THE ITALIAN SYSTEM OF HYDROELECTRIC CONCESSIONS

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Abstract: The article examines difficulties regarding competition in the area of hydroelectric concessions in the Italian market. The failure to implement the legislative and regulatory recommendations of the Italian Competition Authority (ICA) suggests that advocacy power needs to be transformed into concrete actions designed to remove obstacles to the development of competition which, as is well known, ensures the production of significant positive effects in terms of consumer welfare, efficiency and market innovation.

1. INTRODUCTION

As agreed with the organisers of this meeting, my speech will focus on a specific topics, which invests the activity of the Italian Competition Authority (ICA) in relation to such a topical sector as the assignment of hydroelectric concessions.

In view of the common objective of ensuring truly competitive market structures, national antitrust agencies have seen their powers of advocacy progressively strengthened complementary with those of enforcement, directed to promote the real fulfilment of competition policies.

The importance of this function is fully confirmed by the establishment within the International Competition Network (ICN) of the Advocacy Working Group, the institutional mission of which is to support national antitrust agencies in developing a global culture of competition.3

In recent times, the ICA’s powers of advocacy have been significantly strengthened.4 In addition to the traditional powers of issuing opinions and reports,5 since 2009 the ICA’s annual report has represented the basis for the annual law on competition.6

Significant developments were made in 2011 and 2012. First of all it was established that the ICA must issue a prior opinion on legislation proposed by the government and on the

5 Article 21, Law no. 287, 10 October 1990.
regulations which introduce restrictions on access to and exercise of economic activities.\(^7\)

The Italian legislator has provided that the Prime Minister’s Office gather the opinions and reports of independent authorities involving restrictions on competition and obstacles to the correct functioning of markets in order to organise the steps necessary to coordinate the action of the ministries and administrative regulations.\(^8\)

Uniquely among European legal systems, Italy’s national legal system has recently given the ICA the power to oversee the activities of any public administration and, when it finds an act contrary competition principles, issue specific opinions. Failure on the part of the public administration concerned to comply with said opinion gives it the power to bring a legal action before the administrative court.\(^9\)

However, enforcement of the ICA’s advocacy power is not sufficient in itself to ensure the creation of a competitive structure of the markets, as it is necessary that the function of promotion of competition should be converted into concrete legislative and regulatory actions to remove obstacles to the development of competition which, as is well known, has significant positive effects on consumer welfare, efficiency and market innovation.

The hydroelectric concessions sector is an example of the need to convert the clear opinions issued by the ICA into concrete legislative and regulatory measures, thereby ensuring a competitive structure for a strategic sector such as hydroelectric concessions.

2. THE NATIONAL REGIME OF HYDROELECTRIC CONCESSIONS

The need for a competitive and open market inspired the repeated opinions stated by the ICA on hydroelectric concessions.\(^10\) Recently,
the ICA has intervened in tender procedures for the assignment of these concessions.\textsuperscript{11}

As is widely acknowledged, the regulatory framework of reference is represented, essentially, by article 12 of Legislative Decree no. 97 of 16 March 1999 (commonly referred to as the “Decreto Bersani” or “Bersani Decree”), implementing Directive 96/92/EC on common rules for the internal electricity market, as amended by the national legislator – for the sole purpose of delaying the process of market liberalisation and openness – by introducing extensions to the expiration date of the concessions systematically censored by the Constitutional Court.\textsuperscript{12} The aforementioned article 12 of the Bersani Decree was last amended by article 37 of Decree Law no. 83 of 22 June 2012 (converted into law by Law no. 134 of 7 August 2012). As with previous amendments, these regulatory amendments have not yet achieved their purpose of ensuring a reliable and stable regulatory framework for hydroelectric concessions, in accordance with the principle of assignment by public tender based on parity between the outgoing company and potential competitors in the tender.

Article 37 obliges Italy’s Regions and Autonomous Provinces to hold public procurement procedures for the award of hydroelectric concessions five years before the expiry of the concession (if an overriding public interest in a different water use conflicting with the maintenance of the use for hydroelectric purposes is deemed not to exist). The rule, however, specifies that, for concessions which are overdue or which fall due by 31 December 2017 (and hence for which compliance with the five-year term is impossible), the tender notice must be published within two years of entry into force of the Ministerial Decree which establishes conditions concerning tenders for the award of hydroelectric concessions; in this case the concessions will be effective from the end of the fifth year after the original deadline and in any event no later than 31 December 2017.

To date, the Ministerial Decree which provides the conditions for the public tenders has not been adopted.\textsuperscript{13} The deadline for its adoption, originally established by Decree Law no. 78 of 2010 (converted into law by Law no. 122 of 2010) as six months after its entry into force, and extended until 30 April 2012 by Decree Law no. 1 of 2012 (converted into law by Law no. 27 of 2012), was not observed.

