Denmark, according to which Danish distribution companies are obliged to purchase the heat-driven electricity produced by these plants at cost-covering prices if the electricity cannot be sold without making a loss on the free market. This guarantee has been examined by the Commission and accepted in relation to the Treaty provisions on State aid (see footnote 2). It has also been analysed in relation to the provisions of the Directive, and the Commission has,

⁽²⁾ State aid N 305/96 — Denmark — Measures in favour of centralised electricity generating plants.

(*) Business secret.

in a preliminary assessment, found the scheme to be compatible with the Directive. This assessment has been transmitted to the Ministry of Environment and Energy⁽³⁾.

- (21) The 'CHP guarantee' operates until 2006 and for three of the plants, H. C. Ørstedsværket, Svanemølleværket and Avedøreværkets Blok 2, the bulk of electricity production would be covered by the guarantee, as it is produced in combination with heat. The Danish Government therefore does not foresee any problems before 2006 regarding take-or-pay contracts for these plants, as the 'CHP guarantee' ensures that the heat-driven electricity can be sold at a price which covers the production costs. Regarding the last plant, Skærbækværket, only 30% of the electricity production is expected to be covered by the 'CHP guarantee' and, with respect to this plant, the gas take-or-pay contracts may pose difficulties depending on the movements of gas market prices compared to that fixed in the contracts.

Extent of stranded costs

- (22) The Danish Government has calculated the commitment related to the three take-or-pay commitments at DKK 8,9 billion, corresponding to the value of the natural gas destined for electricity production, which is not covered by the 'CHP guarantee'; the assumption is that the natural gas price will remain stable. This figure is calculated on the basic assumption that the electricity price would be reduced to zero.
- (23) The Government assumes, however, that it is more realistic that the market price of electricity would increase from the present level of DKK 0,12 per kWh (current price in Nordic electricity pool as reported by the Danish Government in its letter of 16 October 1998) to DKK 0,15 per kWh in 2000. Thereafter, the Government expects [...] (*).
- (24) Under the above assumptions of increasing market prices of electricity and gas, the Government has estimated the stranded costs related to take-or-pay contracts at DKK 993 million in total over the period 1999 to 2020.

Method of recovery

- (25) The Government is considering allowing the electricity undertakings to put a surcharge on electricity consumption. This will be levied at final consumer level. The amount will be calculated *ex post* and may only

cover actual losses. In cases of overcompensation the surplus will have to be paid back to the consumers. The undertakings must have separate accounts for the support in order to avoid cross-subsidising and ensure transparency. The amount will be indicated separately on consumers' electricity bills.

4.3. Closures of power plants

The commitment

- (26) Electricity generating companies in Denmark have until now not been allowed to make provisions for future costs for closing and dismantling production plants. Thus, costs for dismantling were met on an 'as-and-when' basis through the electricity tariffs, which could if necessary be increased to meet these costs.
- (27) In a non-competitive market this has not therefore posed any problems for the generation companies, as the costs in the end have been passed on to the final consumers. In a competitive market where consumers are no longer captive, it may no longer be possible to pass on these costs.
- (28) The Danish Government has reported that 30 production units are expected to be closed and dismantled in the period 1999 to 2025 and that six production units have recently been closed and are being dismantled. The normal lifetime of a production unit is estimated at 30 years. In certain cases, the closure and dismantling has been ordered by the Energy Agency for environmental reasons. Dismantling can only take place with a licence from the Energy Agency, (see Article 5(1) of the Electricity Supply Act).

Extent of stranded costs

- (29) The Government has estimated that the dismantling costs per production unit amount to between DKK 100 million and DKK 170 million depending on the size of the unit. The dismantling costs for a 137 MW unit closed in 1996 (Nordjyllandsværket, Blok 1) have been estimated at DKK 87 million. However, according to the Danish notification, these costs are below normal costs, as part of the unit will not be dismantled, but will be used in connection with the other units of this power plant.
- (30) Following the adoption of the new Electricity Supply Act (expected during 1999), electricity companies will be able to make provisions to cover such costs. The Government has therefore only notified costs for power units for which a licence for dismantling has been or is

⁽³⁾ Letter of 31 October 1997 from DG XVII of the Commission to the Ministry of Environment and Energy.

expected to be issued in the period from 1 January 1998 to 31 December 2007. Companies with plants that are expected to close after this date will be required to make adequate provision for decommissioning between now and closure. The stranded cost regime is intended to finance, or contribute towards the financing, of the plants to close before this date. For such plants, no provisions to cover costs have yet been made and insufficient time remains for adequate reserves to be built up prior to closure. In total, 21 units and six plants currently being dismantled will be covered.

