COMMISSION DECISION

of 8 July 1999

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

(notified under document number C(1999) 1551/8)

(Only the Danish text is authentic)

(1999/798/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community,

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

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

Whereas:

I. **FACTS**

1. ***Procedure***

(1) By letter of 19 February 1998, the Danish Ministry of Environment and Energy (*Miljø- og Energiministeriet*) applied for a transitional regime pursuant to Article 24 of the Directive.

(2) On 25 June 1998, a meeting between the Commission and representatives from the Danish Ministry of Environment and Energy was held in Brussels to discuss the application. The Ministery was asked to provide more detailed information.

(3) By letter of 16 October 1998, the Ministry submitted this information.

2. ***Structure and development of the electricity sector in Denmark***

(4) In 1997, there were 111 companies in the Danish electricity industry. 46 of the companies are directly owned and run by municipalities, 43 are organised as consumer owned cooperatives, nine are partnerships, 11 are private foundations and two are joint stock companies.

(5) The transmission network in Denmark is divided into two separate vertically integrated systems. Eltra (separate legal entity and separate management and governing board) operates a network which covers the western part of Denmark (Jutland and Funen) and is linked to the UCPTE net and Elkraft System (organised within Elkraft but has separate management) operates a network which covers the eastern part and is linked to the Nordel net. The distribution companies are responsible for the sale of electricity to the consumers, and for the planning, operation and maintenance of the low and medium-voltage grid.

(6) The generation of electricity is undertaken by eight companies which are owned by the distribution companies. The generation of electricity and the sale of electricity to the distribution companies are coordinated by Elsam (in the Eltra area) and by Elkraft.

(7) There are three electricity undertakings which are producers as well as distributors: Københavns Belysningsvæsen (the municipality of Copenhagen), Østkraft on the island of Bornholm, and the municipality of Randers.

(8) The electricity is mainly produced in combination with heat production. Coal is the predominant fuel in these plants; however, natural gas is growing in importance. Traditional power plants producing only electricity have been phased out in recent years. In addition, renewable energy sources such as biomass and wind power are becoming more important in electricity production. It is

[1] OJ L 27, 30.1.1997, p. 20.

the policy of Denmark that this development should continue.

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

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

(10) The Danish electricity market is regulated through the Electricity Supply Act (ESA), which entered into force in 1977. Since then it has undergone several amendments, but the structure remains unchanged.

(11) The transition towards a more market-based system commenced with the adoption of an amendment to the ESA by Parliament in May 1996. The purpose of the amendment was to introduce competition in Denmark while at the same time ensuring that the electricity industry would have to fulfil a number of public service obligations relating to environmental protection, security of supply and consumer protection. The amendment entered into force on 1 January 1998 after the approval of certain elements of the Bill by the Commission on 3 December 1997 (State-aid procedure) ([2]).

(12) Since 1 January 1998, distribution companies with an annual supply of electricity above 100 GWh and final consumers with an annual electricity consumption above 100 GWh per consumption site have been considered as eligible customers. The Danish electricity market is characterised by having only a few large electricity consumers. In fact, only seven consumers exceed the 100 GWh threshold and their market share equals about 5% of total consumption in Denmark. By including distributors the potential market involved indirectly increases to about 90% of the market.

(13) Denmark has opted for negotiated third party access in the present legislation. In practice, however, Eltra and Elkraft System have introduced third party access based on published tariffs for access to the transmission networks. The distribution network is still characterised by negotiated third party access.

(14) There are still a number of outstanding issues of detail to be covered by new legislation in order to fully comply with the Directive. The Danish Government is preparing legislation which, *inter alia,* covers these remaining issues.

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

4.1. **Introduction**

(15) The Danish Government has notified transitional regimes for three types of commitments:

(1) Take-or-pay gas contracts

(2) Closure of power plants

(3) Pension obligations.

4.2. **Take-or-pay gas contracts**

The commitment

(16) Two Danish undertakings, Elkraft AmbA and I/S Elsam have concluded three take-or-pay gas contracts with Dangas A/S.

— 1991 — contract, which runs from 1996 until 2020 and requires Elkraft to take a minimum of […] (*) million Nm^3 per annum,

— 1994 — contract, which runs from 1996 until 2020 and requires Elsam to take a minimum of […] (*) million Nm^3 per annum,

— 1995 — contract, which runs from 2001 until 2010 and requires Elsam to take a minimum of […] (*) million Nm^3 per annum and Elkraft to take a minimum of […] (*) million Nm^3 per annum.

