

Public Service Obligations in the Electricity and Gas Sectors: Portugal

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1. The notion of PSOs in Portugal in the electricity and gas sectors

Decree-Law 23/96 of July 26, 1996 introduced in Portugal the concept of "essential public services"¹ with the scope of protecting the end-users of water supply, electricity, gas and telephone services.

According to this Decree-Law, the undertakings that operate in these markets must guarantee service according to high standards of quality, and have the following duties:

- they must always act on a bona fide basis with the consumer;
- they must inform the consumer of the terms and conditions of the service rendered;
- the supplier may not suspend the service without prior notice;
- in case of payment by the consumer being in default, the suspension of the service may only occur after the user is warned in writing with a minimum of eight days' notice prior to the date of suspension; and
- the supplier may not impose minimum consumption requirements or charges.

Likewise, Decree-Law 558/99 of December 17, 1999, which takes into account Arts 86(2) and 16 of the EC Treaty, establishes in its Ch.II that the undertakings charged with the operation of services of general economic interest are considered to be those who provide universal and continuous services, as well as social and economic cohesion and consumer protection, without prejudice to the economic efficiency of the undertaking, while maintaining respect for the principles of non-discrimination and transparency.

¹ The concept of "public service obligation" has not been frequently dealt with by the Portuguese jurisprudence. The notion was indirectly discussed in two cases before the Portuguese Supreme Administrative Court, within a request made by a private television broadcaster for the annulment of financial compensations granted by the Portuguese State to Rádio-televisão Portuguesa, SA (RTP), the Portuguese public television broadcaster (Court Judgment of June 23, 1998 in Case Law No.32.282 SIC—*Sociedade Independente de Comunicação SA v RTP—Rádio Televisão Portuguesa, SA* and Court Judgment of October 24, 2000 in Case Law No.34.900).

In addition, this Decree-Law also mentions that all undertakings charged with the management of services of general economic interest shall proceed with their mission taking into regard, as applicable, the following obligations:

- to secure the service of general economic interest in the whole territory, without discrimination between rural and interior areas;
- to promote access to goods and essential services to the population as a whole under viable economic conditions, seeking, where possible, equal and non-discriminatory treatment for all users;
- to guarantee the supply or management of those services whose profitability is not assured, especially owing to the necessary investments in infrastructure or distribution networks, or owing to the necessity to accomplish activities that are not efficient in economic terms;
- to oversee management efficiency of public service networks, specifically by envisaging that production, transport, distribution and construction of infrastructure is accomplished in an articulated manner, taking into account the organisational modifications imposed by technical or technological innovations; and
- to ensure specific obligations, connected with security, quality, continuous and reliable service, and in conjunction with the goal of environment protection. These obligations shall be clearly defined, transparent, non-discriminatory and, if necessary, the object of control.

2. Electricity review

2.1 Review of existing PSOs imposed on undertakings operating in the electricity sector

In 1975, during the revolution that occurred in Portugal, the Portuguese Government nationalised and combined all the undertakings that were responsible for the production, transport and distribution of electricity in Portugal under the state-owned company *Electricidade de Portugal* (EDP). The main scope of this company was the production, transport and distribution of electricity in Portuguese territory, as well as to promote and satisfy the demands of social and economic development in Portugal.

The public service commissioned to EDP was granted on an exclusive territorial basis and for an indefinite period of time. Accordingly, this public undertaking had a legal monopoly over its activity in the electricity sector.

However, after the revision of the Portuguese Constitution in 1989, access to the electricity sector by private undertakings was permitted, and, as a result of the reprivatization of EDP, the Portuguese State currently holds a minority stake in the undertaking.

As detailed below, PSOs in the generation, transmission and distribution markets are a reality in Portugal. For instance, Decree-Law 183/95 of July 27,

1995, as amended, and the Regulation of Commercial Relations (*Regulamento de Relações Comerciais*) from the national regulator, *Entidade Reguladora dos Sectores Energéticos* (ERSE), specifically state that the objective of the public electrical system (SEP) is to guarantee the satisfaction of consumer needs under a public service regime.

