

GERMAN ENERGY LAW VIOLATES EU DIRECTIVE - UNBUNDLING AND REGULATORY INDEPENDENCE FALL SHORT

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Legal Briefings

Uncertainty for business as ECJ presses Germany to bolster watchdog independence and extend scope of unbundling rules

On 2 September 2021, the European Court decided that the German legislator has not implemented correctly requirements of the EU Electricity Directive and the EU Natural Gas Directive. In particular, the German concept of a vertical integrated undertaking is too narrow. Besides and most notably, the Federal Network Agency must become more independent.

BACKGROUND

The EU Electricity Directive (2009/72/EG) and the EU Natural Gas Directive (2009/73/EG) (jointly the "**Directives**"), inter alia, set forth specific requirements for the term of a vertical integrated undertaking ("**VIU**"). The concept of the VIU plays a fundamental role in connection with the unbundling requirements. Moreover, the Directives stipulate that, inter alia, the national regulatory authority, i.e. the Federal Network Agency (*Bundesnetzagentur*), shall fix or approve in accordance with transparent criteria, transmission or distribution tariffs or their methodologies. On 20 May 2014, the European Commission initiated a pre-litigation procedure against Germany as they argued that Germany has not implemented sufficiently four requirements of the Directives. After completion of such pre-litigation procedure and non-compliance with the European obligations, the European Commission filed an infringement procedure against Germany on 16 November 2018. On 14 January 2021, the Advocate General proposed to declare that Germany violates the Directives in four aspects. The European Court ("**ECJ**") fully decided in line with the Advocate General's opinion.

CLARIFICATION OF VERTICAL INTEGRATED UNDERTAKING

Under European and German energy law, the unbundling requirements relate to a VIU. A VIU is understood as an electricity or natural gas undertaking (or group) where the same person or the same persons are entitled, directly or indirectly, to exercise control, and where the undertaking or group of undertakings perform at least one of the functions (related to electricity or gas) of transmission, distribution or storage, and at least one of the functions of production or supply. Unlike the European stipulation, German law encompasses only undertakings which operate in the European Union.

The ECJ decided that Germany did not implement correctly the European concept of a VIU. The respective European provisions do not contain any reference to the territory in which a VIU must carry out activities or the place where it has its registered office. According to the ECJ, the German restriction of the territorial scope of a VIU violates European law.

LACK OF INDEPENDENCY OF FEDERAL NETWORK AGENCY

According to section 24 of the German Energy Act (*Gesetz über die Elektrizitäts- und Gasversorgung, EnWG*), the Federal Government has the competence to fix transmission and distribution tariffs, and to determine the conditions for balancing services. Furthermore, the Federal Government constitutes detailed sets of instructions addressed to the Federal Network Agency on the exercise of its regulatory powers.

The ECJ decided that European law constitutes the national regulatory authorities various powers, *inter alia* the power to define or approve tariffs and their methodologies as well as the power to define or approve the methodologies used to calculate or establish the terms and conditions for connection and access to national networks. This idea of an largely independent national regulatory authority does not comply with the current German regime.

WHAT ELSE DID THE EUROPEAN COURT SAY?

In addition, the ECJ decided that Germany failed to implement correctly the European rules on transitional period as well as the European requirement to dispose of any shares held in the capital of the VIU that were acquired by 3 March 2012.

WHAT ARE THE CONSEQUENCES FOR THE FEDERAL NETWORK AGENCY, INVESTORS, ENERGY PROVIDERS AND CUSTOMERS?

The Federal Network Agency commented yesterday that they will apply the current legal framework until changes of law will be implemented. The reason for that is that they would like to avoid uncertainties for market participants and ensure stable and predictable conditions in the energy market.

Investments by foreign investors in German energy infrastructure assets will become more complex. If, for example, a foreign company is an energy producer outside the European Union and intends to acquire a transmission system operator in Germany, such foreign company must comply with the unbundling requirements in the future which oblige the VIU to ensure transparency and to operate the network operation in a non-discriminatory manner.

Energy providers and other energy companies need to check their current group structure and assess whether they are now qualified as a VIU. If this is the case, then they also need to comply with the unbundling requirements.

The consequences for customers are not yet clear. It could be possible that energy prices will decrease but it is too early to say.

WHAT ARE THE NEXT STEPS FOR THE GERMAN LEGISLATOR?

The European Court decided that Germany breached European law. Hence, the legislator must take action to comply with the judgement and change several provisions of the German Energy Act.

Düsseldorf Regulatory Partner, Dr. Marius Boewe, comments: "It will be a challenge for the legislator to implement the clear guidelines from the ECJ in a way that is consistent with our constitutional requirements". Düsseldorf Corporate Counsel, Dr. Sebastian Schürer, adds: "We will monitor the future developments and legislative activities closely. Although the unbundling requirements will need to be considered stronger in M&A transactions, we expect that the appetite for investors in German infrastructure assets will remain high."

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