



Energy law Preparation material

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1. General EU law

The European Union is a legal community that consists of a system of legal standards that, according to their rules of creation, can be classified into various types of standard levels.

The most important position within EU law is taken by primary law where a decision for its application is by means of a declaration of intent by a member state. Besides the treaties, numerous protocols as well as alterations to the treaties decided by member states are also applicable. An example of one such treaty alteration is the EU entry treaty that also needs to be taken into account as part of EU primary law. Included in EU primary law are the rules for the creation of further legal standards, for EU secondary law and EU derived laws respectively. Depending upon the sphere of influence and the effect, one differentiates between regulations which are directed at all EU member states and community members and which are immediately mandatory in all areas; guidelines that are directed at all or certain membership states and only are binding with respect to predetermined goals and which are regularly incorporated into the internal laws of member states; decisions which are directed at certain member states or certain persons and which are binding on both of them; and recommendations or statements aimed at all or certain member states but which are not legally binding.

On the basis of EU primary law, there are already some commitments for member states and citizens of the membership states that relate to the domestic energy market. This applies particularly to article 12 of the EU treaty that excludes discrimination on the basis of citizenship. This means that it is basically not possible under state law to grant a certain right only to their own citizens or businesses that are domiciled in that particular member state. Article 14 also defines the single European market as an area without internal borders where the free movement of goods, people, services and capital must be guaranteed in accordance with the provisions of the treaty. Alongside the principle of freedom from discrimination and the principle of the free exchange of goods, the general provisions relating to competition laws and public monopolistic companies, as well as the provisions relating to assistance law, are also of particular importance.



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Overall it should be noted that the situation prevailing before liberation of the electricity and gas markets in the European Union contradicted most, if not all, of these provisions. In this regard there were many special rights that were limiting the internal European market and which were reserved for companies or citizens of a particular member state. Public owners were used to demanding non-market interest rates for capital employed etc.

However, it should be noted that the EU treaty does not recognise a fundamental ban on monopolies. It merely forbids the misuse of a monopoly position. The particular cases covered by regulations are those cases where the monopoly status of a company has been granted as the result of national legal order or as the result of the granting of special or exclusive rights. The member states are required to ensure, with respect to public and private businesses to which special or exclusive rights have been granted, that none of these measures that contradict the treaty are retained. The granting of a legal monopoly is fundamentally in accordance with the treaty but abuse of this position is not permitted. A further limitation to the general freedom of the movement of goods applies to essential service companies. Companies in charge of serving general commercial interest only have to fulfil the regulations of the EU treaty, particularly the rules relating to competition, to the extent that their fulfilment does not create a hindrance to them being able to effectively deliver services of general commercial interest. In this regard, an actual or legal impediment to the fulfilment of their duties is enough for them to be absolved from the commitments of the rules of competition.

As a consequence, that is why there has been intense discussion about the manner and extent of public interest in the duties and responsibilities of the electrical utility companies. At this point it needs to be noted that the network operator in particular has these duties and, as a monopoly company, is not subject to competition, whereas essential services in the areas of electricity production and distribution appear to be exceptions.



2. Guidelines for the internal EU electricity market

On the June 20, 1996 at a special meeting of the EU Council of Ministers for Energy in Luxembourg, a unanimous political agreement was achieved regarding a collective view in favour of a guideline from the European Parliament and the Council concerning common rules for the internal EU electricity market. This marked the end of more than 5 years of negotiations. For the first time in its 100-year history, this branch of the economy was, at least in part, brought under the jurisdiction of the rules applying to the free market. The background to the negotiations associated with this guideline was primarily the aim to develop a free competitive market for the production and marketing of electricity but, in contrast, to permit regional monopoly companies in the areas of electricity transmission. Because the electricity networks are portrayed as being so-called "essential facilities", each market participant, offering party, or consumer, must use these facilities. This regulation is of special importance because electricity distribution networks are so called "essential facilities" and so every market participant must use these facilities. This approach to the regulation of networks is of particular importance.