In the exercise of those activities, the development of economic and social cohesion, the well-being of the population and the rationality and efficiency of the resources used, from generation to supply, must be considered. Such activities must be developed based on the rational use of natural resources, on their preservation and on the maintenance of the ecological equilibrium.²

As a general principle, Tariff Regulation (*Regulamento Tarifário*) from ERSE also states that the electricity sector shall contribute to the improvement of environmental conditions, allowing, specifically, a wider transparency in the use of renewable and indigenous energy sources.

The undertakings that operate in the electricity sector have the duty to develop their activity on a continuous and regular basis and can only suspend such activity if authorised or instructed by the national regulator.

It should be duly noted that the majority of the obligations described above entered into force in the Portuguese legal system prior to the enactment of Directive 96/92.

(a) PSOs in the generation market

Within the generation market, the Portuguese public authorities have been granting exclusive rights, through licences, to a limited number of undertakings.

The primary measure regarding the generation market, Decree-Law 183/95 of July 27, 1995, as amended, specifically states that the holder of the licence shall adopt all required measures to minimise environmental damage, while observing the applicable legal dispositions, as well as complying with instructions from the competent authorities.

Furthermore, each undertaking shall also maintain the electricity-producing centre in sound condition, and for that purpose it shall provide the required maintenance, as well as the necessary measures to assure the safety of persons and goods.

If the undertakings promote or give their consent, in any form, to the interruption or irregularity of electricity production, affecting the public interest and failing to re-establish normal exploration within the deadline determined by the Directorate-General of

Energy (DGE), or if they systematically infringe the dispositions applicable to the activity, the licence can be revoked by the Director-General of the DGE.

(b) PSOs in the transmission market

In the transmission market, the Portuguese public authorities granted an exclusive right, through a concession agreement, for the transmission of electricity at greater than 110kV ("very high voltage"), for the entire Portuguese territory, to *Rede Eléctrica Nacional, SA* (REN—a company owned by the Portuguese State and by EDP).

Decree-Law 185/95 of July 27, 1995 states that the concessionaire is obliged to supply energy to the holders of distribution licences in high or medium voltage. The supply can only be interrupted for reasons of service, public interest or security, or by facts imputable to the holder of the licence in high or medium voltage.

According to the bases of the concession contract, the concessionaire must also fulfil its obligations through regular, continuous and efficient functioning of the service and for this purpose it shall adopt the best means and technologies generally used in the electricity sector.

The following sanctions are applicable for breach of the obligations by the concessionaire:

Misdemeanour	Sanction
Application to clients of tariffs or prices not approved	Fine from €4,987.98 up to €29,927.87
Failure to observe the rules regarding the use of the grids	Fine from €1,995.19 up to €24,939.89

Source: Decree-Law 185/95 of July 27, 1995

Finally, it should be noted that such concession can be terminated unilaterally by the Portuguese State, if the concessionaire suspends its activity or does not accomplish the necessary maintenance or development of the infrastructure or charges prices higher than those administratively established.

(c) PSOs in the distribution market

PSOs have been a reality in Portugal in the low-voltage distribution market (voltage up to 1kV) since Dispatch 148/84 of March 15, 1984, as amended, according to which the concession contracts signed between EDP and each municipality are subject to the following conditions:

- the concessionaire is mandated to provide all the material and human resources required for the good execution of the activity and, in a general manner, to secure the continuity of the public service on an ongoing basis;
- the undertaking exercises its activity on an exclusive basis in the area of the municipality but is obliged to satisfy all the supply needs of the collectivity; and
- electricity must be supplied to any consumer that requires it on a permanent and continuous basis.

² In 2003 the Government, by Council of Ministers Resolution 63/2003, with the aim of reducing CO₂ emissions, stated its intention to introduce a mechanism of taxes for relevant consumers of electricity. Equally, to endorse the rational use of energy, it adopted the following measures: (a) the Solar Hot Water Program (*Programa Água Quente Solar*) with the objective of installing 1 million m² of solar collectors before 2010; (b) the fiscal deduction of the acquisition of solar equipment up to €700; and (c) the reduction of VAT to 12 per cent on equipment destined to take advantage of indigenous energy sources.

These obligations were acknowledged in Decree-Law 184/95 of July 27, 1995 which states that the holders of licences of distribution in low voltage must:

- provide electricity to those who require it;
- expand the distribution network to ensure a regular and continuous supply of electricity to their clients;
- maintain the grids and respective installations and equipment in proper working condition and carry out their regular conservation, adopting for that purpose all the measures required to safeguard the security of persons and goods; and
- comply with the obligations stated in the contracts signed with the municipalities.

