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Lisbon-Kyoto-Moscow: Joining the Dots

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LISBON - KYOTO - MOSCOW: JOINING THE DOTS?

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I. INTRODUCTION: 2007 A CRITICAL TURNING POINT?

History will judge whether the year 2007 was a turning point in the European Union's policy towards a new commitment to meet the compelling challenges of creating a competitive market in the EU (Lisbon), climate change (Kyoto) and of securing sustainable energy resources (Moscow). The title of the paper links three major policy areas which have been brought together in 2007 in an exotic triangle. Underlying each policy are a number of tensions which could ultimately lead to the policies conflicting and running against each other.

The Spring 2007 European Council called upon the Member States and EU Institutions to pursue a policy in order to develop a sustainable integrated European climate and energy policy:

Given that energy production and use are the main sources for greenhouse gas emissions, an integrated approach to climate and energy policy is needed to realise this objective. Integration should be achieved in a mutually supportive way. With this in mind, the Energy Policy for Europe (EPE) will pursue the following three objectives, fully respecting Member States' choice of energy mix and sovereignty over primary energy sources and underpinned by a spirit of solidarity amongst Member States:

-increasing security of supply;

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- ensuring the competitiveness of European economies and the availability of affordable energy;
- promoting environmental sustainability and combating climate change.¹

The European Council supported a comprehensive Energy Action Plan 2007-2009, inviting the Commission to submit proposals to implement the plan as quickly as possible. A firm commitment was made for the EU to achieve at least a 20% reduction of greenhouse gas emissions by the year 2020, compared to the year 1990; to increase energy efficiency in the EU in order to achieve the objective of saving 20% of the EU's energy consumption compared to projections for 2020; and, importantly, endorsed a binding target of a 20% share of renewable energies in overall EU energy consumption by 2020 as well as a 10% binding minimum target to be achieved by all Member States for the share of bio-fuels in overall EU transport petrol and diesel consumption by 2020.² The Member States are obliged to adopt and aim to achieve an overall national indicative energy savings target of 9% over 9 years.³

The Treaty of Lisbon, signed on 13 December 2007, promotes energy issues as a prime focus of EU policy. In the Reform Treaty, Energy is addressed in Title XVI, Article 176a. This is a new clause and new words (here in italics) are inserted into existing EC Treaty provisions.

1. In the context of the establishment and functioning of the internal market and with regard for the need to preserve and improve the environment, Union policy on energy shall aim, *in a spirit of solidarity between the Member States*, to:

- (a) ensure the functioning of the energy market;
- (b) ensure security of energy supply in the Union;

1. Presidency Conclusions, Brussels European Council (Mar. 9, 2007), *available at* http://www.consilium.europa.eu/ueDocs/cms_Data/docs/pressData/en/ec/93135.pdf.

2. Cf. Richard Doornbosch and Ronald Steenblick, *Biofuels: Is the Cure Worse Than the Disease?*, *OECD Round Table on Sustainable Development*, SG/ST/RT (2007) 3, *available at* <http://media.ft.com/cms/fb8b5078-5fdb-11dc-b0fe-0000779fd2ac.pdf>.

3. Council Directive 2006/32, ¶¶ 10, 12, 2006 O.J. (L 114) 64.

- (c) promote energy efficiency and energy saving and the development of new and renewable forms of energy; and
- (d) promote the interconnection of energy networks.

2. Without prejudice to the application of other provisions of the *Treaties, the European Parliament and the Council, acting in accordance with the ordinary legislative procedure, shall establish the measures necessary in order to attain the objectives referred to in paragraph 1. These measures shall be adopted after consultation of the Committee of the Regions and the Economic and Social Committee.*

Such measures shall not affect a Member State's right to determine the conditions for exploiting its energy resources, its choice between different energy sources and the general structure of its energy supply, without prejudice to Article 175(2)(c).