The guidelines agreed to in 1996 in fact on one hand regulate the fundamental provisions with regard to new producers entering the market but, on the other hand, the focus of these provisions is the regulation of network operators. The rights and responsibilities of the transmission and distribution network operators are specified. For this reason no non-approved cash flows can occur between competitive areas such as production, distribution, and the monopoly network area and so divestiture and transparency in the accounting area needs to be brought in. In this way the intention is to ensure that older established integrated electricity supply companies don't use money earned from the distribution network to support their own competitive positions. On the other hand, the network operator is required to only demand tariffs that truly correspond to the costs incurred by the network operator and, in particular, not the costs of marketing.



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Originally the guidelines envisaged a gradual opening up of the market to a little more than 30% by the year 2003. The experience of the EU members was that some member states with a high level of market openness tried to restrict the free play of market forces because of inefficient regulatory measures. On the other hand, other EU members only opened up their markets to the minimum levels required right from the start. It quickly became obvious that equitable competition between market participants could only be possible with two prerequisites:

1. With an equitable 100 % opening up of the market for all consumers,
2. With equitable rigorous regulation of the network operators by independent regulatory authorities.

The EU's acceleration guidelines agreed to in 2003 were designed to ensure fulfilment of precisely these two points. This is to be done by introducing independent regulatory authorities by the year 2004 and to guarantee access to a free electricity market in the EU by the end of 2007.

The above-mentioned rigorous regulatory moves also include greater separation of the distribution network activities from the competitive activities within vertically integrated electricity supply companies. A core element of this separation is their separation under company law. This means that for a certain population size (100.000 customers), a separate network company must be formed. In addition the guideline clearly defines which potential rights remaining holding company (parent company) is allowed to have with regards to the activities of network operator. Basically these rights are limited to being those of a financial investor. Any influence on the daily trading or actual investment decisions must be excluded.



3. Liberalisation of the gas market

The guideline agreed to in 1998 regarding common regulations for the internal EU natural gas market is a regulation similar to that for the internal EU electricity market - on one hand the activities of the competing natural gas companies and, on the other hand, the particular activities of the distribution network operators. In this case the guideline also contains a few provisions regarding the entry of new participants for the delivery and wholesaling of natural gas into the market. Particular problems impacting on the liberalisation of the internal EU gas market are illustrated by two elements:

1. So called Take-or-Pay contracts,
2. Regulation of storage facilities

1: Traditionally, the European gas market has been based upon extremely long-term contracts that have largely been dependent upon imports from Russia. Within the scope of these contracts, the buyer agrees to purchase a certain quantity and the seller can structure the pricing on a variable basis to ensure that natural gas remains competitive with alternative energy sources. Take-or-Pay contracts therefore designate the duty of a buyer to be committed to buying a certain quantity of gas or to pay a defined price for the equivalent amount at the current price. On the basis of these contracts, the liberalisation situation for existing natural gas companies is similar to those for generation plant operators in the electricity market. These contracts can become "Stranded Investments" in the same way such that generation plants are not able to produce electricity competitively.

2: In regard to the coordination of gas storage, discussions in Europe have not produced a clear classification. On one hand gas storage serves to even out pressure variations in the transmission system. On the other hand, this gas storage also serves to compensate for the highly variable demand structure in western European consuming countries. In the first instance, gas storage is connected more with a regulated distribution network company. In the second case it is connected more to the competitive gas market. Because historically, both services cannot be clearly separated from each other, there have been interim regulations in the form of so called negotiated access. Upon the basis of the guidelines, this enables a limitation on regulation of storage services required for the distribution network. Separation of the two areas is technically very complicated to achieve. The findings from the first years of European gas market liberalisation are similar to those for electricity liberalisation. These are that, as well as totally opening up the market, rigorous distribution network tariff regulation is also essential to ensure efficient competition exists.