

**NOTE OF DG ENERGY & TRANSPORT ON DIRECTIVES
2003/54/EC AND 2003/55/EC ON THE INTERNAL MARKET
IN ELECTRICITY AND NATURAL GAS**

THIS DOCUMENT IS NOT BINDING ON THE COMMISSION

PUBLIC SERVICE OBLIGATIONS

16.1.2004

1. INTRODUCTION

Article 3 of the new electricity Directive and of the new gas Directive strengthens the current provisions in force regarding public service obligations and consumer protection.

This note aims to indicate what measures should be taken in the Member States in order to avoid PSOs distorting competition and slowing down the genuine opening-up of the market as provided for in Article 21 of the amended electricity Directive and Article 23 of the gas Directive.

2. THE SCOPE OF PUBLIC SERVICE OBLIGATIONS

PSOs SHOULD COMPLY WITH SPECIFIC CRITERIA AND OBJECTIVES AND BE STRICTLY REGULATED

Article 3(2) of the new electricity Directive and Article 3(2) of the new gas Directive stipulate that:

"Having full regard to the relevant provisions of the Treaty, in particular Article 86 thereof, Member States may impose on undertakings operating in the electricity sector, in the general economic interest, public service obligations which may relate to security, including security of supply, regularity, quality and price of supplies and environmental protection, including energy efficiency and climate protection. Such obligations shall be clearly defined, transparent, non-discriminatory, verifiable and shall guarantee equality of access for EU electricity companies to national consumers. In relation to security of supply, energy efficiency/demand-side management and for the fulfilment of environmental goals, as referred

to in this paragraph, Member States may introduce the implementation of long-term planning, taking into account the possibility of third parties seeking access to the system."

As a result, PSOs must be clearly defined, transparent, non-discriminatory and verifiable.

2.1. PSOs must be clearly defined

2.1.1. Reminder of the legal definition of PSOs

Under Community law, Article 2 of Council Regulation No 1191/69 of 26 June 1969 (OJ L 156 of 28 June 1969) concerning PSOs in inland transport stipulates that PSOs are "obligations which the undertaking ..., if it were considering its own commercial interests, would not assume or would not assume to the same extent or under the same conditions".

Article 86(2) of the EC Treaty stipulates on this subject that "undertakings entrusted with the operation of services of general economic interest ... shall be subject to the rules contained in this Treaty, in particular to the rules on competition, insofar as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them. The development of trade must not be affected to such an extent as would be contrary to the interests of the Community."

These provisions, and in particular the limits of the concept of services of general economic interest, have been clarified by the case law of the Court of Justice of the European Communities¹.

The Commission applies this definition to the energy sector, subject to the following conditions:

- the obligations imposed must be related to the supply of the service of general economic interest in question;
- they must contribute directly to satisfying this general economic interest;
- they must be imposed in such a way that they do not affect the development of trade to an extent contrary to the interests of the Community.

2.1.2. The obligations must be related to the supply of the service of general interest

Article 3(2) of the electricity Directive and Article 3(2) of the gas Directive set out the areas in which PSOs can be imposed in order to take account of Article 86 and in particular paragraph 2 thereof.

¹ Judgment of European Court of Justice of 27/8/ 1994, Municipality of Almelo and others, Case C-393/92

2.1.2.1. Security, including security of supply

Security of supply is examined in detail in the documents "Measures to ensure security of supply of electricity" and "Measures on security of supply of gas".

2.1.2.2. Regularity

This aspect is related to the question of systems security and can be included in the concept of the security of supply.

2.1.2.3. Quality and price of services supplied

This relates to the wish of the Member States to keep a certain amount of control over the level of prices and to maintain fairness between price systems.

Quality is a very important concept as, by imposing quality standards, public authorities can affect the operation of the market.

2.1.2.4. Protection of the environment

Several Member States have introduced measures to protect the environment in accordance with Article 3 of the electricity and gas Directives. The Community rules on competition apply to these measures, in particular those concerning State aid. These mechanisms are in principle compatible, provided that the restrictive effects on competition are not out of proportion to the environmental objective pursued.

In the working documents annexed to the legislative proposals presented in March 2001, the Commission gave an initial summary of the main measures taken in the Member States with regard to PSOs. (See <http://europa.eu.int/comm/energy/library/438.pdf> sections 5, 6 and 7).

