

**Federal Ministry of Economics and Labour**

in collaboration with

**Federal Network Agency**

**Federal Cartel Office**

**Benchmarking Report**  
**on the Electricity and Gas Markets**  
**in compliance with the DG TREN requirement of**  
**2 June 2005**

**Berlin/Bonn, 24 August 2005**

## 1 Foreword

The European Commission has requested that each country submit a report on the progress of integration in their electricity and gas markets, pursuant to the EU directives on the internal markets in electricity and gas. This report is jointly issued by the Federal Ministry of Economics and Labour, the Federal Network Agency for Electricity, Gas, Telecommunications, Post and Railway (Federal Network Agency) and the Federal Cartel Office, which are the competent German authorities in this field.<sup>1</sup>

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<sup>1</sup> Unless otherwise indicated, the information on the market situation/developments in 2004 is based on aggregated data provided by the German Electricity Association (VDEW) and the Association of German Network Operators (VDN), as well as the Federal Association of the German Gas and Water Industries (BGW). This information of the associations shall not be binding on future decisions of the Federal Network Agency and the Federal Cartel Office as it was not subject to detailed scrutiny.

## 2 Summary / key developments of the past year

### Organisational overview of the regulatory authority

The new Energy Industry Act (Energiewirtschaftsgesetz – EnWG) entered into force on 13 July 2005 as part of the Second Energy Statutes Reorganisation Act. The goal of the Act is to establish non-discriminatory third-party access to networks at charges that are fair and efficient, at the same time ensuring that the grid-based supply of electricity and gas to the public is as secure, reasonably priced, consumer friendly, efficient and environmentally sustainable as possible. It focuses in particular on regulating and unbundling system operation in the electricity and gas markets.

This reorganisation of German energy law derives to a large degree from the requirement to implement the EU's so called "acceleration directives"<sup>2</sup> in national law, concrete implementation of which could only begin in 2004, however, as the negotiations of the industry associations had failed.

At the heart of the new Energy Industry Act are the provisions establishing a regulatory authority for energy networks. The Act splits this authority between the central government and the federal states. The Federal Network Agency for Electricity, Gas, Telecommunications, Post and Railway (Federal Network Agency) acts on behalf of the central government, while the federal states each have their own regulatory apparatus. The Federal Network Agency is the successor to the Regulatory Authority for Telecommunications and Posts, a body whose responsibility was limited to the telecommunications and postal markets.

Section 54(3) EnWG gives the Federal Network Agency general authority for implementing the Energy Industry Act. The Agency has primary responsibility for transmission systems, as well as for distribution systems that cross at least one federal state boundary or to which more than 100,000 customers are connected, either directly or indirectly. It also discharges all duties that are not expressly assigned to another authority.

Section 54(2) EnWG lists the duties that the federal states perform "in their own right" within the meaning of Article 83 of the Basic Law. These notably include the regulation of charges

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<sup>2</sup> Directive 2003/54/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in electricity and repealing Directive 96/92/EC;  
Directive 2003/55/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in natural gas and repealing Directive 98/30/EC.

(sections 23a and 21a EnWG), the special control of anti-competitive practices including skimming-off additional proceeds (sections 30f and 33 EnWG), the monitoring of unbundling in the case of integrated undertakings (sections 6-10 EnWG), the policing of rules governing connection to the system (sections 17-19 EnWG) and the responsibilities of distribution system operators and gas transmission system operators (sections 14–16a EnWG), and the obligation to determine if a system is used solely to meet the supplier's own needs (such systems are largely exempt from the provisions of the Energy Industry Act, as per section 110 EnWG).

The Federal Network Agency, for its part, also exercises authority in matters where it is particularly important to have a single national regulator as an efficient means of providing market oversight. This includes such duties as monitoring markets in order to ensure transparency (section 35 EnWG), cooperating with the European Commission and the regulatory authorities of other EU Member States (section 57 EnWG), informing the public about the progress of energy market liberalisation (section 63 EnWG) and devising an incentive-based regulatory model.

The Federal Network Agency also performs the duties assigned to the regulatory authorities of the Member States by Regulation (EC) No. 1228/2003 on conditions for access to the network for cross-border exchanges in electricity (as per section 56 EnWG).

The Federal Network Agency and the regulatory authorities of the federal states support each other in discharging their respective duties, while a committee of representatives from the federal states ensures a uniform application of regulatory provisions.