- (31) The Government estimates the total stranded costs at DKK 2 750 million, broken down as follows:

- Sjællandske Kraftværker (part of Elkraft area): DKK 800 million, relating to eight power units,
- Københavns Belysningsvæsen (part of Elkraft area): DKK 600 million, relating to six power units,
- Elsam: DKK 1 350 million, relating to seven power units and costs of six plants currently being dismantled.

- (32) The Government envisages granting a subsidy of up to DKK 170 million per unit for which an application for a dismantling licence is submitted to the Energy Agency before 1 January 2001. The maximum subsidy will be reduced for applications after this date. In 2001, the maximum amount will be DKK 102 million and this will be reduced by DKK 17 million for each of the following years. Dismantling must commence at the latest one year after the licence has been issued.

- (33) The aggregated costs of the subsidy schemes have been calculated by the Danish Government at DKK 2 300 million.

Method of recovery

- (34) The Government is considering introducing two separate schemes to finance the subsidy; one for Elsam and one for Elkraft. They will be permitted to put a surcharge on electricity consumption through a separate charge to final consumers in their area, and the costs will therefore be paid by both consumers of the electricity generated by the undertakings themselves and by consumers of electricity purchased on third party contracts.

- (35) In cases of overcompensation the surplus will have to be paid back to the consumers. The undertakings must have separate accounts for the support in order to avoid cross-subsidising and ensure transparency. The amount

will be indicated separately on consumers' electricity bills.

4.4. Pension obligations

The commitment

- (36) Municipal undertakings operating in the electricity sector have traditionally employed a large number of staff as civil servants. Their terms of employment oblige the municipal undertakings to make regular pension payments to retired employees. Money has not been put aside to cover present and future costs related to pension payments. Instead the costs have been included in the price of electricity on an 'as-and-when' basis when they occurred.

- (37) Since 1 January 1997, new staff have been employed on a contractual basis, and the undertakings pay pension contributions throughout the period of employment. The change from hiring staff as civil servants to employment on contract implies that municipal undertakings for some years will have to pay pension contributions for present employees as well as pensions to former employees for which no provision has been made.

- (38) The Danish Government feels that this will only pose problems for generating companies, as distribution companies will continue to have a supply monopoly in their distribution area and can therefore always cover pension costs through their distribution tariffs. Only one generating company, which is also a distributor, Københavns Belysningsvæsen, will need a transitional regime. The company has not hired any new staff on civil servant conditions since 1 January 1997, which was before the Directive entered into force.

Extent of stranded costs

- (39) *Assurandørgruppen* (Group of insurers) has calculated the capital value of the pension obligation for Københavns Belysningsvæsen to be DKK 600 to 700 million (end of 1997) depending on the assumptions of the retirement age for the employees covered by the obligation.

- (40) Concerning future pension rights for employees with civil servant status, Københavns Belysningsvæsen will pay a pension contribution equal to 15% of salary to cover these costs.

Method of recovery

- (41) The Government is considering a transitional regime where Københavns Belysningsvæsen, for a period of ten

years, receives the right to collect DKK 700 million from electricity consumers. The notification does not contain any further description of how the scheme will be designed.

- (42) In cases of overcompensation the surplus will have to be paid back to the consumers. The undertakings must have separate accounts for the support in order to avoid cross-subsidising and ensure transparency. The amount will be indicated separately on consumers' electricity bills.

II. LEGAL ANALYSIS

1. *Legal basis: Article 24 of Directive 96/92/EC*

- (43) The Danish notification explicitly applies for a transitional regime under Article 24 of Directive 96/92/EC.

2. *Requirements of Article 24*

- (44) Article 24(1) and (2) of Directive 96/92/EC, in the light of the EC Treaty, require the following elements to be examined by the Commission when considering any application for a transitional regime.