In the absence of rules for conducting tenders, therefore, the outgoing concessionaire continues to manage the plant “under the same

\textsuperscript{11} See the following opinions of the ICA: AS1151, 8 October 2014, “Provincia Autonoma di Trento – Affidamento di concessioni per grandi derivaizion di acqua pubblica ad uso idroelettrico”; AS1137, 2 July 2014: “Proposte di riforma concorrenziale ai fini della legge annuale per il mercato e la concorrenza anno 2014”; AS1089, 17 October 2013, regarding the draft of the decree of the Ministry of Economic Development on tenders for the assignment of hydroelectric concessions.

\textsuperscript{12} See also the following judgements of the Constitutional Court: no. 1 of 2008 and no. 205 of 2011.

\textsuperscript{13} Article 12, paragraph 2, Legislative Decree no. 79, 16 March 1999, as amended by article 37, paragraph 4, Decree Law no. 83, 22 June 2012 converted with amendments into law by Law no. 134, 7 August 2012.
conditions established by law and by the rules of the concession in force\textsuperscript{14}. The problem concerns both potential new concessions and those that have already expired or are expiring.

This neutralises the legislative measures which, on the basis of repeated infringement proceedings initiated by the European Commission\textsuperscript{15} and the judgments of the Constitutional Court\textsuperscript{16} in recent years, have attempted to open the markets up effectively to competition.

Such difficulties are common to many EU Member States.\textsuperscript{17} A recent study by the Florence School of Regulation, *Regimes for Granting Rights to Use Hydropower in Europe*, clearly shows that various EU Member States are yet to implement a tender system for the award of hydroelectric concessions,\textsuperscript{18} and that the legal frameworks vary greatly between EU Member States, not in compliance with the fundamental principles of the European Union. It also describes how Sweden releases the concessions indefinitely (until 2003 the United Kingdom also applied the same criterion). In other cases they are expected to last a very long time (for example, in Austria the maximum duration is 90 years, while in France and Portugal it is 75 years).

In Germany a different system applies. Current legislation in this EU Member State (as in other countries such as Austria, Norway, Portugal and Sweden) allows the competent authorities to assign concessions without a public tender procedure. Nevertheless, infringement proceedings are currently pending (for breach of competition rules) only against Italy and Portugal (it should be noted, however, that in the past France too was subjected to an infringement procedure concerning preference given to outgoing concession-holders, while in Spain an infringement procedure originated the introduction of the rule that concessions may only be awarded on the basis of a tender procedure).

On 26 September 2013, the European Commission sent Italy a “letter of formal notice” (in the context of the infringement proceeding no. 2011/2026) in which it was pointed out that the abovementioned article 37 is in conflict with EU law for two different reasons.

1) in providing an “extension” to existing concessions, it unlawfully extends the duration of existing hydroelectric concessions, mostly assigned to domestic operators. Specifically, it constitutes a breach:

a) of article 49 of the Treaty on the Functioning of the European Union (TFUE), which protects the freedom of establishment of companies by other Member States. Companies

\textsuperscript{14} Article 12, paragraph 8-bis of Legislative Decree no. 79, 16 March 1999.

\textsuperscript{15} Infringement procedures nos. 1999/4902, 2002/2282 and 2011/2026.

\textsuperscript{16} Sentence no. 1 of 2008 and sentence no. 205 of 2011.

\textsuperscript{17} For an in-depth analysis of this topic see the proceedings of the conference “Idoneum państregime of the hydroelectric concessions in Europe: state of the art, problems, what lessons are to be learned?” organised by the Vittorio Bachelet Public Administration Research Centre and held at LUISS (Guido Carli Free International University for Social Studies) on 9 July 2014.

\textsuperscript{18} European University Institute (Robert Schuman Centre for Advanced Studies), November 2014.
of other EU Member States cannot enter the Italian market until the existing concessions will be into force;

b) of the “Services Directive” No. 2006/123/EC, article 12, which states that in the event of the number of authorisations available for an activity being limited in consideration of the lack of natural resources or technical capacity, it is prohibited to grant authorisations or concessions with an excessive duration that are automatically renewable.

2) by obliging the new concessionaire to acquire the whole business unit “even if it has to build new plants”. This represents an unjustified advantage for the incumbent concessionaire. The Commission noted in particular that the unlawfulness of this provision would be accentuated by the fact that the new concessionaires forced to pay for the “wet works” even though these at the end of the concession would not be transferred to a successor but would still be acquired automatically by the State without any compensation pursuant to the provision contained in article 25, paragraph 1, of Royal Decree no. 1775 of 1933 (Public Water Code). Imposing such high and unjustified financial burdens on successful bidders would ultimately guarantee current contractors (who would be paid for the purchase of the plant) a significant competitive advantage, creating a strong barrier to entry for new operators in the Italian market.