The regulatory decisions of the Federal Network Agency are made by its Ruling Chambers (section 59(1) EnWG). These constitute the “judiciary branch” of the regulator, the aim being to guarantee the independence of its decision-making mechanisms. Each Chamber comprises a chairperson and two associates. They must all be civil servants and hold authority for judicial office or have qualified for the higher civil service grade. The members of the Ruling Chambers may neither own nor manage an energy undertaking, nor may they sit on the management or supervisory board of an energy undertaking.

The headquarters of the Federal Network Agency are in Bonn. Just like its predecessor, the Regulatory Authority for Telecommunications and Posts, it is a higher federal authority within the scope of business of the Federal Ministry of Economics Labour. It is consequently subject to the supervision of the federal ministry in both professional and legal matters. For the purpose of transparency, and owing to their central importance, general instructions

from the ministry concerning the issuing or rescinding of orders are to be published in the Federal Gazette (section 61 EnWG), together with an explanatory statement.

Section 58 EnWG addresses the relationship between the Federal Network Agency and antitrust authorities. The Federal Network Agency and the Federal Cartel Office must endeavour to interpret the Energy Industry Act in a uniform manner and in a way that preserves the link with the Act against Restraints of Competition. The two bodies may, irrespective of the type of proceedings in question, share information including personal data and industrial and commercial secrets, insofar as this information is necessary for them to discharge their duties. Information shared in this way may also be used in proceedings.

Section 58(1), first sentence, lists various instances in which a decision of the Federal Network Agency requires the concurrence of the Federal Cartel Office. In addition, before taking a decision that concerns the regulation of system operation (Part 3 of the Energy Industry Act), the Federal Network Agency must give the Federal Cartel Office, plus the competent authority under the law of the federal state in which the network operator in question is based, the opportunity to comment on the case before proceedings are closed (section 58(1), second sentence).

Section 58(2) EnWG similarly requires that antitrust authorities give the Federal Network Agency opportunity to comment on competition proceedings.

Germany's new energy legislation has heralded a change in the duties of the Federal Cartel Office. Responsibility for regulating networks in the electricity and gas industries, as well as for unbundling network monopolies from those areas that are subject to competition, has namely been transferred to the regulatory authorities. Under the new Energy Industry Act, the Federal Cartel Office and the competition authorities of the federal states remain responsible for the control of anti-competitive practices in the exchange of electricity, the generation and procurement markets, and the distribution of electricity and gas, as well as for the application of Articles 81 and 82 of the EC Treaty. The Federal Cartel Office also retains responsibility for merger control.

Pursuant to section 51 EnWG, the Federal Ministry of Economics and Labour monitors the security of supply from the electricity and gas grids. Prior to the reorganisation of the energy statutes, the Ministry submitted a monitoring report on 1 September 2003 to the German Bundestag on developments in the market for networked electricity and gas. Monitoring encompasses, in particular, the supply/demand balance on the domestic market, the level of

expected future demand and supply, network maintenance and network malfunctions, as well as measures to cover peak demand and to deal with shortfalls of individual suppliers.

## **Key developments in the electricity and natural gas markets**

### Electricity

System operators appear to have desisted from practices that significantly impede the supply of electricity in the downstream distributor and large customer segments, a development that now signals the emergence of single national markets. These markets, however, are dominated by Germany's four large electricity companies: E.ON, RWE, Vattenfall Europe and EnBW. Together, they control over 80% of the country's generating capacity (without long-term contracts securing power plant capacity) and own almost the entire extra-high voltage network (220kV and above). The companies each have their own balancing areas, within which system users offset the consumption of electricity by their customers against feed-in, with the operator in that area usually providing the balancing power needed to make up the shortfall.

The Federal Cartel Office is of the opinion<sup>3</sup> that E.ON and RWE constitute a duopoly in the national markets for supplying major industrial/commercial customers and in the electricity distribution markets (supplying regional undertakings and municipal utilities). Consequently, proposed mergers involving even just one of the two oligopolists have regularly met with significant reservations on the part of the Federal Cartel Office, which fears the impact such measures might have on competition. During the period under review, significant acquisitions of downstream distributors were therefore prohibited or, in some cases, made subject to the fulfilment of certain conditions and obligations.

The number of new providers entering the market after liberalisation has fallen sharply in recent years. There were no reliable indications of a significant change in this trend during the period under review.

The Federal Cartel Office is constantly watching developments in wholesale electricity prices; in response to specific complaints it is currently investigating whether E.ON Energie AG, München, and RWE AG, Essen, as dominant undertakings, are abusing their position in the

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<sup>3</sup> Cf. 2003/2004 Activity Report of the Federal Cartel Office, Bundestag printed paper 15/5790, pages 22, 126 f., 128 ff. (page 25 in the abbreviated English-language version). Please note that, unless otherwise indicated, references to documents and orders from the Federal Cartel Office refer to German-language texts.

national wholesale electricity supplies market in conjunction with CO<sup>2</sup> emissions trading. The essence of the complaints is that the large power companies are factoring in as costs in their electricity prices the CO<sup>2</sup> emissions certificates allocated free of charge by the federal government, which trade for a high price on the power exchanges.