(17) The gas price is […] (*).

(18) The contracts include a clause which […] (*).

(19) The contracts are […] (*).

(20) The gas is destined for use at four central combined heat and power plants which are partly covered by a 'CHP guarantee' which exists in Denmark, according to which Danish distribution companies are obliged to purchase the heat-driven electricity produced by these plants at cost-covering prices if the electricity cannot be sold without making a loss on the free market. This guarantee has been examined by the Commission and accepted in relation to the Treaty provisions on State aid (see footnote 2). It has also been analysed in relation to the provisions of the Directive, and the Commission has,

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

(*) Business secret.

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

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

Extent of stranded costs

(22) The Danish Government has calculated the commitment related to the three take-or-pay commitments at DKK 8,9 billion, corresponding to the value of the natural gas destined for electricity production, which is not covered by the 'CHP guarantee'; the assumption is that the natural gas price will remain stable. This figure is calculated on the basic assumption that the electricity price would be reduced to zero.

(23) The Government assumes, however, that it is more realistic that the market price of electricity would increase from the present level of DKK 0,12 per kWh (current price in Nordic electricity pool as reported by the Danish Government in its letter of 16 October 1998) to DKK 0,15 per kWh in 2000. Thereafter, the Government expects […] (*).

(24) Under the above assumptions of increasing market prices of electricity and gas, the Government has estimated the stranded costs related to take-or-pay contracts at DKK 993 million in total over the period 1999 to 2020.

Method of recovery

(25) The Government is considering allowing the electricity undertakings to put a surcharge on electricity consumption. This will be levied at final consumer level. The amount will be calculated *ex post* and may only cover actual losses. In cases of overcompensation the surplus will have to be paid back to the consumers. The undertakings must have separate accounts for the support in order to avoid cross-subsidising and ensure transparency. The amount will be indicated separately on consumers' electricity bills.

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

4.3. **Closures of power plants**

The commitment

(26) Electricity generating companies in Denmark have until now not been allowed to make provisions for future costs for closing and dismantling production plants. Thus, costs for dismantling were met on an 'as-and-when' basis through the electricity tariffs, which could if necessary be increased to meet these costs.

(27) In a non-competitive market this has not therefore posed any problems for the generation companies, as the costs in the end have been passed on to the final consumers. In a competitive market where consumers are no longer captive, it may no longer be possible to pass on these costs.

(28) The Danish Government has reported that 30 production units are expected to be closed and dismantled in the period 1999 to 2025 and that six production units have recently been closed and are being dismantled. The normal lifetime of a production unit is estimated at 30 years. In certain cases, the closure and dismantling has been ordered by the Energy Agency for environmental reasons. Dismantling can only take place with a licence from the Energy Agency, (see Article 5(1) of the Electricity Supply Act).

Extent of stranded costs

(29) The Government has estimated that the dismantling costs per production unit amount to between DKK 100 million and DKK 170 million depending on the size of the unit. The dismantling costs for a 137 MW unit closed in 1996 (Nordjyllandsværket, Blok 1) have been estimated at DKK 87 million. However, according to the Danish notification, these costs are below normal costs, as part of the unit will not be dismantled, but will be used in connection with the other units of this power plant.

(30) Following the adoption of the new Electricity Supply Act (expected during 1999), electricity companies will be able to make provisions to cover such costs. The Government has therefore only notified costs for power units for which a licence for dismantling has been or is

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

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

— Sjællandske Kraftværker (part of Elkraft area): DKK 800 million, relating to eight power units,

— Københavns Belysningsvæsen (part of Elkraft area): DKK 600 million, relating to six power units,

— Elsam: DKK 1 350 million, relating to seven power units and costs of six plants currently being dismantled.

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

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

Method of recovery

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

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

4.4. **Pension obligations**

The commitment

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

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

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

Extent of stranded costs

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

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

Method of recovery

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

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

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

II. LEGAL ANALYSIS

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

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

2. *Requirements of Article 24*

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

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

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

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

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

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

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

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

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

3. *Assessment of the notification*

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

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

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

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

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

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

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

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

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

HAS DECIDED AS FOLLOWS:

Article 1

The proposed transitional regime relates to commitments undertaken by Danish electricity undertakings regarding take-or-pay gas contracts, closures of power plants and pension obligations as notified by the Danish Government in its letter of 19 February 1998.

Article 2

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

Article 3

This decision is addressed to the Kingdom of Denmark.

Done at Brussels, 8 July 1999.

For the Commission

Christos PAPOUTSIS

Member of the Commission