

The Third Energy Package of the EU: A Limited Deregulation of Private Networks

Imagine an average industrial zone (e.g., an industrial site with several factories, an airport or a seaport): several unrelated undertakings need natural gas or electricity supplies for their operations in significant quantities.

Quite often, these different operators (“downstream users”) are not directly connected to the public distribution natural gas or electricity grid. In many cases, they take-off their energy supplies from a “private network” managed by an industrial entity that developed this infrastructure.

The operator of such a private network may be a (air)port authority, the developer of the industrial site, the main energy consumer at the site or another entity. This private network may itself be connected to the public transmission/distribution grid from which it sources its energy. In some cases, the private network may also often include a local generation facility (so-called distributed generation), such as a combined cycle heat and power plant (also known as “co-generation”).

Recently, industry participants have considered the issue of whether downstream users enjoy the rights granted by EU secondary legislation to choose their energy supplier and pay regulated tariffs, or whether they may be obliged to buy their energy through the private network operator at the tariff rates established by such operator. Conversely, are the operators of private networks subject to the obligations imposed by EU law on distributors—including so-called “unbundling” obligations between production and distribution?

Directives 2003/54 and 2003/55 (the Second Energy Package) did not directly and

explicitly address this issue. Some Member States, such as Germany, chose to put in place a separate regime for such private networks, with the aim to exempt them from most of the obligations of liberalisation.

The Citiworks Judgment: Private Networks Are Submitted to Liberalisation

The European Court of Justice (ECJ) has found, however, that the separate regulatory regimes for private networks put in place by certain Member States do not comply with EC Law. In a judgment dated 22 May 2008 (C-439/06, citiworks AG), the ECJ found that, excluding certain limited exceptions created by applicable EU directives (and unavailable for most private networks), every downstream user has the right to enjoy the full benefit of liberalisation—that is, downstream users may freely choose their energy supplier and bypass the operator of a private network.

In other words, the ECJ found that there is no such thing as a “private network”—there are only distribution networks, all subject to the full scope of EC secondary law, including the freedom to choose a supplier for downstream users, regulated tariffs for energy transportation and the unbundling of distribution from production.

Under this decision, Member States may not exempt such systems from the scope of EU legislation.

Three Main Consequences of the Judgment for Private Networks Operators

The consequences of this judgment for the operators of private networks such as airport and sea port authorities, industrial site operators and others are significant.

First, if such operators had entered into long-term energy supply contracts providing for the delivery of minimum quantities of energy and with quantity rebates covering the needs of the whole site, they may default under these contractual obligations as their connected customers select other suppliers and stop taking off energy deliveries from the private network. In other words, if downstream users opt out of their joint purchasing obligation, this leaves private network operators facing their own obligations with respect to the entire site.

Second, according to the judgment, private networks are subject to the full scope of the obligations imposed on all Distribution System Operators. As such, among other things, private network operators must submit their distribution tariffs to national energy regulators for prior approval, their energy purchases must cover system losses and balancing and such purchases should be accomplished through open procedures.

Third, the private network is subject to unbundling obligations, which mandate the separation of distribution activities from generation activities. As a consequence, if there is a co-generation plant within the private network, this plant cannot be operated by the same legal entity as the entity operating the distribution network.

The Third Package Solution: A Limited Liberalisation for Downstream Users

The situation of private networks was apparently brought to the attention of the European legislature during the discussions concerning the Third Energy Package.

Two ad-hoc provisions, similarly worded, were added to the legislation text then being discussed.

Article 28 of the electricity directive and article 28 of the gas directive both provide, among other things, for a limited exemption to private networks (in the directives' terms, "closed networks").

Under these directives, there are several conditions that must be met in order for a private network operator to be qualified as a "closed network" by a regulator:

- distribution must occur within a geographically confined industrial, commercial or shared services site;
- household customers may only be connected marginally to the network, and the primary concern of such network should be non-consumer operators; and
- for specific technical or safety reasons, operations or production process of the downstream users of the network should be integrated, or the private network should distribute energy primarily to the owner or operator of the system or its related businesses.