In general, the Federal Cartel Office observed a marked decline in the competition for downstream distributors and major industrial customers that had been triggered by market opening. Furthermore, it has been noted that prices are rising again. In addition to the increase in primary energy costs, taxes and other state-imposed burdens, it should also be pointed out that the overcapacity which existed in the former monopoly market has now been largely depleted.

This situation may improve in future when the new power plants that have been announced (and in some cases are already being built) come on line.

For some time now (since 2002 in fact), the Federal Cartel Office has reverted to the view that the small customer segment is made up of many regional/local markets, each based on the low-voltage network of one electricity supplier. This view is derived from its assessment of competitive activity, notably the low level of customer turnover. In taking this stance, the Federal Cartel Office is not ignoring the fact that there have also been price cuts in the small customer segment - in the form of either universal tariffs or special offers for certain categories of consumers - and that this may be a reason why small customers are unwilling to switch supplier. Nevertheless, the price cuts first seen after market opening have turned out to be significantly smaller than those in the large customer segment and the Federal Cartel Office interprets this as an indication that low-voltage networks have not been liberalised to the same degree as high-voltage ones. Besides, the prices for small electricity customers have since risen again. In the view of the Federal Cartel Office, such defensive behaviour by established local suppliers, aimed at stifling the emergence of competition, does not amount to the creation of a single national electricity market in the small customer segment.

The Federal Cartel Office believes that there are two principal reasons for the low customer turnover in the small customer segment. Firstly, the customer can only make small savings by switching supplier. Allied to this is the fact that charges for using low-voltage systems are high and new electricity providers therefore have little prospect of earning significant margins.

It is not yet possible to assess the impact of the new Energy Industry Act, as it only entered into force on 13 July 2005.

### Natural gas

The supply situation in the gas market is very different, largely due to the high import dependency. However, the market structure is similar to that found in the electricity market and is characterised by vertical supply chains and a large number of regional and local providers. The industry continues to be highly concentrated<sup>4</sup>.

So far, competition in the gas industry has only taken root in the large consumer segment and, even there, only in isolated areas and certainly not nationwide. There are few instances of third-party access to networks. Nor is there nationwide, across-the-board price competition between providers, particularly in the case of private households. The number of new market entrants is low. This is due on the one hand to the lack of liquidity in the gas market, and on the other to the deficiencies that exist in terms of network access.

In order to boost liquidity, a gas release programme (involving the auction of a particular volume of gas, to be released over a defined period) has been implemented as a condition of the E.ON/Ruhrgas merger. Furthermore, the new legislative framework for the energy industry should serve to eliminate the current obstacles to network access. The Federal Cartel Office has also addressed the anti-competitive impact of long-term contracts for supplying downstream distributors and what effect these have in terms of market foreclosure. In addition, the Federal Cartel Office is currently investigating whether suppliers have abused the linkage of gas prices to oil prices in order to implement price hikes that are not objectively justified.

### Main issues addressed by the Federal Cartel Office

The Federal Cartel Office holds the view that RWE and E.ON together dominate the national markets for supplying electricity distributors and major electricity customers<sup>5</sup>.

In the small customer segment, the lack of competition via third-party access has caused it to revert to a local/regional market perspective. In each of these local or regional markets, the supplier (and system operator) regularly occupies a dominant market position<sup>6</sup>.

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<sup>4</sup> Cf. the various merger control proceedings initiated by the Federal Cartel Office, 2003/2004 Activity Report, pages 135 f. (pages 18 f. in the abbreviated English-language version).

<sup>5</sup> Prohibition order of 17 January 2002, Journal of German and European Competition Law/Decisions DE V, pages 511 ff. "E.ON/Ruhrgas I";  
Prohibition order of 26 February 2002, Journal of German and European Competition Law/Decisions DE V, pages 533 ff. "E.ON/Ruhrgas II".

<sup>6</sup> Cf. 2001/2002 Activity Report of the Federal Cartel Office, Bundestag printed paper 15/1226, pages 162 f.

During the reporting period, the Federal Cartel Office was constantly compelled to review proposals by grid companies wishing to acquire a stake in downstream distributors. It regularly found that proposed equity investments by E.ON and RWE raised concerns under competition law.

