

The new German Energy Law: green light for competition?

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In its Benchmarking Reports the EU has consistently suggested that unbundling and regulatory issues provide the main remaining obstacles to increased competition in the German energy market⁽¹⁾. To comply with the requirements of the Gas and Electricity Acceleration Directives of the European Union (Directives 2003/54/EC and 2003/55/EC respectively), the German parliament passed on June 17, 2005 extensive amendments to the nation's existing Energy Industry Act (EnWG). Furthermore the Federal Government outlined detailed guidelines on electricity and gas grid access and tariff calculation methods in draft ordinances which will enter into force this summer.

We examine the most salient features of the proposed new Energy Industry Act as it stands to date and their implications for various market participants. Given the length of the new provisions (a non-scientific indication of their comprehensiveness is the fact that the draft law and ordinances put together are about seven centimetres thick), this discussion is meant to provide an overview of the main areas of interest and stimulate discussion rather than make any claims to completeness.

The requirements of the EU Directive which are of particular interest

The new EU Directives have departed from Directives 96/92/EC and 98/30/EG they superseded in two major areas:

- The new Directives have sharpened unbundling requirements: If a distribution or transmission system operator is part of a vertically integrated undertaking, it has to be *independent at least in terms of its legal form, organisation and decision making from other activities not relating to distribution/ transmission* (e.g. Articles 10 and 15 of Directive 2003/54/EC);
- The new EU Directive sets out the minimum set of competences, which the regulatory authorities in all Member States should share.

Since Germany was unique in Europe in not having a regulatory authority with ex ante rule making powers, the regulatory provisions of the EU Directive will pose some of the greatest cultural and law-making challenges for Germany.

According to the new EU Directives, regulatory authorities are required to be entirely independent from the interests of the electricity and gas industry. Their minimum responsibilities include ensuring non-discrimination, effective competition and the efficient functioning of the market. (Directive 96/92/EC, Article

23.1). In this context regulation is to contribute to guaranteeing non-discriminatory access to networks. *National regulatory authorities should be able to fix or approve tariffs, or the methodologies underlying the calculation of the tariffs* (ibid Point 18 of the Preamble). The regulatory authority can be required to submit its tariffs or calculation methods to a *relevant body in the Member State* of the country concerned, such as the Economics Ministry in the case of Germany. *The relevant body shall, in such a case, have the power to either approve or reject a draft decision submitted by the regulatory authority* (Article 23.4). *More specifically the Ministry should be permitted to either accept or reject the decision, it may not amend the decision of the regulatory authority* (Interpretative notes, Footnote 1).

Unbundling

The high degree of vertical integration in the German energy sector has contributed to the large number of grid access disputes since energy sector liberalization in 1999. One of the crucial aspects of the New German Energy Act is to provide rules on legal, operational (management and information) and accounting unbundling, which in their wording closely mirror the provisions of the EU Directive (Article 1, Part 2 EnWG). In this context the recent insertion of the requirement to make available to interested third parties the 'internal' unbundled accounts (Article 1 §10.5 draft EnWG) will prove essential in providing transparency in unbundling and accounting practices, which in turn will be crucial in reducing the scope for discriminatory network charging practices and in settling future network access disputes.

The new Act does not, however, foresee separate accounting for power generation and marketing activities. Although this is not an explicit requirement of the EU Directive, some European countries such as the UK have in effect introduced strong unbundling requirements between generation and retail thus avoiding e.g. the possibility of cross subsidies from the de facto less competitive market segment (e.g. generation) to the de facto more competitive one (e.g. supply).

The German regulator will have the power to institute administrative proceedings against a grid operator in the event that it is not compliant with the provisions of the new EnWG or it abuses its dominant market position. Such proceedings may be initiated ex officio or upon request by a person who is concerned by the abusive behaviour.

Regulated third party access

Germany's reliance to date on negotiated rather than regulated third party access was unique in Europe and contravened the provisions of the new EU Directives. The new EnWG and the two draft ordinances on

network access introduce provisions for non-discriminatory (§20.1), regulated third party access based on distance independent point of connection charges in electricity and an entry-exit regime in gas⁽²⁾.

At the last minute parliament adopted a new, significantly simplified entry-exit model for gas network charges. In future, only one entry and one exit capacity has to be reserved in order to get access to the comprehensive German gas grid comprising about 700 different operators. In order to facilitate gas transport by only two bookings, the gas network operators are obliged to fully co-operate with each other. However, such access arrangements can be denied for technical reasons or due to economic efficiency concerns. Furthermore, access to network capacity may be denied if this capacity is needed to fulfil long-term import contracts.

