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MEMORANDUM

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To Vattenfall AB

From John Ratliff; Philippe Claessens

Re **Norwegian Ministry of Petroleum and Energy's Consultation Paper on Proposed Changes to the Norwegian Energy Act concerning Interconnector Ownership and Control – EU/EEA Aspects**

[1] The object of this advice is to comment on the compatibility with EU/EEA law of the Norwegian Ministry of Petroleum and Energy's Consultation Paper on proposed changes to Section 4(2) of the Norwegian Energy Act[1]. These concern the ownership and control of electricity interconnectors with Norway.

[2] In its Consultation Paper, the Ministry states that the purpose of the proposed changes is to bring that provision into line with requirements set out by the EEA Agreement. Further, the Ministry states that it intends to clarify the licensing requirements, the criteria for the assessment of whether a trading licence should be granted and the scope of the structural and trading licences.[2]

[3] Under the proposed changes Statnett, the Norwegian State-owned transmission system operator for electricity would have to own the Norwegian part of any electricity interconnector to Norway, or at least Statnett would have to have decisive influence over any company owning such a part of the interconnector.[3]

[4] Based on our review of the relevant legislation and facts here, we consider that the proposed changes would be incompatible with EU/EEA Law in three main ways:

1 The proposed changes would also apply to Offshore Energy Act aspects.

2 The Ministry also states that it is following a similar provision in Swedish law (see Chapter 1, Section 5(b), and Chapter 2, Section 10 of the Swedish Electricity Act).

3 The proposed changes are a matter of concern to Vattenfall, in part, since it has a 25% stake in the NorthConnect project for an HVDC interconnector between Norway and Scotland, planned to be in operation in around 2020/22; and, in part, since it is seeking generally wider trading possibilities in the EU/EEA for a projected energy surplus. The participants in the NorthConnect project do not intend to make use of the interconnector themselves, but offer third party access through market-based mechanisms, such as market coupling (implicit auctioning) and/or explicit auctioning of the transmission capacity.

(i) They deny private merchant interconnectors the procedural rights provided for in Article 17 of Regulation 714/2009 and Article 7 of Regulation 1228/2003.

(ii) They may lead a State-owned undertaking, Statnett, to abuse its dominant position.

(iii) They constitute a disproportionate interference with the free movement of capital in the EEA.

[5] We propose now to examine each of these aspects in turn.

I. EU/EEA Energy Regulatory Law

[6] The EU/EEA electricity market is regulated now generally by the so-called "Third Energy Package". With respect to electricity, the Third Energy Package consists mainly of Directive 2009/72/EC and Regulation 714/2009, neither of which has been incorporated into the annexes to the EEA Agreement ("EEA") as yet, although we understand that this process is under way. At present therefore, it is the "Second Energy Package", consisting of Directive 2003/54/EC and Regulation 1228/2003/EC, which applies as regards the EEA, but the Third Energy Package is imminent.

[7] Under the Second and Third Energy Packages, put shortly, a "door" was opened, allowing for private parties to develop and build interconnectors. That opening now appears to be being closed by the proposed changes. More specifically, the EU Energy Regulations provide that Member States must have a procedure, through which private parties may seek exemption, if certain criteria are met.

[8] This is in Article 17(1) of Regulation 714/2009 in the Third Energy Package (and Article 7 of Regulation 1228/2003 in the Second Energy Package is similar). Although one may argue that Member States are not necessarily obliged to grant such an exemption, in the sense that these provisions state that new interconnectors "*may, upon request*" be exempted, both Regulations provide that procedurally Member States:

(i) must at least allow private parties to apply for an exemption;

(ii) consider the application as against the six criteria indicated in Article 17(1) of Regulation 714/2009 and the considerations in Article 17(4) of Regulation 714/2009 "*on a case-by-case basis*";

(iii) copy the Agency for the Cooperation of Energy Regulators ("ACER") and the Commission on the request for exemption; ACER then being entitled to submit an advisory opinion to the national regulatory authorities concerned, which could provide a basis for their decision;

(iv) duly reason and publish any exemption decision they may take;

(v) accept that the exemption decision "*shall be taken*" by ACER where the regulatory authorities concerned jointly so request, or where those authorities have not been able to reach agreement on the request for exemption within six months (Article 17(5) of Regulation 714/2009);

(vi) where taking the decision on the exemption, notify the Commission, with any other regulatory authorities concerned, of the decision (whether a grant or refusal of exemption) and the related reasons and information (Article 17(7) of Regulation 714/2009); the Commission then being entitled to take a decision requesting the notifying bodies (which could also be ACER) to amend or withdraw the decision to grant an exemption; and

(vii) must comply with any Commission decision to amend or withdraw the exemption.

[9] With its proposed changes, Norway is requiring that BEFORE any such application for a licence/exemption can be made, any merchant interconnector project has to agree to ownership, or at least decisive influence, by Statnett. That means, in practice, that Norway is:

(i) denying third party merchant interconnectors the procedural rights of Article 17 of Regulation 714/2009 and Article 7 of Regulation 1228/2003;

(ii) in effect, giving Statnett the ability to decide whether a private merchant interconnect project can request a licence/exemption; and

(iii) denying private merchant interconnectors the opportunity to develop EU/EEA integration, through private funding, taking advantage of any scope for cross-border electricity business as a result.

