

on Russia's eastern seaboard. Japan has been lobbying for this route by offering financial assistance.

Although it is believed that the Daqing route would be cheaper to build and that China's fast-growing market for oil consumption provides positive potential for the expansion of future exports, there is greater perceived political risk as part of the pipeline will be located in Chinese territory. The Nakhodka route, on the other hand, also has market potential as it would assist Russia in exporting oil to Japan and the United States.

OIL AND GAS

CNOOC Limited acquires stake in related financial services company

CNOOC Limited's acquisition of a 31.8 per cent stake (worth over US\$51.3 billion) in its parent's financial services subsidiary, CNOOC Finance Corp, has created much controversy. Many are of the view that this is an unnecessary diversification into an unrelated business, which contradicts CNOOC's emphasis on oil and gas exploration and production. The company, however, defended the move as one which will cut costs and bring in profits. Those who agree with the move believe that CNOOC could reap savings by dealing with CNOOC Finance instead of mainland banks, given the high interest rate spread between borrowing and lending rates at mainland financial institutions.

OIL AND GAS

Sinopec profits disappoint market

Sinopec's announcement in early September 2003 of lower than expected first-half profits has disappointed the market. At the same time, personnel expenses at the company have risen by 35.59 per cent compared with the first half of 2002.

This was not the only surprise for investors and analysts. The company also announced a US\$144 million bonus for its employees, despite not having previously hinted at such a move.

The lack of transparency of Sinopec's compensation system and the failure to disclose the increase in bonus payments beforehand had misled the market into expecting higher net profits than were actually announced.

Lynia Lau
Jones Day, Hong Kong

Germany

GAS Competition

VNG, Wingas and WIEH

Federal Supreme Court
(Bundesgerichtshof)
February 18, 2003

German Act Against Restraints of Competition

Article 1—Prohibition of Cartels

Agreements between competing undertakings, decisions by associations of undertakings and concerted practices, which have as their object or effect the prevention, restriction or distortion of competition, shall be prohibited.

Article 19—Abuse of a Dominant Position

(1) The abusive exploitation of a dominant position by one or several undertakings shall be prohibited. . . .

(4) An abuse exists in particular if a dominant undertaking, as a supplier or purchaser of certain kinds of goods or commercial services, . . .

4. refuses to allow another undertaking access to its own networks or other infrastructure facilities, against adequate remuneration, provided that without such concurrent use the other undertaking is unable for legal or factual reasons to operate as a competitor of the dominant undertaking on the upstream or downstream market; this shall not apply if the dominant undertaking demonstrates that for operational or other reasons such concurrent use is impossible or cannot reasonably be expected.

Article 32—Prohibition

The cartel authority may prohibit conduct by undertakings and associations of undertakings which is in contravention of this Act.

Facts

The dispute concerns an appeal on points of law to the German Federal Supreme Court.

At the heart of the dispute lies a demarcation agreement, which was concluded in 1994 between three companies engaged in the supply and distribution of natural gas in East Germany. The Federal Cartel Authority prohibited the agreement between the companies VNG (Verbundnetz Gas AG), Wingas (WINGAS GmbH) and WIEH (Wintershall Erdgas Handelshaus GmbH), because it constituted a restraint of competition according to the Act Against Restraints of Competition.

Wintershall AG and the Russian OAO Gazprom company jointly own two participants in the agreement, Wingas and WIEH. These two companies distribute natural gas from Russia through a long-distance pipeline, which is operated by an affiliate of Wingas. WIEH and Wingas sell Russian natural gas to German purchasers. VNG is an enterprise engaged in the distribution of gas to end users. It supplies users within large parts of East Germany, where it owns distribution grids.

On January 31, 1994 VNG and WIEH concluded an agreement under which WIEH undertook to supply VNG with some 3.5 billion cubic metres (bcm) of natural gas annually. This amount was anticipated to increase to some 7 bcm from 1997 onwards. VNG undertook to take at least 80 per cent of the gas or to make corresponding payments (in a "take-or-pay" arrangement). The agreement contained a demarcation clause in which WIEH undertook to refrain from the supply of third parties within the denominated territory of supply. On January 31, 1994 Wingas joined the agreement and declared that it would consider itself bound by the terms of the agreement like WIEH.

Based on Art.103(5), sentence 1, No.1 and Art.103(6), No.3 of the old version of the German Act Against Restraints of Competition,¹ the Federal Cartel Authority declared in its order of March 7, 1995 that the agreement was without effect.² Upon appeal, the Court of Appeal of Berlin reversed the order in its decision of February 14, 1996.³ On further appeal on points of law, the Federal Supreme Court reversed this decision on September 28, 1999 and referred the case back to the Court of Appeal of Berlin.⁴ In the meantime the German Act Against Restraints of Competition was modified. The former exemption of contracts for the supply of energy from the application of the general principles of antitrust law, which was contained in Art.103 of the Act, was repealed. Therefore the Court of Appeal of Berlin asked the Federal Cartel Authority to reconsider the case.

The Federal Cartel Authority amended its original order, achieving the same result—the demarcation agreement was held to be in restraint of competition and prohibited in application of Arts 32 and 1 of the new version of the German Act Against Restraints of Competition. The parties concerned complained to the Court of Appeal of Berlin, which rejected the appeal in its order of January 23, 2003.⁵ VNG, WIEH and Wingas appealed on points of law to the Federal Supreme Court. The Federal Supreme Court upheld the Federal Cartel Authority's decision in its order of February 18, 2003.