Equally, the distribution of electricity in low, medium (voltage higher than 1kV and equal to or less than 45kV) and high (higher than 45kV or equal to or less than to 110kV) voltage, according to Decree-Law 192/95, is also subject to the two following principles:

- the principle of uniform tariffs, according to which, at any given moment, the tariff system in force must be applicable universally to all final customers of the SEP³; and
- the principle of the economic equilibrium of the undertakings holding a binding distribution licence.

Simultaneously with these two principles, the undertakings charged with the distribution of electricity are obliged to supply electricity to the customers that request it within their areas of operation and that fulfil the legal requirements thereto.

The *Regulamento de Relações Comerciais* from ERSE also requires that the supply of electricity comply with the public service principles of security, universality, equality, quality, continuity and price accessibility. The holder of a binding distribution licence is obliged, within its area of distribution, to supply electricity to the client who requires it. The conditions of the agreement between distributor and client are subject to scrutiny and approval by the regulator. ERSE, before the approval of the agreement proposed by the distributor, must seek advice from relevant consumer associations.

In a recent Council of Ministers Resolution (63/2003), the Government reaffirmed its intention to safeguard the existence, in the electricity sector, of a PSO to those customers for which the supply, by the distributor, of electricity is not economically viable.

The supply can only be interrupted for reasons of public interest, service, and security or by facts imputable to the client or third parties. The supply of electricity shall also adhere to standards of high quality (as mentioned in the Regulation of Quality of Service of ERSE).

The following sanctions are applicable for breach of the obligations:

Misdemeanour	Sanction
Failure to observe the conditions established in the licence	Fine from €2,493.98 up to €27,433.88
Interruption of the supply or abandonment of the installations without permission	Fine from €1,995.19 up to €24,939.89

Source: Decree-Law 184/95 of July 27, 1995

In addition, if the undertakings promote or give their consent, in any form, to the interruption of or to the irregularity of electricity production, affecting the public interest and not re-establishing the normal supply within the deadline determined by the DGE, or systematically contravene the applicable dispositions to the activity, the licence can be revoked by the Director-General of the DGE.

(d) Justification of the PSO in the electricity markets

There may be several reasons for the existence of PSOs in the three markets discussed above.

First, electricity is an essential service—lack of access to electricity by all citizens can result not only in discomfort and inconvenience but also in a threat to health or life itself (consider for instance the case of hospitals).

Secondly, the PSOs in this activity are indispensable in providing a service that is vital for social inclusion.

Thirdly, if PSOs were not a reality there could be discriminatory prices. In particular, people with low incomes, or those living in areas where provision of infrastructures is expensive, would likely find themselves unable to afford access to this essential service.

Fourthly, certain groups of consumers who are viewed as unprofitable might not be offered the benefits of lower prices without obligations being placed on suppliers requiring them to do so.

Fifthly, without the PSOs there would be a risk of creaming-off and concentration of the new players in the most lucrative activities of SEP, which would be liable to compromise SEP's economic viability and consequently the fulfilment of the relevant PSOs.

(e) Mechanisms for cost recovery of PSOs

At present, the Portuguese legal regime does not provide for financial compensation or other forms of compensation for performance of PSOs by the undertakings in the electricity market obliged to provide them.

Within the future liberalisation of the sector, such financial compensation may become a reality for the "supplier of last resort" in the distribution of electricity to the most remote and rural areas of the Portuguese territory.

According to the view of the Consumers Committee (the consultative committee of the European Commission), besides financing by the State, the following options may be taken into account:

- Funding by government: via grants or social security payments to specific groups of consumers to help them with the costs of particular services, via tax advantages to the supplier and/or by

³ The Regulator in *Regulamento Tarifário* (the Tariff Regulation) restates the principle of uniform tariffs.

direct payments to the suppliers in order to subsidise prices.

- Funding by suppliers, through a universal fund paid by suppliers or for those suppliers exceeding a certain market share. This would probably entail financing by end-consumers, as the costs would normally be passed on to consumers through charges, unless specific provisions are made to prevent this from happening.
- Funding by consumers: through cross-subsidies in the prices charged for supply. Structures of cross-subsidisation can be designed to impact positively and negatively on different users.

