

**Doubled Quotation and Legal Uncertainty in Financial Security of
Grid**

Yang LIU

University Bonn, Germany

Contents

1.general introduce.....	1
2.legal prescriptions.....	2
2.1.liquid assets.....	4
2.1.1.legal decisions and disputes.....	5
2.1.2.emendation and result.....	7
2.2. interest rate for own capital.....	8
2.2.1. doubled quotation in disputes.....	8
2.2.1.1. comment.....	11
2.2.2. impact of own capital definition.....	12
3. playroom of government.....	13

4. higher authorized revenue.....	14
5. depreciation under zero.....	15
6. conclusion.....	16

Doubled Quotation and Legal Uncertainty in Financial Security of Grid¹

Doubled quotation is one the core issues in the German energy reform, which will decide the interest rate of applied own capital. However, the authority and appellate courts hold different positions on the issue, which would then endanger a stable financial framework of grid charge formulation and the reforms.

1. general introduce

The reformation in the legal section on energy issues in Germany has been practiced around three years. However, there are still some uncertainties in the core issues, which would endanger the though carrying of the whole reform.

Accord with the judgments of several appellate courts, the most influential question is about the “doubled quotation”.

In the German energy reform, the most important issue is the depreciation ratios of grids applied before 1st Jan.2006 (old facility). In 2005, the advanced reform in energy law (EIA) has clarified its principle and objects with §1 Para.1, which ensures that the supplement of electricity must be delivered in an efficient way with inexpensive prices.

¹ The author is a JSD student of University Bonn, Germany.

Therefore, in the implementing of the law, the code of grid charge of electricity (NEV) settled the proportion of own capital of grid company in its networks. And portion of investment of the grid company over 40% in the whole assets would be legally counted as debt capital. This principle is for a lower price of charges demanded from the grid company, which would decrease the price of electricity for the consumers at the end, as the deference of interest rates between own capital and debt capital is 1.7%. But the law has not illustrated, what are the legal definition of own capital and its counterpart, the debt capital. So the judgments of German appellate courts are in the inconsistency.

And the proportions of own capital and debt capital in the whole assets are namely the quotations of the grid company belongings. The “doubled quotation” in the law means therefore the two different proportion rates of capital investments.

2. legal prescriptions

The code of grid charge in electricity (NEV) has established the concrete regulations on the depreciation of old facilities. According to the §6 Para.1 NEV the grid company must report its costs and revenues of operation in the account book, which shall release only the costs or revenues of prerequisite facilities of business operation. This legal order is rigorous for

the company, as it shall not fix its tariff or price with the costs, which are relative unnecessary for the operation. And the depreciation shall be divided into two items in the account book, in according to the §6 Para.1 Sent.2 NEV, which are calculative costs and calculative revenues.

Margin of own capital of grid company is 40% of the whole assets value, and own capital shall also obey the principle of “operative necessity”. On the other side, the debt capitals can 100% in maximum.

Additionally to the principle of depreciation is the canon “net substance maintenance”. And this gold canon² in the cost calculation of accounting is explicated by § 21 Para.2 EIA. Under the legal condition of net substance maintenance the investment in the grids shall be mortised with the depreciation and herewith the reproduction of network services would be refinanced with interest rates of own capital. Meanwhile, the inflation rate will be also calculated.

In the § 7 NEV, the German authority has created the mechanism on calculative own capital. In the clause, the code accomplishes all the preconditions and legal requirements on interest rate accounting, which, however, brings in many problems in the practice.

² M. Schmidt-Preuss: N&R 2/05, 51&52.

2.1 liquid assets

The federal Network Agency of Germany has settled that sum of liquid assets, which could be accounted with same interest returns of own capital, is limited within 3/12 of cash account or 1/12 of network costs. And in the practice, the sum could rise higher to 2/12 of whole network costs.