It is pointed out that article 25, paragraph 1, of Royal Decree no. 1775 of 1933, provides for special treatment for “wet works” (also called “freely transferable assets”), stating that at the termination of the concession and in the cases of forfeiture or relais they pass into the State property, without compensation, including works of collection, adjustment, penstocks and drainage channels, in a functioning state. In contrast, in the case of “dry works”, paragraph 2 of the same article provides that the State can only take immediate possession of any other building, machinery, plant utilisation, processing and distribution relating to the concession, paying a price equal to the estimate of the installed material, calculated at the time of holding, and without any further assessment of others incomes deriving from it.

3. THE ICA OPINIONS

In this context the ICA has delivered its opinions.

Initially in this regard the ICA has issued opinion AS1089 of 17 October 2013 (upon the request of the Ministry of Economic Development, under article 22 of Law no. 287/90), pointing out a number of critical issues on the drafting of the abovementioned Ministerial Decree of the Ministry of Economic Development which defines the conditions for tenders for the awarding of concessions and the identification of criteria and values for the definition of the compensation that the outgoing operator must receive for the assets included in the business unit, “dry works”, valued at the cost of new construction, minus ordinary degradation, and the amount for so-called “wet works”, valued at historical cost, decreased of the ordinary deterioration.
The ICA has underlined an initial critical aspect regarding the provisions stating for “transfer of a business” by the outgoing operator to the winner of the tender. The definition of a fair, appropriate sum to be paid to the outgoing operator is a “crucial element”, as the concrete quantification of such sums “(...) may represent a high economic barrier to entry and correspondingly a significant competitive advantage for the outgoing operator (...).” This said, in the draft Ministerial Decree the ICA has provided some guidance which aims to reduce, any elements of “discretion and arbitrariness” to a minimum in establishing the mechanisms of exploitation of dry and wet works.

On this basis, the ICA found, first of all, that the draft ministerial decree obliges the outgoing operator to draw up (in order to define the specification and the tender notice) an “end-of-concession report” which determines the value of the works which are to be transferred to the incoming operator based on a technical evaluation by experts appointed (and paid) by the outgoing operator, yet conducted jointly with the granting administration (i.e. the Region or Autonomous Province). The identified methods state that the value of the fees essentially depends on an “agreement” between the ongoing operator and the granting administrations on the assumption, not always obvious, of a conflict of interests between these two parties.

A second critical aspect for the ICA in the draft Ministerial Decree is the definition of “ordinary deterioration” (which consists in estimating the remaining life of the works) used as a value to adjuste the historical cost of “wet works” and the cost of reconstruction of “dry works”. In this regard, the ICA has found that excessive extension and inappropriate use of the useful life of the works (for example considering various maintenance costs) could result in an undue advantage in favour of the outgoing operator.

Regarding the abovementioned critical points, the ICA has expressed its clear, unequivocal judgment regarding the unsuitability of the system of valuations based substantially on negotiated agreements, as it is unable to sufficiently protect potential participants against the risk of compensating the outgoing operator for an “arbitrarily” excessive sum, thereby discouraging them from participating in the tender itself. In light of these considerations, the ICA did not consider the potentially equally satisfactory alternative solution, which is to provide for technical evaluations to be commissioned by the granting administrations (with related expenses to the outgoing operator or the tendering process). For these reasons, the ICA recommended that AEEGSI (the Italian Regulatory Authority for Electricity Gas and Water) be the third party to perform such functions.

In expressing its opinions, the ICA has also considered the possible negative impacts on consumers. The abovementioned opinion, in fact, showed that the provision of inadequate compensation, in addition to impacting competitive procedures negatively, would prevent the correct application of a provision in the draft Ministerial Decree, which states that 60% of the economic offer proposed in the tender procedure by the company must be paid into the so-called “Equalisation Fund”
created to reduce electricity costs, or to final consumers (in the form of a reduction of the so-called “A3” component of the bill). On this point, the ICA noted that, given the fact that competitors in future tenders are subject to a financial restriction which limits their economic capacity, increasing compensation for the outgoing operator would operate in the direction of reducing their economic offer, and therefore the percentage for the reduction of A3 component.

The ICA has also expressed its opinion on article 3, paragraph 10, of the draft Ministerial Decree, which makes provision for a kind of census, establishing a list of “(...) concessions to be assigned, concessions in force, their power, expiration date and any case of provisional budget in place (...).” The ICA points out that this provision creates regulatory uncertainty regarding the applicability and compatibility between the new rules and those previously set out in Royal Decree no. 1775 of 1933, with regard to applications for concessions assigned under the previous system and pending the date of entry into force of the new Ministerial Decree. The ICA has suggested the introduction of a transitional system or the renewal of all applications submitted, in order to “avoid any possible reason for appeal which may represent an objective obstacle to the development of future tenders”.

