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:

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 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.

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 prejudge 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 prejudge 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.

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,

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:

(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:

(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.

Done at Brussels, 8 July 1999.

For the Commission

Christos PAPOUTSIS

Member of the Commission