[10] It follows from the above that, instead of the decision on exemption being considered, as required by Regulation 714/2009 "*on a case-by-case basis*" by the regulatory bodies concerned, with the issues being specifically examined against the criteria therein and with the procedural steps outlined above, the fate of a private merchant interconnector project in Norway will turn simply on whether Statnett wants to do it or not.

[11] In its Consultation Paper, the Ministry submits various reasons why centring interconnector ownership and control in Statnett, its transmission system operator ("TSO") may be seen as in line with the EU Regulations.[4]

[12] Against this, however, the merchant interconnector exemption provided for in Article 7 of Regulation 1228/2003 and Article 17 of Regulation 714/2009 was specifically established, as we understand it at the instigation of the European Parliament, to promote the entrepreneurial development of new infrastructure by others than TSOs (see Recital 23 of Regulation 714/2009 and the EP justification for its amendment to the proposed legislation in February 2002).[5]

[13] The EU/EEA Member States are not at liberty to vary or modify the terms of EU/EEA Regulations in the way the Ministry is now proposing with its changes to the Energy Act.[6]

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4 The Ministry argues, for example, that (i) the ownership/control requirement is in line with what has been practiced previously, (ii) the TSO is best placed to view the various interconnectors in the context of the domestic energy system, including for impact on security of supply and any need for reinforcement of domestic grids resulting from interconnectors, (iii) the principle of interconnectors being owned and operated by the TSO is in line with the EU's Third Energy Package, and (iv) that there is a need for controlled development of infrastructure between Norway and other countries, among other things because of security of supply related reasons.

5 http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+REPORT+A5-2002-0074+0+NOT+XML+V0//EN. The justification for the EP amendment stated: "*The text of* [Article 6(6), which became Article 7] *omits to allow for the financing of interconnector projects on an entrepreneurial basis and also fails to allow for the fact that these projects could be developed by a party other than the TSO.*"

6 In its Consultation Paper, the Ministry also recognises that it is adding a new condition to Article 7 of Regulation 1228/2003 / Article 17 of Regulation 714/2009, in so far as it states that: "*Besides the requirement for the system operator to be involved on the ownership side, the conditions set out in the regulations on cross-border trade* [apply]" and summarises them (Section 3.1, para. 4) (Informal translation).

II. The duty of EU/EEA Member States not to enact measures which will lead a State-owned undertaking to abuse its dominant position

[14] Under Articles 102 and 106 of the Treaty on the Functioning of the European Union ("TFEU") taken together and Articles 54 and 59 EEA taken together, it is unlawful for a State to take a measure which may lead a State-owned company (such as Statnett), or one entrusted with a public task, to abuse its dominant position. This might be, for example, because the measure puts the company in a position:

- of conflict of interest[7]; or
- to prevent the access of other operators to the market concerned[8]; or
- of not meeting demand[9].

[15] The mere extension or strengthening of a dominant position is not enough. However, the possibility of exercising the right in an abusive way may suffice (see Greek Lignite[10]).

[16] This appears to be the case here. Notably, Statnett would have a clear conflict of interest in so far as a competing private merchant interconnector may affect/undermine the profitability of (one or more of) Statnett's own interconnectors. Statnett therefore has a financial interest to deny private merchant interconnector projects access to the interconnector services market, even if that means that demand is not fully met.

[17] We understand that the Ministry may argue that under Article 106(2) TFEU and Article 59 EEA, a Member State may argue that the ownership and control rights for Statnett are necessary to enable Statnett to perform its tasks of a general economic interest under acceptable conditions.

[18] However, it may be argued with force that this is not the case and less restrictive solutions, including simple regulation of the interconnector activity, would suffice.

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7 Case C-163/96, Raso and Others [1998] ECR I-533.

8 Case C-49/07, MOTOE [2008] ECR I-4863.

9 See, e.g. Case C-41/90 Höfner and Elsener v. Macrotron GmbH, [1991] ECR I-1979; Case C-55/96, Job Centre [1997] ECR I-7119.

10 Case T-169/08, DEI v Commission, Judgment of the General Court of 20 September 2012.

[19] We may add that the proposed changes to Section 4(2) of the Energy Act would also put Statnett in a very difficult position. For example, it may be that, in some circumstances Statnett would be under a duty to invest (e.g. if not doing so could lead to an increase in charges; or a failure to meet demand, whether in Norway or the United Kingdom, or wider such as in Sweden to the extent that trading through a proposed interconnector would be involved, see e.g. EU cases like Svenska Kraftnät[11]).

[20] However, even if Statnett were to invest, private merchant interconnectors would still be denied the right to compete independently with Statnett on such interconnector services (and the proposed change would be unlawful for the reasons indicated in Sections I and II here).