But the higher regional courts have their own judgments. In according to the legal decisions, the first question is, whether liquid assets can be allowed to account in the category of own capital. As the code has accentuated the precondition of own capital in the clause again, that own capital shall be necessary for the operation. And in implementing the law § 21 EIA, whose object is to provide an efficient electric productivity that will benefit all end consumer and the economy, liquid assets as own capital of grid company shall also be operative necessary. However, such “necessity” principle is not enough for judging the permission of liquid assets

2.1.1 legal decisions and disputes

In the judgments, the appellate courts share some absolute opinions on the subject liquid assets.

On one side, court like OLG³ Stuttgart supports the idea of the Federal Network Agency. In its judgment, the judge said⁴,

“Although there still has no concrete prescriptions or fixed depreciation ratios in § 7 Para.1 Sent.2 NEV, that liquid assets shall be settled in the own capital account ... or it can be calculated with depreciative interest rate of own capital, the decision on the (liquid assets) settlement is beyond the scope of judicative, as it is just bund with economical or financial management (of grid company).”

Meanwhile, the judgment has gone further, as the court has given grid companies a decisive role on settling, which parts of their assets are for the business operation necessary. Therefore, the company would have its autonomic decision, whether liquid assets are for the productive operation necessary and therefore can be calculated as part of own capital. The grid company can employ its right of deciding to arrange its financial situations just basing on the business or management demands.

On the other side, court OLG Düsseldorf rejected the rights of own capital deciding from grid companies. As the court argued, that the setting

³ The higher regional court, also appellate court.

⁴ OLG Stuttgart, judgment 3.5.2007, 202 EnWG 8/06 = VW 2007.

of capital returns is already done with the § 21 Para.2 Snet.2 EIA, which has higher force level than § 7 NEV in the legal systems. And in according with the law, those assets, which are not necessary for the operation shall not be calculated in returning account. The liquid assets are such operative unnecessary assets.

The judgment of OLG Düsseldorf is quoted by court OLG Frankfurt⁵. And OLG Frankfurt brought more supporting grounds that over calculated or operative unnecessary liquid assets are neither economical nor efficient. In implementing the energy law under preconditioned principle efficiency in § 1 EIA, those uneconomical and inefficient capital cannot be premised to be calculated as own capital, especially when those liquid assets are short termed.

As the judgments of appellate courts share different decisions on the liquid assets, it is needed to clarify the intents and prescriptions of that clause.

⁵ OLG Frankfurt/Main, judgment 11.9.2007, 11 W 39/06 (Kart).

2.1.2 emendation and result

Because of the legal disputes among court judgments, the federal government emendated the § 7 NEV on 29.10.2007⁶. In the emendation, the cod repeats the precondition and criterion again, that the value of liquid assets in business accounting shall be operative necessary. And those regulated liquid assets would be part of own capitals.

Thus, the sum of liquid assets shall be limited within necessary operative requirements. And the interest rate accounting of liquid assets under operation demand is identical with the interest rate of own capitals.

However, the questions of liquid assets are not resolved totally. The criterion “necessary” has even casted the obligation of evidence on the board of grid companies. OLG Frankfurt has criticised that setting of a asset cap is not reasonable and will be just relative reasonable in the future. The monthly report on financial balance delivered by grid companies can not release the (truly) efficiency with simple identical model. The report shall then be specialized with focusing on character of energy brands.

⁶ The Federal Juristic Ministration 2008.

2.2 interest rate for own capital

2.2.1 doubled quotation in disputes

As mentioned before, the investment of grid company in its own grids is divided into two parts legally, the own capital and debt capital, when the sum of investment is over 40% of the whole asset value. The higher section over 40% of asset belongs to the category debt capital, which will be calculated with lower return interest rate in accounting than the section under 40%, the own capital namely. In the judgments of appellate courts⁷, the judges hold up the permission of such “doubled quotation” of investment in § 7 NEV, especially in Para.1 Sent.3. According to their decisions even over quoted proportion of own capital shall be calculated by interest rate (of debt capital). So, economically, § 7 Para.1 Sent.3 brings in the “second border” of own capital interest calculation, which will combine with § 6 Para.2 NEV, as § 6 Para.2 Sent.4 NEV settles the 40% calculative quotation on own capital. The judges opine, that § 7 is with implemental function for § 6 NEV.