2.1.3. *PSOs must be imposed in such a way that they do not affect the interests of the Community*

The classification of a service of general economic interest is left, in accordance with the subsidiarity principle, to the Member States but under the control of the Community level responsible for ensuring that the imposition of a PSO for carrying out such a service does not affect the developments of trade to such an extent contrary to the interests of the Community.

According to the case law of the CJEC, it is the Commission's responsibility, under the supervision of the Court, to define the interests of the Community according to which the development of trade can be assessed.

The CJEC considers that the activity of an undertaking, which must "ensure that throughout the territory in respect of which the concession is granted, all consumers, whether local distributors or end-users, receive uninterrupted supplies of electricity in sufficient quantities to meet demand at any given time, at uniform tariff rates and on terms which may not vary save in accordance with objective criteria applicable to all customers", comes under the definition of a service of general economic interest.

In the case of the Municipality of Almelo (judgment of 27 April 1994, case C-393/92), the CJEC identified a series of tasks which were considered to come under this category:

- the obligation to supply all consumers throughout the territory (supplier of last resort);
- the obligation to supply all customers in a service area (this applies to gas);
- ensuring continuity of supply;
- ensuring equal treatment of consumers;
- ensuring the operation of the national electricity supply system at the lowest possible cost.

As indicated in the "non-paper" presented by DG COMP in December 2002, *"the review of the CJEC case law suggests that the classification as services of general economic interest normally applies to services:*

- *the provision of which is generally entrusted to private operators rather than being entrusted by statute to all the undertakings in the sector;*
- *which are intended to meet individuals' general needs, notably in the case of a universal service or in the case of certain network services, and do not benefit a specific category of user".*

(http://europa.eu.int/comm/competition/state_aid/others/1759_sieg_en.pdf).

As it reiterated in this document *"the Commission is determined to follow the Court's case law scrupulously and only in a very few cases does it contest the classification as SGEIs. Such action does not constitute interference by the Commission in the powers of the Member States but is designed solely to avoid abuse. This is the case in particular where a given activity does not exhibit any specific characteristics relative to other economic activities or where that activity is already carried out satisfactorily by undertakings operating in accordance with the rules of the market"*.

The text of the new Directive has not amended the definition of the scope of its interest with regard to competition.

The text of Article 3(8), like the current text of Article 3(3), limits this interest to eligible customers but the big difference is that from 2007 all consumers will be eligible. From 1 July 2007, the Community interest will include compliance with full competition.

2.2. Public service obligations must be transparent

In order to ensure that the criterion of transparency is met, the Commission considers that the public service task must be assigned by way of an official public instrument *"that may take the form of a legislative or regulatory instrument or a contract or instruction."*

"This official instrument must specify:

- *the nature of the public service obligations;*
- *the undertakings and territory concerned;*
- *the responsibility for determining the undertaking's selling prices and the conditions for reviewing such prices;*
- *the nature of any exclusive or special rights assigned to the undertakings;*
- *the amount of any compensation granted to the undertakings and any revision clauses;*
- *the period covered by these obligations."*

If the method of implementation is left, in accordance with the subsidiarity principle, to the Member State (law, regulatory instrument, concession etc.), it is accepted that Member States should set out in greater detail in the transposition laws the general interest tasks to be undertaken in the context of opening up the electricity and gas markets. But as they do not specify in these instruments the details for implementing the PSOs, there is a need to have an official public instrument.

Until now, Member States have not communicated these measures to the Commission in a systematic manner.

The publication and communication obligations provided for in Article 3(2) were laid down (see Annex) in the Commission document presented during the meeting of the monitoring group of 19 November 1998 with the Member States.

The aim of publishing PSOs is to ensure transparency vis-à-vis the economic players throughout the sector, and to enable all or several operators to make a bid to carry out the PSO. If the PSO is put out to tender, it is necessary to give a detailed outline and assess the costs.

The new Article 3(9) does not amend the structure of the 1996 text but extends the information obligation to all measures taken in application of the new Article 3(2) and (3), whether or not such measures require a derogation from this Directive.

2.3. PSOs must be non-discriminatory

The Member State can impose various PSOs on companies in the sector but in order to do this, the public authorities must ensure that the obligations are non-discriminatory.

According to the Commission, a competitive tender between the various operators shall be introduced from now on in the electricity and gas sectors in order to carry out certain obligations which are still too often imposed on the public or private company which has had the monopoly.

This tendering process exists in other sectors (air transport and telecommunications in particular).

However, the particular case of obligations which can only be imposed on the transmission system operator should be distinguished. If it is a natural monopoly, it goes without saying that in these cases it is not possible to have a tendering process.