If these conditions are not met, the would-be closed network would instead be subject to the full scope of EC secondary legislation on distribution.

If, on the other hand, a distribution system qualifies as a "closed network", it would benefit from two limited exemptions:

- closed electricity networks would not be obliged to procure the energy they use to cover energy losses and reserve capacity in their systems according to transparent, non-discriminatory and market-based procedures; this exemption is solely of interest for large "closed networks" that would suffer from energy losses and would need to procure reserve capacity; and
- both natural gas and electricity closed networks would not need to obtain prior approval of tariffs—or the methodologies underlying tariff calculations—from the applicable regulator prior to those tariffs coming into effect. However, downstream users on a closed network may request their review and approval by the regulator after the fact.

A "Closed Network" Will Nonetheless Be Subject to All the Other Obligations of a Public Distributor

The consequences of the citiworks judgment are very broad, including those outlined below.

The limited exemptions do not limit the right of each downstream user to choose its own energy supplier—a cornerstone of the liberalisation process. As a result, even when qualifying as a “closed network”, the private network would still have to allow each downstream user to enter into a supply agreement with an energy supplier other than the one chosen by the operator of the private network.

With respect to electricity, Directive 2001/77/EC of the European Parliament and of the Council of 27 September 2001 on the promotion of electricity produced from renewable energy sources in the internal electricity market (OJ L 283, p. 33) and its successor, Directive 2009/28/EC of the European Parliament and of the Council of 23 April 2009 on the promotion of the use of energy from renewable sources and amending and subsequently repealing Directives 2001/77/EC and 2003/30/EC (OJ L 140, p. 16), impose certain obligations on “distributors”. These obligations set forth certain mandatory connection requirements that distributors must follow for producers of electricity from renewable energy sources.

These directives lay these obligations for “distributors”; there is a broad reference at the beginning of these directives to the internal market directives defined terms. Therefore, indirectly, private networks, whether or not they are qualified as “closed networks”, would be subject to these obligations vis-à-vis renewable energy producers.

The operator of the private network, whether or not it is qualified as a “closed network”, is still subject to all the rules relating to the separation of generation and distribution, creating potentially disproportionate burdens. This implies, for instance, that an entity operating a local production plant within a private network should be organised as a separate legal entity. This also implies that the legal entity operating the private network should be functionally unbundled from the production entity. These requirements do not comport with the support that the EC legislature intended to provide to co-generation plants (see for instance Directive 2004/8, which aims to facilitate grid access of cogeneration units, among others).

Member States were authorised by Directive 2003/54 and Directive 2003/55, and are still authorised by the Third Package, not to apply some of these unbundling constraints to certain de minimis “integrated undertakings”, which include the concept of integration between distribution and

generation or supply, and non-electricity or non-gas activities. Not all the Member States implemented such a de minimis exclusion in the past, and its implementation raises some potentially delicate issues.

There might also be a possibility to consider the link with customers as a “direct line”, not a private network, but the conditions for the qualification as a direct line are stringent.

The Obligations Put on Distributors by National Law

The above only reflects considerations of EC law.

Many Member States imposed additional obligations on distribution network operators, without any obligation to do so under EC law. From the viewpoint of EC law, a Member State might therefore validly exempt a private network from these “purely national” distributors’ duties. The only limit would be the non-discrimination principle.

Preliminary Conclusion

The basic rule remains that a private network is subject to the full scope of the EC law applying to public distributors.

From a policy perspective, there is a strain between favouring private networks, industrial activity in general and distributed production on one side, and submitting private networks to the full EC regulatory framework governing distribution networks on the other.

However, subject to the Member States’ election, the Third Package provides for a set of separate exemptions subject to precise conditions and with limited practical implications, depending on the scope of the implementation by the Member States. As far as obligations imposed by national law on distributors are concerned, Member States may validly decide to set up a special regime for private networks, exempting them from these obligations.



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