(f) Application of Art.86(2) EC to undertakings charged in the electricity market in Portugal with PSOs

By virtue of the legal regime under which undertakings operate in the electricity sector in Portugal, for the purposes of Art.86(2) EC, they can be considered as undertakings entrusted with the operation of services of general economic interest that, consequently, may, exceptionally, not be subject to specific EC Treaty rules.

In fact, in the judgments in *Almelo v Energiebedrijf Ijsselmij*,⁴ *Commission v Netherlands*,⁵ *Commission v Italian Republic*⁶ and *Commission v French Republic*,⁷ the European Court of Justice stated that the uninterrupted supply of electricity to all consumers, whether local distributors or end-users, 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, is a task of general economic interest within the meaning of Art.86(2).

Similarly, the Commission, in its Decision 91/50/EEC,⁸ has already recognised that an undertaking entrusted with the main task of ensuring the reliable and efficient operation of the national public electricity supply at costs which are as low as possible and in a socially responsible fashion provides services of general economic interest within the meaning of Art.86(2) EC.

Accordingly, the financial compensation granted to electricity undertakings by the Portuguese State to secure the "universal service",⁹ may derive the benefit of a derogation from the application of Art.87(1) EC which, as a general rule, prohibits the granting of financial aid by the State to undertakings.

2.2 PSOs to be introduced to undertakings that operate in the electricity sector

As detailed above, the majority of the PSOs referred to in Art.3 of the new Directive 2003/54¹⁰ have been implemented in Portugal. However, certain measures

4 Case C-393/92 [1994] E.C.R. I-1477.

5 Case C-157/94 [1997] E.C.R. I-5699.

6 Case C-158/94 [1997] E.C.R. I-5789.

7 Case C-159/94 [1997] E.C.R. I-5815.

8 Case IV/32.732 *Ijsselcentrale*, January 16, 1991 relating to a proceeding under Art.81 EEC [1991] O.J. L28/32.

9 See Decree-Law 558/99.

10 Proposed Directive of the European Parliament and of the Council, amending Directive 96/92, concerning rules for the internal market of electricity as mentioned in common position (EC) No.5/2003, adopted by the Council on February 3, 2003 [2003] O.J. C50/15.

mentioned in Annex A and in Art.3(3) and (6) of the Directive are not yet in force in Portugal, specifically:

- the appointment by the national authority of the "supplier of last resort";
- information to final customers of the contribution of each energy source to the overall fuel mix of the supplier over the preceding year, and reference to existing reference sources, such as web pages, where information on the environmental impact, in terms of emissions of carbon dioxide resulting from the electricity production from different energy sources, is publicly available; and
- ensuring that customers are not charged for changing supplier.

Therefore, these PSOs must be implemented in the near future by the Portuguese national authorities.

3. Gas review

3.1 Existing PSOs imposed upon natural gas undertakings

Portugal became a natural gas purchaser for the first time in 1998. The natural gas sector in Portugal is controlled by *Gás de Portugal, SGPS, SA* (GDP), a subholding of *Petróleos e Gás de Portugal, SGPS, SA* (GALP—established in 1999, in which the Portuguese State is a major shareholder).

The GDP holding company, *Transgás—Sociedade Portuguesa de Gás Natural, SA* (TG) is responsible for the import of natural gas and for the development and maintenance of transportation and distribution infrastructure in high-pressure pipelines. The undertaking also provides natural gas to the regional distributors.

GDP is also a shareholder in the undertakings involved in the distribution of gas at the regional level. Taking into account its experience in the electricity sector, ERSE also became recently the regulator of the natural gas sector.

As to PSOs in this sector, according to Law 23/96 of July 26, 1996, natural gas undertakings that operate at the regional level provide an "essential public service" and, for that reason, the duties listed in section 1 above are also applicable to them in the quality of suppliers of final customers.

Decree-Law 373/89 of October 25, 1989, as amended, establishes the general rules for the import, storage, transport and distribution of natural gas and specifically states that these activities are exercised in a public service regime.