This view was informed by the following considerations of the Federal Cartel Office:

- Every equity investment by one of the duopolists in an electricity distributor increases the degree of vertical integration. The new stake improves their chances of remaining or becoming the chosen supplier of other companies, thereby further consolidating their market position and increasingly limiting the opportunities open to other providers.
- In the wholesale market for electricity, the market dominance of the duopolists is reinforced by the fact that each equity investment extends their sphere of influence to include the market shares of the newly associated companies, thereby further weakening external competition.
- In the small customer segment, if the company making the equity investment could realistically compete in terms of exploiting third-party access to local low-voltage networks (in the opinion of the Federal Cartel Office, this category includes first and foremost E.ON and RWE, whose electricity interests extend throughout Germany, as well as EnBW, which operates nationally through Yello, its household customer arm), then by removing itself as a potential competitor, or at least limiting the possibility of competition, it strengthens the local market dominance of the company in which it is investing.

The Federal Cartel Office has prohibited two planned equity investments on the above grounds. The first of these was the intended acquisition by EAM Energie AG, a company belonging to the E.ON group, of a 33% stake in the municipal utility Stadtwerke Eschwege GmbH<sup>7</sup>, while the second concerned the acquisition by E.ON Hanse AG, also part of the E.ON group, of a 49.9% holding in the municipal utility Stadtwerke Lübeck GmbH<sup>8</sup>. The prohibition order in the case of “Stadtwerke Lübeck” is now final. In the case of “Stadtwerke Eschwege”, however, an appeal has been lodged and is currently waiting to be heard by the Intermediate Court of Appeals in Dusseldorf.

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<sup>7</sup> Order of 12 September 2003, Journal of German and European Competition Law/Decisions DE-V, pages 823 ff. “E.ON/Stadtwerke Eschwege”.

The aim of these prohibitions is to keep the energy markets open and to prevent market foreclosure<sup>9</sup>.

Some cases were only approved subject to conditions and/or obligations designed to at least offset the expected anti-competitive effects (section 40(3) of the Act against Restraints of Competition). Examples of such cases are the acquisition by RWE of stakes in three municipal utilities - Wuppertaler Stadtwerke AG, Stadtwerke Velbert GmbH and Stadtwerke Remscheid GmbH – and the increase of a further stake in a fourth (Energieversorgung Oberhausen AG). These were only cleared<sup>10</sup> under the suspensive condition that RWE sell its 40% stake in the municipal utility Stadtwerke Leipzig GmbH and part with its 20% holding in Stadtwerke Düsseldorf AG. RWE has since fulfilled the condition and obligation.

In several other cases, the duopolists have shelved proposals after the Federal Cartel Office voiced concerns about their anti-competitive impact at the hearing stage. These include the plan by Thüga AG to acquire a 25.1% stake in the municipal utility Stadtwerke Ulm (SWU Energie GmbH), the intended acquisition by E.ON Bayern AG of a 12% holding in Aschaffener Versorgungs GmbH, and the plan by E.ON Hanse AG to increase its 25.1% stake in Stadtwerke Neumünster GmbH to 49.9%. Thüga AG, E.ON Bayern AG and E.ON Hanse AG are all part of the E.ON group.<sup>11</sup>

In the gas sector<sup>12</sup>, the Federal Cartel Office is currently reviewing the antitrust impact of long-term gas supply contracts in a series of ex officio administrative proceedings.

The Office is also examining whether the linkage of gas prices to oil prices is still justified by developments in the market, or whether this constitutes anti-competitive behaviour.

At the same time, it is looking at what form this linkage takes in practice. During the period under review, the Federal Cartel Office initiated formal prohibition proceedings against regional/local gas providers on suspicion of abusive pricing for household and small business customers. These have since been discontinued after the companies in question promised to lower their prices.

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<sup>8</sup> Order of 20 November 2003, Journal of German and European Competition Law/Decisions DE-V, pages 837 ff. "E.ON/Stadtwerke Lübeck".

<sup>9</sup> Cf. 2003/2004 Activity Report of the Federal Cartel Office, Bundestag printed paper 15/5790, page 22 (page 25 in the abbreviated English-language version).

<sup>10</sup> Order of 26 August 2003, Journal of German and European Competition Law/Decisions DE-V, pages 831 ff. "RWE/Wuppertaler Stadtwerke".

<sup>11</sup> Cf. 2003/2004 Activity Report of the Federal Cartel Office, Bundestag printed paper 15/5790, pages 31 and 129.

<sup>12</sup> Cf. 2003/2004 Activity Report of the Federal Cartel Office, pages 137 ff. (page 40 in the abbreviated English-language version).