

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:

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

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.
- 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.

- (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.

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

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.

- (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.

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.
- (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

- (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.

Article 4(3) (new *Länder*) of the German 'Gesetz zur Neuregelung 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.

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.

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