In all other cases, and in view of experience gained, the Commission considers that the only way to effectively guarantee the non-discrimination provided for in Article 3 is to use a tendering process to carry out the public service obligation.

This call for tenders should be published in a transparent and non-discriminative way, according to the related appropriate procedures of the Member State.

In both cases (PSOs imposed on the transmission system operator or PSOs granted by call for tender) separate accounts should be kept as set out in point 3.2 in order to avoid the risk of excess compensation for the costs relating to this obligation.

2.4. PSOs must be verifiable

In the control which the Commission carries out/will carry out of the obligations to be communicated to it, the following principles will be applied.

The measure chosen must be the least restrictive possible for competition and trade between the Member States in order to fulfil the legitimate general interest objectives.

The burden of proof lies with the public authorities which impose the measure or on the undertaking if, in the context of the internal subsidiarity of the Member State, it can choose the measure to fulfil the objective imposed on it (for example in the case of security of supply where there are several techniques).

In its control, the Commission will assess the proportionality of this measure and, if necessary, standardise it in relation to practice in other Member States.

As the Commission already indicated in its note of 29 April 1999 on PSOs in the gas sector, it will apply the following principles to analyse measures in both the electricity and gas sectors:

http://europa.eu.int/comm/energy/en/gas_single_market/finalpso29aprilffm.pdf

- evaluation of PSOs and their compatibility with the areas of general interest covered by the Directive (test of conformity with Articles 3) and with Article 86(2) of the Treaty, and in particular the question of whether carrying out this obligation is a service of general economic interest or not;
- evaluation of the appropriateness of the measure proposed to carry out the objectives pursued (not to obstruct the performance of PSOs);
- evaluation of the need and scope of the proposed measure (alternative measures).

If any doubts arise, the Commission reserves the right to consult all the Member States.

3. THE ISSUE OF COMPENSATION FOR THE COSTS RELATING TO CARRYING OUT PSOs

The new Article 3(4) stipulates that "when financial compensation, other forms of compensation and exclusive rights which a Member State grants for the fulfilment of the obligations set out in paragraphs 2 and 3 are provided, this shall be done in a non-discriminatory and transparent way."

3.1. Community law

The question of compensation either in the form of direct aid or exclusive rights is an issue which concerns all the liberalised sectors in the European Union (post, telecommunications, gas, electricity, air transport etc.).

Reference should therefore be made to existing case law and to Commission decisions taken on this subject. The issue is dealt with in detail in the Commission's "non-paper" (paragraphs 83-101).

(http://europa.eu.int/comm/competition/state_aid/others/1759_sieg_en.pdf).

3.2. Allocation in company accounts

With regard to the issue of allocating these charges in company accounts, a watertight system should be set up which ensures that the subsidised part of the sector does not allow predatory commercial behaviour in the part of the sector which is totally liberalised and/or not subject to a public service obligation.

This question has been the subject of discussions, for example Opinion No 2000-A-29 of the French Competition Council of 30 November 2000 on separate accounting for the production, transmission and distribution of electricity, an opinion given during the preparations for the law on electricity.

It reiterated its position in favour of the liberalisation of the telecommunications sector in Opinion No 97-A-07 of 27 May 1997 according to which: *"When a company holding a dominant position on a market carries out both activities of general interest and activities open to competition, the control of compliance with the rules of competition requires a clear separation to be made between these two types of activities so as to prevent the activities open to competition benefiting from the conditions specific to the performance of general interest tasks, to the detriment of companies operating on the same markets."*

Furthermore, by adopting Commission Directive 2000/52/EC of 26 July 2000 amending Directive 80/723/EEC on the transparency of financial relations between Member States and public undertakings, the Commission hoped to clarify these relations in the new context of the opening-up of markets.

In the second recital, the Commission reiterates that "sectors of the economy which were characterised in the past by the existence of monopolies have been or are being opened to competition. This process has highlighted the importance of ensuring that the rules on competition contained in the Treaty are fairly and effectively applied in these sectors, in particular that there is no abuse of a dominant position within the meaning of Article 82 of the Treaty, and no State aid within the meaning of Article 87 of the Treaty unless it is compatible with the common market, without prejudice to the possible application of Article 86(2) of the Treaty".

Article 1(2) of this Directive requires the Member States to "ensure that the financial and organisational structure of any undertaking ... is correctly reflected in the separate accounts, so that the following emerge clearly: a) the costs and revenues associated with different activities; b) full details of the methods by which costs and revenues are assigned or allocated to different activities".