No Germany-wide balancing power market for electricity is envisaged, although the network is highly interconnected and a lack of liquidity has been a well-documented problem in various German balancing power markets. The law does suggest that network operators should co-operate with the aim of acquiring balancing power in joint auctions. But the new Act does not force organizational consolidation through, for example, the creation of a Germany-wide Independent System Operator.

Network tariffs

In accordance with the EU Directive, the new EnWG states that network tariffs for energy network operators are to be appropriate, non-discriminatory, transparent and are to be no higher than those which network operators charge de facto or nominally to companies with which they have ownership ties (§21.1).

Network charges must be determined “on the basis of the cost of that of an efficient and structurally comparable grid operator”. The EnWG requires that the cost of maintaining the real value of the existing grid (Nettosubstanzerhaltung), incentives for cost-efficient operation and adequate interest on the invested capital be taken into account when setting tariffs. For new network elements, only the initial costs can be taken into account.

The EnWG provides for two basic regimes for determining network tariffs, which are further detailed in the two draft ordinances on network tariffs:

- Cost of service regulation. In this context the regulatory authority will be allowed to undertake tariff comparisons between structurally comparable companies, under the assumption that tariffs which exceed the average charged by the relevant comparator group are excessive (§21.4).
- Provisions allowing the regulatory authority to use an incentive based regime for tariff determination have been recently inserted into the draft law (§21a). Unusually for an energy law, the EnWG contains detailed provisions in this context as to the length of regulatory periods, the components of the price

control formula, the allocation of costs into controllable and non controllable cost categories, inflation provisions and quality targets, etc.

One of the most controversial issues in the legislation process was and still is the question of whether the regulator should set network tariffs ex ante, or should only set the methodology for tariff determination. The first draft of the EnWG did not foresee any ex-ante regulation of prices. The final EnWG draft provides for an ex-ante tariff setting for third party access to the electricity and gas grid in the event of price increases.

The Federal Regulatory Authority

Creating a sector specific regulator is one of the major compliance challenges faced by Germany. The EnWG proposes a split of power between the federal regulatory authority and regulatory authorities in each state (Länder). The latter will be solely competent for network operators with up to 100,000 network connections. The Federal Regulatory Authority which will extend its existing regulatory authority for Telecommunications and Post and will bear the name “Bundesnetzagentur” (Federal Agency for Grid Operation). The main questions in this context are:

- Will it be able to effectively exercise the minimum core competencies assigned to regulatory bodies in the EU Directive? In this context, will the new regulatory authority be merely in charge of policy implementation or will it be able to determine regulatory policy?

With respect to the question of whether the new regulator will be able to exercise the core competencies assigned to it in the EU Directive, developments in the complicated relationship which the new EnWG creates between the regulator, the Federal Government (i.e. the Ministry of Economics) and the Bundesrat will be of key interest. The EU Directive, and in particular the associated interpretative notes, make it clear that the regulatory authority is intended to have broad powers for all regulatory tasks associated with the core duties and responsibilities assigned by the EU Directive.

However, since the EnWG and the draft Ordinances contain very detailed provisions concerning, e.g. the price cap formula and the calculation of grid tariffs, it is questionable to what extent the regulatory authority is left with decision-making power to adapt and develop further the regulatory regime using the administrative means at its disposal, and whether a law-making process will be required for what one might regard as relatively minor changes to, for example, the tariff calculation principles.

- Will the new regulator be sufficiently independent of energy sector interests?

The EnWG (Article 2) does not contain explicit provisions on how to ensure the independence of the personnel of the Federal Agency for Grid Operation from

energy industry interests. §4 does suggest that the President of the Agency is not allowed to have any other employment and is allowed to sit on company boards only with the permission of the Minister of Economics, but it does not state that the President and all other members of the Agency are not permitted to have financial interests (e.g. pensions) in the companies they regulate. Furthermore the law does not seem to clearly regulate the conditions under which key members of the Agency could be dismissed from their positions, which in practice has proven a central question in determining the independence a regulator enjoys from political interests.

Conclusions

The provisions of the new EnWG reflect a concerted effort on the part of German policy makers to be compliant with the provisions of the new EU Directive, but also a distrust of the concept of a sector specific regulator. The provisions regarding the unbundling of gas and electricity sectors should significantly contribute to achieving transparency and non-discrimination in network access.

The de facto competencies of the regulatory authority form the main area in which the provisions of the EnWG might lead to compliance issues with the EU Directive, depending on whether the eventual distribution of responsibilities between the regulator, the Federal Government and the Bundesrat will leave the regulator with the ability to decide key regulatory issues rather than just with an implementation role.

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¹ Annual report on the implementation of the gas and electricity internal market, EU Commission, 05.01.05, page 5

² BEB and Ruhrgas have already adopted an entry-exit regime in 2004 as a result of market abuse proceedings in front of the EU, COMP/36.246.