A. *Requirements concerning the nature of the commitments or guarantees of operation in question*

- (1) The existence of a commitment or guarantee of operation must be proven.
- (2) The commitment or guarantees of operation must have been given before 20 February 1997.
- (3) A causal link between the entry into force of the Directive and the inability to honour the commitment must be established.

B. *Requirements concerning the measures proposed to achieve the objectives in question*

- (1) The measures of the transitional regime must fall within the scope of derogation from Chapters IV, VI and VII of the Directive.
- (2) The transitional regime must be of limited duration and linked to the expiry of the commitments or guarantees of operation in question.
- (3) The transitional regime must apply the least restrictive measures reasonably necessary to achieve the objectives in question, which themselves must be legitimate. In deciding on these issues the Commission must take into

account, amongst other things, the size of the system concerned, the level of interconnection of the system and the structure of its electricity industry.

3. *Assessment of the notification*

- (45) In the present case, concerning the transitional regime as notified, it is not necessary to determine whether requirements A(1), (2), (3) or B(2), (3) are met, because the measures in question do not fall within the scope of derogations from Chapters IV, VI and VII of the Directive and thus do not meet requirement B(1) above.

- (46) Article 24(1) and (2) of Directive 96/92/EC states the following:

'1. Those Member States in which commitments or guarantees of operation given before the entry into force of this Directive may not be honoured on account of the provisions of this Directive may apply for a transitional regime which may be granted to them by the Commission, taking into account, amongst other things, the size of the system concerned, the level of interconnection of the system and the structure of its electricity industry. The Commission shall inform the Member States of those applications before it takes a decision, taking into account respect for confidentiality. This Decision shall be published in the *Official Journal of the European Communities*.

2. The transitional regime shall be of limited duration and shall be linked to expiry of the commitments or guarantees referred to in paragraph 1. The transitional regime may cover derogations from Chapters IV, VI and VII of this Directive. Applications for a transitional regime must be notified to the Commission no later than one year after the entry into force of this Directive.'

- (47) It is clear, therefore, that in order to constitute a transitional regime within the meaning of Article 24, the system chosen by the Member State must provide for a derogation from the requirements laid down by the Directive in its Chapters IV, VI or VII.

- (48) Thus, a pure compensation scheme, i.e. a system of charges or levies implemented by a Member State in order to compensate for stranded costs caused by the application of the Directive, cannot be regarded as a transitional regime within the meaning of Article 24 of Directive 96/92/EC. The application of such a levy would not require a derogation from the abovementioned chapters of the Directive.

- (49) The fact that measures such as those under consideration in this case can result in very considerable distortions of competition in the single market for electricity do not affect this conclusion. The Commission thus recognises that the payment of such levies can result in economic consequences substantially similar to those resulting from a total or partial derogation from some of the

obligations contained in Chapters IV, VI or VII of Directive 96/92/EC. However, such distortions by their very nature do not result from such a specific derogation as envisaged by the Directive. The transfer of a compensation payment to certain electricity producers, financed through a levy or charge on the consumers is, therefore, a measure which is not directly addressed by the Directive but one which needs to be examined pursuant to Article 87(3)(c) of the EC Treaty. Under these circumstances, it is understood that measures of similar economic effect will be treated in a consistent manner, regardless of the relevant procedure in each individual case.

- (50) In the light of the non-applicability of Article 24 of Directive 96/92/EC, it is not necessary to assess the abovementioned further requirements (2) and (3),

HAS DECIDED AS FOLLOWS:

Article 1

The proposed transitional regime relates to commitments undertaken by Danish electricity undertakings regarding

take-or-pay gas contracts, closures of power plants and pension obligations as notified by the Danish Government in its letter of 19 February 1998.

Article 2

The transitional regime notified by the Danish Government contains no measures which would constitute derogations from Chapter IV, VI or VII of Directive 96/92/EC. Article 24 of the Directive is therefore not applicable to the transitional regime notified by the Danish Government.

Article 3

This decision is addressed to the Kingdom of Denmark.

Done at Brussels, 8 July 1999.

For the Commission

Christos PAPOUTSIS

Member of the Commission