Held

A demarcation agreement by means of which the supplier of natural gas undertakes not to supply third parties within the purchaser's territory of supply contravenes the prohibition on cartels in Art.1 of the German Act Against Restraints of Competition; there is no justifiable interest in such an agreement, neither by reason of the purchaser's substantial investment in the construction of the grids nor by reason of the stipulation of a minimum purchase clause.

In its order of February 18, 2003 the Federal Supreme Court observed that before the conclusion of the demarcation agreement in January 1994 there was lively competition between VNG on the one hand and WIEH and Wingas on the other hand in the geographical areas of east Germany where Wingas operated its long distance pipeline and its mains. Even though WIEH and Wingas were not major distributors to end users, unlike VNG, the Court considered that the existence of competition, even if modest, was a persuasive argument in the legal assessment of the facts. In the Court's view, this competition was particularly valuable, since VNG possessed a natural monopoly (resulting from its ownership of the distribution network in its territory of supply to end users).

After the amendment of the German Act Against Restraints of Competition the regulation of transmission is governed by Art.19(4), No.4 of the Act. The ownership of the grid nevertheless provides the owner or operator with a competitive advantage despite the fact that the legislator has introduced a right of access for the benefit of competitors. The exercise of the transmission right presupposes negotiations with the rightholder, which may be lengthy or cumbersome, before the competitor can obtain access to his customers.

The Court rejected the view that the demarcation agreement was necessary for the supply of natural gas from a functional point of view, and held that the parties of the demarcation agreement did not pursue a justified interest, based on the purposes of the law. VNG asserted that its considerable investments in the distribution network necessitated the demarcation agreement, because it needed this protection in order to organise distribution to end users. The Federal Supreme Court, however, dismissed this argument. Even though it might be admitted that VNG made substantial investments, its

1 See, on the former version of the Act Against Restraint of Competition, Arnold Vahrenwald, "Gas Supply in Germany and Antitrust Law: 103 of the German Antitrust Act" (1993) 6 O.G.L.T.R. 174; "Court of Appeals of Berlin of 09/06/93" (1994) 3 O.G.L.T.R. 93; "Agreement on Territorial Demarcation", Federal Cartel Authority, order of April 17, 1994 [1994] 3 O.G.L.T.R. D-63.

2 Federal Cartel Authority, order of March 7, 1995, WuW 1995 at 443.

3 Court of Appeal of Berlin, order of February 14, 1996, WuW 1996 at 940.

4 Federal Supreme Court, order of September 28, 1999, WuW 2000 at 53.

5 Court of Appeal of Berlin, order of January 23, 2003.

potential competitors would not be able to benefit freely from VNG's accomplishments. In the words of the Court, "they would have to make an adequate remuneration, the calculation of which would include expenses for investments undertaken by VNG. Just as the owner of the grids may include costs arising from the construction and maintenance of the network as expenses for transmission in the calculation of its sales prices, these costs may also be considered in the calculation of the 'adequate remuneration' which it may claim from the claimant of an access right according to Article 19(4) No. 4 of the German Act Against Restraints of Competition."

The fact that VNG had accepted a "take-or-pay" provision could not lead to a different evaluation of the demarcation agreement. It is true that there is a close correlation between territorial demarcations, exclusivity agreements and minimum purchase agreements. For example a producer will only be prepared to concede exclusivity for an important territory to one of his purchasers if the purchaser guarantees a minimum purchase, but the Court made it clear that an agreement, which contravenes the prohibition on cartels, cannot be justified with a minimum purchase agreement.

Other circumstances were also viewed as reinforcing the damaging effect of the demarcation agreement on competition. The Court observed: "It has to be considered that the territorial demarcation between competitors is susceptible to affect competition to a stronger degree than other limiting agreements. In the case concerned it excludes competitors completely from competing, which, by reason of the existing long distance pipeline for the transmission of natural gas would be susceptible to compete with VNG in its traditional territory of supply. Additionally, the long term nature of the contract may contribute to entrenching the dominant position of the participants." Finally the Court observed that after the modification of the German Act Against Restraints of Competition in 1998, contracts for the supply of energy were no longer excluded from the general prohibition on cartels and subject to special legal regulation, which was contained in Art.103 of the Act. The Court pointed out that it is incompatible with the aims of the legislator if competitors should be able to delimit their respective territories of supply through demarcation agreements. Accordingly, agreements by means of which suppliers and distributors of natural gas limit competition by allocating exclusive territories for their activities will not be admissible on the basis of the German Act Against Restraints of Competition.

*Arnold Vahrenwald
Centre Barr*

United Kingdom

ELECTRICITY
Security of supply
*Sufficient supply forecast for peak
winter demand*

National Grid Transco (NGT), the entity responsible for balancing electricity supply and demand on the national transmission system in the United Kingdom, has advised the UK electricity and gas industry regulator Ofgem that it does not anticipate power shortages in the United Kingdom this winter.

NGT expects to have a reserve generating capacity of around 18 per cent over peak demand this winter. This excludes 7.5GW of mothballed capacity and a further 2GW which can be imported from France and, although lower than in previous years, such a margin is not unprecedented.

Rising baseload electricity prices over the past year have resulted in generators returning mothballed plants to the system, and NGT believes that it can potentially call on up to 2,600MW of additional generating capacity this winter, although generators expect that they will only have returned 800MW over the last quarter of this year.

For its part, Ofgem has indicated that it will be watching generators closely to ensure that they do not artificially inflate prices by keeping capacity mothballed when such capacity could economically have been returned to the market.

Denton Wilde Sapte