(a) PSOs in the transmission, distribution and supply markets

Decree-Law 14/2001 of January 27, 2001 that implements Directive 98/30, mentions that the undertakings responsible for the production, transmission, distribution, supply, purchase or storage of natural gas, including liquefied natural gas (LNG), can be obliged to fulfil PSOs regarding security of supply, regularity, quality, price of supplies and environmental protection, through their respective concession agreement or licences.

The undertakings are compelled to operate, maintain and develop, under reliable, efficient and secure

economic conditions, transmission and storage facilities for natural gas and LNG. They shall also refrain from discriminating between system users or classes of system users, particularly in favour of related undertakings.

The incumbent undertakings, responsible for the distribution and supply of natural gas, according to the PSO established in their respective contracts or licences, can be obliged to ensure the supply of customers who are located in remote areas of the Portuguese territory.

In the matter of sanctions for breach of the PSO in distribution and supply markets according to Decree-Law 374/89 of October 25, 1989, a concessionaire's wilful misconduct can result in termination of the contract. No other sanctions are mentioned in the Portuguese legal regime concerning natural gas.

(b) Justification of PSOs in the markets

Regarding the existence of PSOs in the markets mentioned above, besides the reasons referred to in 2.1(d) it should be emphasised that the imposition of PSOs in this market is a way to:

- ensure sustainable development;
- combat social discrimination (equality for all in access to the service, affordability);
- strengthen social cohesion, reducing, *inter alia*, regional imbalances;
- ensure transparency and full information (for example, clear and comparable information on tariffs, terms and conditions of contracts, complaint handling, and dispute settlement mechanisms);
- create a dynamic equilibrium between competitiveness and the promotion of the general interest; and
- safeguard the shared social values of the European Union.

(c) Mechanisms for cost recovery of PSOs

At present, mechanisms for cost recovery of PSOs are not in use in the Portuguese natural gas sector. However, according to Decree-Law 558/99, undertakings that are present in the natural gas market and that perform a service of general economic interest, if necessary according to a proportionality test, can receive financial compensation (*indemnizações compensatórias*) from the Portuguese State for the fulfilment of their missions.

(d) Application of Art.86(2) EC to undertakings charged in the natural gas market with PSOs

By virtue of the legal regime under which undertakings operate in the natural gas sector in Portugal, they can be considered, for the purposes of Art.86(2) EC, as undertakings entrusted with the operation of services of general economic interest that, consequently, may exceptionally not be subject to the EC Treaty rules. In

fact, in *Commission v French Republic*,¹¹ the European Court of Justice stated that the obligation of *Gaz de France, Service National* to supply natural gas, to all customers, in the areas it served, ensuring continuity of supply, endeavouring to provide the most competitive tariffs and the lowest costs for the community and observing equal treatment between customers, is a task of general economic interest within the meaning of Art.86(2).

As a result, financial compensation will be granted eventually to natural gas undertakings by the Portuguese State to ensure that PSOs can benefit from a derogation from the application of Art.87(1) EC which, as a general rule, prohibits the granting of financial aid by the State to undertakings. For that purpose the following conditions must be met: (a) the activity exercised by the undertaking constitutes a mission of public service; (b) the mission cannot be accomplished by measures which are less restrictive of competition; (c) the undertaking has been charged by the Portuguese State with the management of the service by an express public mandate; (d) the application of competition rules jeopardise the accomplishment of the particular mission of the undertaking; and (e) the development of trade is not affected to such an extent as would be contrary to the interests of the Community.

3.2 PSOs to be introduced to undertakings operating in the natural gas sector

Some of the PSOs referred to in Art.3 of the new Gas Directive 2003/55 are already a reality in Portugal, in particular those determining that Member States may adopt appropriate measures to protect customers in remote areas.

Regarding Annex A of the Directive, it is envisaged that when the Portuguese State implements the Community measure at the national level, those obligations will become a reality for the natural gas suppliers, specifically those concerning:

- the possibility for eligible customers to switch to a new supplier;
- not charging final customers for changing supplier; and
- contractual transparency (types of maintenance service offered, compensation and refund arrangements which apply if contracted service quality is not met, and a method of initiating procedures for settlement of disputes).

Finally, in light of the above, the authors must mention that in March 2003, through Council of Ministers Resolution 63/2003, the Government reaffirmed its goal to improve, in the energy sector (gas and electricity), the quality and safety of the services provided to final customers.

¹¹ see n.7 above.