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 Compañia 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 tarification 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.

(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,

HAS DECIDED AS FOLLOWS:

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:

(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.

Article 2

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

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 4

This decision is addressed to Spain.

Done at Brussels, 8 July 1999.

For the Commission
Christos PAPOUTSIS
Member of the Commission