Troublesome is, that in the judgment of OLG Naumburg⁸ judges hold a connection between doubled quotation and principle “necessity”. Therewith, operative necessary own capital in § 7 Para.1 Sent.3 NEV

⁷ OLG Frankfurt and OLG Düsseldorf.

⁸ OLG Naumburg, judgment 11.9.2007, 11 W 38/06 (Kart).

means directly the own capital within 40% proportion in § 7 Para.1 Sent.2 NEV.

As the legal principle of “operative necessity” predominates the whole framework, the judgment of OLG Naumburg combined the own capital proportion with required efficiency of business operation in grid companies.

The second dispute is the calculative rest value of grid facilities, in according with §32 Para.3 NEV. As the calculative rest value in depreciation duration is influenced by the investment rate of owned capital in § 7 NEV, so when the sum of calculation depreciation in the past durational period cannot meet the supposed grade, § 32 Para.3 & 4 NEV would take the charge⁹. That means the legal connection between rest value calculations and own capital interest rate.

The problem is, the law would empower a demanded price controlling by the third party at the beginning of each authorized period, when §32 Para.3 NEV is in charge in setting the value of own capital. As one of fundamental precondition of price authorization, the electricity prices shall be formulated with costs counting from power generation to electric transportation. So OLG Koblenz opines that individual demanded examination on the costs (like rest value depreciation) or revenue is not necessary at the beginning of extended price authorization, because

⁹ OLG Stuttgart, judgment 3.5.2007, 202 EnWG 8/06 = VW 2007; OLG Koblenz, judgment 4.5.2007 W 595/06 (Kart).

authorization of electricity tariffs has already fulfilled the obligatory tasks. If the regulated company had formulated its price tariffs obeying regulative requirements of BTOElt (the Federal Tariff Code Electricity), electricity price would be only concerned with the grid charges of distribution. Therefore, OLG Koblenz disapproves the possible individual demand on rest value calculation (depreciation) controlling by third parties.

OLG Stuttgart shares the decision of OLG Koblenz. The appellate court Stuttgart opines, it will be adequate for the authorization, when grid company formulated its charges under legal regulations of § 32 Para.3 Sent.3 NEV. Demand from third party will not have any function or sense in the legal procedure of authorization.

Contrarily, OLG Frankfurt disagrees with the judgment of OLG Stuttgart and OLG Koblenz. In its understandings, cost calculation of rest value depreciation is absorbed by the electricity tariff, thus such depreciation costs shall be accounted separately. A controlling on those costs will certainly have legal meanings.

2.2.1.1 comment

In order to judge the disputes among high courts, we shall first look at the contents and objects of § 32 Para.3 NEV. The regulation § 32 Para.3 NEV is to ensure, that calculated depreciation of the past would not be recalculated in the future, or possibly to be charged by the grid tariffs again. That is the task of avoiding a “doubled depreciation”. It depends on, which calculative usage duration would be implemented in the past.

Also it must be ensured as priority, that electricity price or tariff is formulated under principle of cost orientation, accord with § 21 Parar.2 EIA.

However, it is uncertain, what is the enforcement scope of § 32 Para.3 NEV and what is its reversibility. But it could be sure, that electricity tariff authorization does not have direct legal impact in confirming the rest value depreciations. Herewith, price authorization indicts its disadvantage in examining depreciation account.

2.2.2 impact of own capital definition

Legally, settlement of interest rate of own capital is prescribed in § 7 Para.1 NEV. But the uncertainty is, what is the proportion of own capital under principle “operative necessary” of § 7 Para.1 Sent.2 NEV.

In order to answer the question of operative necessary proportion of own capital, we must clarify, what is the definition of own capital in the laws.

One “convenient” way to illustrate the meaning of “own capital” is by implementing the prescriptions of § 6 Para.2 Sent.3 NEV. However § 6 Para.2 Sent.3 has used same descriptions “operative necessary” as in § 7 Para.1 Sent.2 NEV.