Article 2(e) of this Directive clarifies the concept of 'different activities' which include "on the one hand, all products or services in respect of which a special or exclusive right is granted to an undertaking or all services of general economic interest with which an undertaking is entrusted and, on the other hand, each other separate product or service in respect of which the undertaking is active".

The abovementioned provision of this Directive will serve as a guideline for undertakings in the gas and electricity sectors with regard to drawing up and keeping separate accounts. The legal basis for this obligation is Article 3(2) of the electricity Directive and the corresponding Article of the gas Directive.

As a reminder, Article 19(3) also requires that: "Until 1 July 2007, they shall keep separate accounts for supply activities for eligible customers and supply activities for non-eligible customers".

4. DEROGATIONS TO CERTAIN PROVISIONS OF THE DIRECTIVES

In application of the new Article 3(8) of the electricity Directive and Article 3(5) of the gas Directive, the Member States are allowed not to apply certain provisions of the Directive if *"their application would obstruct the performance, in law or in fact, of the obligations imposed on undertakings in the general economic interest"*.

Firstly, it should be pointed out that Member States can choose whether or not to apply these derogations, but derogations decided on will be subject to the general communication obligation provided for in Article 3(9) of the electricity Directive, as explained in point 3 of this note, and in Article 3(6) of the gas Directive.

Secondly, it goes without saying that it is up to Member States which decide to make derogations to provide proof of the obstruction as specified in paragraph 8. This proof will be explained in the communication which the Member States make to the Commission.

5. PSOs MUST BE REPORTED TO THE COMMISSION

Article 3(9) of the electricity Directive and Article 3(6) of the gas Directive stipulate that:

"Member States shall, upon implementation of this Directive, inform the Commission of all measures adopted to fulfil universal service and public service obligations, including consumer protection and environmental protection, and their possible effect on national and international competition, whether or not such measures require a derogation from this Directive. They shall inform the Commission subsequently every two years of any changes to such measures, whether or not they require a derogation from this Directive."

"Member States shall, upon implementation of this Directive, inform the Commission of all measures adopted to fulfil public service obligations, including consumer and environmental protection, and their possible effect on national and international competition, whether or not such measures require a derogation from the provisions of this Directive. They shall notify the Commission subsequently every two years of any changes to such measures, whether or not they require a derogation from this Directive."

These Articles place a general obligation on the Member States to provide the Commission with information about **all measures taken** to carry out the universal service (for electricity) and public service objectives and not only those relating to a request for a derogation, as is the case in the current text.

For the implementation of the 1996 and 1998 Directives, there was no notification because the PSOs implemented did not require any derogations. For the future, the new Directive creates a general communication obligation for all measures taken to fulfil the universal service and public service obligations, whether or not these measures require a derogation from the Directive.

Notifying the Commission of instruments (primary and secondary legislation) taken by the Member States (national, regional and local authorities) to transpose the Directives does not cover the new specific obligation provided for in the new Article 3.

As already indicated by the Commission in 1998, the fact that PSOs are included in the transposition instruments notified in application of the new Article 30(1) (ex Article 27(1)) is not enough to ensure the transparency which the Commission needs to check the compatibility of PSOs with the Treaty and the Directive.

All of the following information therefore needs to be submitted to the Commission:

- a copy of the official instrument(s) imposing the PSO and including all the information required in point 2.4;
- the possible impact of these PSOs on the application of the Directive and information on the intentions of the Member State to derogate from provisions of the Directive as provided for in Article 3(8);
- a reference to the legal provisions concerned;
- the method of calculating possible financial compensation.

6. THE JUDGMENT OF THE COURT OF JUSTICE OF 24 JULY 2003, ALTMARK

It clarified the CJEC'S case law regarding the application of the state aid rules for cases relating to public service compensations (art.87 of the treaty).

Compensation relating to the accomplishment of a public service obligation is not, in principle, a state aid.

FOUR CUMULATIVE CONDITIONS HAVE TO BE MET:

1. the company has actually to be responsible for the implementation of such obligations, which have to be defined clearly;
2. the parameters for the calculation of the costs have to be established beforehand in an objective and transparent way;
3. the compensation can under no circumstances exceed what is necessary;
4. if the selection of the undertaking to carry out the obligations is not done by a public tendering procedure, the compensation level has to be determined compared to the costs that a well managed and adequately resourced company would have to bear.