The relationship between the old and new system was recently the subject of a judgment of the Supreme Court of Cassation, the judgment of the United Sections no. 607 of 2015, which in upholding a decision of the Superior Court for Public Waters, has considered the legality of a resolution of the Provincial Government of Bolzano which ordered the filing of applications submitted under articles 9 and 10 of Royal Decree no. 1775 of 1933 in view of the need to assign the concessions under public procedures.

Finally, the ICA deemed unnecessary the provision, contained in article 12 of the draft Ministerial Decree, according to which, in the event of corporate changes, any successful commercial tenderer company must send a specific communication to the ICA. This provision, in fact, is an unnecessary bureaucratic burden for the companies concerned, and brings no benefit because it is not “necessary for the monitoring of competition in the relevant markets”.

In the light of the criticisms expressed by the ICA, the draft Ministerial Decree was withdrawn, resulting in permanent closure of competition in the hydroelectric market.

The ICA subsequently returned to the subject of the hydroelectric concession market in issuing opinion AS1137 of 4 July 2014, entitled “Proposals for Competition Reforms for the Purposes of the Annual Market and Competition Law”. In this context the ICA, in addition to calling attention once again to the contents of opinion AS1089 of 17 October 2013, and subsequent developments which recommended that the Ministry of Economic Development withdraw the draft Ministerial Decree (essentially represented by the observations of the European Commission expressed with the aforementioned letter of formal notice of 26 September 2013, as part of infringement proceeding no. 2011/2026), put forward a proposal to amend article 37 of
Decree Law no. 83 of 2012 (converted into law by Law no. 134 of 2012), as follows: “(...) the Authority considers it necessary to reformulate the rules on tenders for major hydroelectric branches in order to go beyond the present approach set out in the current text of article 37 of Decree Law 83 of 2012, based on the principle of the “transfer of the (entire) business unit” for conducting of tenders, that provided, instead, the transfer for consideration only of “dry works” and the simultaneous free transfer of “wet works” to state property. “Dry works” should be evaluated using a transparent method and based on a comparison between incoming and outgoing operators, possibly by entrusting to an independent third party the task of certifying the appropriateness of the value of compensation”.

Finally, the ICA has recently expressed its opinion on the provincial legislation enacted by the autonomous province of Trento with regard to the assignment of hydroelectric concessions. More specifically, in opinion AS1151 of 8 October 2014, the ICA pointed out the “anti-competitive” scope of article 44, paragraph 1, letter i) of Provincial Law no. 23 of 21 December, by which the Autonomous Province of Trento amended Provincial Law no. 4, of 6 March 1998, article 1-bis, paragraph 15-ter, which provides for a “ten-year extension” to the “concessions of large-scale diversions of public water for hydroelectric purposes, in force at the date of entry into force of said paragraph”, at the request of the licensee which must be presented within a set time. On this point, the ICA confirmed that extensions of existing concessions which are due to expire or have already expired, in the light of the general principle of public procedures for their assignment introduced by Legislative Decree No. 79 of 1999 (transposing EU Directive 96/92/EC on the internal electricity market), cannot be justified, except when they are beneficial to a process of competitive selection of the new concessionaire. Any other extension is contrary to the EU legal framework and, in particular, is contrary to the principle of open competitive markets and would result in an undue favour to the outgoing operator. In the ICA’s view, the legislation of the Autonomous Province of Trento is unjustified, as “(...) introducing a ten-year extension on the mere request of the actual concessionaire is not beneficial in terms of assignment of concessions and is undeniably unfairly in its favour, as it delays the tender process”.

However, it should be pointed out that the opinions issued by the ICA have not been followed. The annual competition and market law for 2015 does not contain any provision in this regard.

The rule stated that: “extension period [...] means: a) for the licenses granted to ENEL Spa and other entities referred to in paragraph 15 article 1-bis of the Presidential Decree no. 235 of 1977, the period between 1 January 2011 and 31 December 2020; b) for other concessions, the period of ten years from 1 January of the year following the expiration date of the concession.”
4. CONCLUSIONS

In response to our roundtable to assess the possible developments in the field of competition it is therefore urges the need to follow up on opinions and reports of the ICA by targeted normative actions no further “unproductive” or “damaging” (to be noticed, on this regards, are significant the critical issues expressed, most recently, by the ICA on the legislation that provides an implied extension of motorway concessions. In particular, the ICA underlined that “infrastructure investment can be more effectively guaranteed by the assignment by tenders to the most efficient economic operator and by an adequate regulations, rather than by the extension of the existing concessions”).