The other way is to connect the 40% proportion with principle operative necessity. But the problem is, there will no other legal ground to back § 7 Para.1 Sent.2 NEV like itself. OLG Koblenz agrees, there has no legal background of establishing own capital proportion, as own capital is the obligate investment of grid company in § 29 Para.2 EIA.

As the result, quotation of own capital will be explicated by canon “net substance maintenance” in § 21 Para.2 EIA. Then § 7 Para.1 Sent.2 NEV will be predicted by § 6 NEV, so that own capital quotation prescribed in § 6 NEV would be able to regulate the calculative depreciation of applied facilities.

3. playroom of government

The judgment of OLG Düsseldorf reject the opinion of the Federal Network Agency, that the administrative authorities shall play a decisive role in the controlling of electricity prices, as the authority has more professional knowledge and experience on supervision the electric industry.

The reason is simple. Because of the legal protection guarantee of Art.19 Constitution Law, a playroom of authority in price controlling, especially beyond the supervision of judicative, will be limited within certain special circumstances. And when there is uncertainty in legal definitions or when the judgment of authority must illustrated by the contents or objects of EIA, autonomous administrative controlling shall even be cancelled¹⁰.

And the Federal Constitution Court supports the judgment of OLG Düsseldorf, because:

“legal explanation on uncertain law definitions is generally the task of judges, who have also right to supervision the implement of laws and codes by the authority¹¹”.

4. higher authorized revenue

¹⁰ OLG Düsseldorf, judgment 9.5.2007, VI-3 Kart 289/06 (V).

¹¹ BverfGE 7, 129: 64, 261.

During the transform period from 1st 11.2005 until 30th 6.2006, possible higher revenues of grid companies would be authorized by the Federal Network Agency.

However, such possible higher revenue of grid company was adjudged as “illegal” by the German appellate courts¹². §118 Para.1b Sent.2 and § 23a Para.5 Sent.1 EIA create the “juridical guarantee” in the transform era, which ensures the continuity of historical electricity tariffs. The administrative settlement on tariff (revenue) increasing will be not permitted under the legal orders. Also, possible increased revenue in the transform period could be illegal, as it does not have any permission under the principle “net substance maintenance” of § 21 Para.2 EIA.

The judgment of appellate courts disapprove any legal combination between § 11 Para.1 NEV and allowance of tariff increasing, because § 11 Para.1 NEV is to implement for the coming calculation period and tariff “maintenance” would then not be regarded as “illegal” in that clause.

5. depreciation under zero

¹² OLG Stuttgart and OLG Düsseldorf.

Both the legal framework and appellate courts agree with the prohibition of depreciation under zero. In prescription of § 6 Para.6 NEV the code limits the total sum of depreciation within the value of applied facilities. And because of § 6 Para.6&7 NEV and Art.12&14 Constitution Law, judges of German appellate courts also consent to the elimination of depreciation over asset values. Thus for the company, which has bought the grid, the returns paid with own capital interest rate cannot cover the whole price paid for the networks.

So argument of the Federal Network Agency is that prohibition of depreciation under zero obstacles market behaviours, like merger or buyout. That would restrain of forming a more efficient business operation and limit the development of productivity¹³.

6. conclusion

¹³ The Federal Network Agency: WAR 22th May 2007, 4.

The legal uncertainties in the code of grid charge of electricity have not been resolved by the judgments of appellate courts in Germany until now. And as the judgments of appellate courts have disputes in several issues, the uncertainties would even be deepened in the problem, which would endanger the stable financial situation of grid companies.

Because of the uncertain definition of own capital and principle on it, grid companies would face more restrictive regulations in the future. Possible increased revenues would even be eliminated with canon “substance maintenance”. Therefore, electricity tariff would be just in a down course.

Role of the authorities will be limited, as the courts believe that legal supervision is necessary for the controlling of electricity prices and grid charges.

Nevertheless, depreciation under zero, which would encourage grids merger or purchasing, would not be allowed under the current laws. Whether the legal frameworks shall consider the permission of depreciation under zero with conference of principle efficiency increasing prescribed in § 1 EIA, is still uncertain.