III. Free movement of capital

[21] Article 40 EEA and Article 63(1) TFEU provide that restrictions on the movement of capital between Member States shall be prohibited. The EFTA Court has indicated on numerous occasions that "*[t]he principle of homogeneity enshrined in the EEA Agreement leads to a presumption that provisions framed identically in the EEA Agreement and the EC Treaty are to be construed in the same way.*"[12] For that reason, the Court has consistently applied the case-law of the Court of Justice of the European Union ("CJEU") on the free movement of capital to Article 40 EEA.

[22] We think that the proposed changes to Section 4(2) of the Energy Act would constitute an unjustified interference with the free movement of capital, for the following reasons:

[23] First, it is established case-law that "capital movements" include "*direct investment in the form of participation in an undertaking by means* of *a shareholding or the acquisition of securities on the capital market*"; and that "*direct investment is characterised, in particular, by the possibility of participating effectively in the management of a company or in its*

[11] Commission decision of 14 April 2010 relating to a proceeding under Article 102 of the TFEU and Article 54 of the EEA Agreement (Case 39351 – Swedish Interconnectors), http://ec.europa.eu/competition/antitrust/cases/dec_docs/39351/39351_1223_2.pdf.

[12] See Case E-2/06, ESA v. Norway, [2007] EFTA Court Reports, para. 59.

control."[13] (Emphasis added) In our view, an investor's participation in an interconnector project is therefore to be considered a "capital movement".

[24] Second, on the case-law capital movements are restricted not only when a Member State's legislation includes directly or indirectly discriminating measures with respect to capital movements, but also when a Member State's legislation hinders access to the market. (see, e.g. Commission v. Portugal[14], Commission v. UK[15] and ESA v. Norway[16].)

[25] Given that the proposed change in Norwegian law would limit the extent to which investors can acquire a shareholding in an interconnector in Norway and render it impossible for investors to effectively control the interconnector, the amended Section 4(2) would constitute a restriction on the free movement of capital.

[26] Although the proposed change does not (directly or indirectly) discriminate between Norwegian and foreign investors willing to participate in an interconnector project, the amended Section 4(2) would hinder access to the market in that it would render investing in interconnectors in Norway much more difficult, since only minority stakes would be allowed, and consequently this is much less attractive.

[27] The free movement of capital, as a fundamental principle of EU law, may be restricted only by national rules which are justified by reasons referred to in the Treaty or by overriding requirements of the general interest. Such measures must not go beyond what is necessary, so as to comply with the principle of proportionality.[17]

[28] It may be noted, for example, that in ESA v. Norway, the EFTA Court ruled that obliging private owners to transfer ownership of waterfalls to the Norwegian State upon expiry of their concession was not suitable for safeguarding the security of energy supply, or ensuring that hydropower production meets environmental concerns. The Court considered that the system did not give the State any control measures which it did not already enjoy in its regulatory capacity.

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13 Case C-367/98, Commission v. Portugal, [2002] ECR I-4731, para. 38.
14 Case C-367/98, Commission v. Portugal, cited above.
15 Case C-98/01, Commission v. UK, [2003] ECR I-4641.
16 Case E-2/06, ESA v. Norway, [2007] EFTA Court Reports, p. 164.
17 See, for example, Case C-367/98, Commission v. Portugal, cited above, para. 49.

[29] With respect to the hydropower resources in public ownership, the Court held that Norway had not demonstrated that "*ownership control is necessary in order to meet the aims of security of energy supply or environmental protection.*"[18]

[30] The Court emphasised that: "*in order for the exercise of ownership rights by public entities to be a necessary means of attaining a legitimate public interest objective, it is not sufficient that this exercise is an easier way of making the undertaking act in a certain way*" and that "*It must be demonstrated that other forms of control, even if administratively more burdensome, may not achieve the relevant public interest objectives in an equally effective way*."[19]

[31] The Consultation Paper does not demonstrate that Statnett ownership or control is necessary for environmental protection purposes, or to ensure security of supply, or for efficiency, or for the assessment of any need for reinforcement of domestic grids (although this is asserted).

[32] For example, it is not explained why other ways of controlling interconnectors would not be enough, instead of requiring Statnett to own or have decisive influence over the interconnectors. Nor why the fact that Statnett is responsible for the physical exchange in implicit auctions is an issue here.

[33] It is not enough just to argue that this has been Norway's practice previously, as the "preferred solution" (see Consultation Paper, Section 3.1, para. 3).

[34] It is even required in Article 17(1)(c) of Regulation 714/2012 that the interconnector company be legally separate from the TSOs concerned. One may note also that, while many interconnectors are between TSOs, some involve private companies (e.g. Imera in the EWC Irish UK interconnector).

Conclusion

[35] For these reasons, we consider that the proposed changes, with the proposed ownership and control restriction in favour of Statnett, is contrary to:

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[18] Case E-2/06, ESA v. Norway, cited above, para. 84.
[19] Case E-2/06, ESA v. Norway, cited above, para. 88.

(i) EU/EEA Energy Regulatory Law, denying the specific procedural rights of Article 17 of Regulation 714/2009 and Article 7 of Regulation 1228/2003;

(ii) the duty of EU/EEA Member States not to enact measures which will lead a State-owned undertaking to abuse its dominant position; and

(iii) EU/EEA rules on the free movement of capital.