3. By way of derogation from paragraph 2, *the Council, acting in accordance with a special legislative procedure, shall unanimously and after consulting the European Parliament, establish the measures referred to therein when they are primarily of a fiscal nature.*

A new development in the Lisbon liberalisation process is the increasing dependence of Western Europe upon gas supplies from Russia in the context of unstable oil prices. A quarter of the EU's gas as well as quarter of its oil originates from Russia. The EC Commission has introduced a new strand to liberalisation by developing a European strategy for sustainable, competitive and secure energy which has a new external relations dimension. A Green Paper was issued on 8 March 2006, and an external energy policy paper was prepared by the EC Commission with the High Representative, Javier Solana, for the European Summit in Brussels in June 2006.⁴

4. *Commission Communication, A European Strategy for Sustainable, Competitive and Secure Energy*, COM (2006) 105 final (Mar. 8, 2006); Javier Solana, EU High Representative for the Common Foreign and Security Policy, Address at the EU Energy Conference: Towards an EU External Energy Policy (Nov. 20, 2006), available at http://ue.eu.int/ueDocs/cms_Data/docs/pressdata/EN/discours/91788.pdf.

Under the proposals of the Commission restrictive rules will apply to non-EU companies wishing to buy a stake in the EU energy markets; foreign buyers who wish to purchase an EU network will have to follow the same unbundling requirements as the EU's own firms. In practice, third countries as well as their individuals should not be able to acquire control over an EU transmission network unless there is agreement between the EU bloc and the companies' country of origin. This has become known as the "Gazprom Clause" but Commissioner Barroso has refused to label the safeguards as protectionism: "This is about fairness; it is about protecting fair competition. It is not about protectionism".⁵

II. THE INTERNAL CHALLENGES

A. *Some Basics*

The EU comprises 27 Member States. The EU has limited competence to act in the field of energy policy and environmental policy and this competence has to be triggered. Agreement is reached by long processes of bargaining, negotiation and compromise. Additionally, EU intervention must respect the principles of subsidiarity and proportionality. The recent enlargement of the EU in 2004 and 2007 has created wider divisions on policy matters and new tensions on environmental policies. The classic North-South divide of the EU now has four axis as divisions between East-West emerge.⁶ Thus, at

5. José Manuel Barroso, President of the European Commission, Energising Europe: a real market with secure supply, Opening remarks at press conference on the Commission's energy package (Sept. 19, 2007), available at <http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/07/553&format=HTML&aged=0&language=EN&guiLanguage=en>.

6. Current issues concern how the overall targets set by the EU should be distributed amongst the Member States, different attitudes towards environment policies as a result of the different economic situations in each Member State, differences in research and development and how to compensate for higher costs often associated with the use of environmentally-friendly products. See Press Release, European Commission, European citizens in favour of a European Energy policy, says Eurobarometer survey (Jan. 24, 2006), available at <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/06/66&format=HTML&aged=0&language=EN&guiLanguage=en>.

best, EU responses to political, economic and social issues tend towards compromise and fragmentation.

The wave of liberalisation which spread across Europe during the 1990s⁷ changed the economic dimension of the regulation of the environment and energy supplies as well as the legal and political power structures as to where the responsibility lies in achieving more environmentally friendly policies *and* ensuring security of supply. The external relations policy of the EU, including neighbourhood policies with contiguous states,⁸ turns this into a complicated exercise in achieving a coherent policy within the EU towards renewable energy sources.⁹

In global terms the EU occupies a small land mass which is densely populated. In the context of the strategy on the environment and renewable energy sources this has an impact in at least two dimensions. Firstly, despite the recent enlargements, the EU is geographically small in terms of land area, but relatively densely populated when compared with say Australia, Brazil, Canada, the Russian Federation and the US. Yet land is a crucial resource for the development of a renewable energy strategy and the EU has set itself a number of ambitious targets against a legal culture of protecting

7. See ERIKA SZYSZCZAK, *THE REGULATION OF THE STATE IN COMPETITIVE MARKETS IN THE EU*, chs. 1, 5 (Hart 2007).

8. For example, the "Energy Community" is a process which aims to extend the EU Internal Market rules to South Eastern Europe through the Treaty Establishing the Energy Community, Oct. 25, 2005, 2006 O.J. (L 198) 18 [hereinafter ENC Treaty], available at http://www.energy-community.org/portal/page/portal/ENC_HOME/ENERGY_COMMUNITY/Legal/Treaty. Preceding the ENC Treaty was the Energy Charter Treaty, Dec. 31, 1994, O.J. (L 380) 24 [hereinafter ECC Treaty], available at http://www.encharter.org/fileadmin/user_upload/document/EN.pdf#page=141. The ECC Treaty has been signed or acceded to by fifty-one states plus the European Communities. The Treaty was developed on the basis of the Energy Charter Declaration of 1991. Whereas the latter document was drawn up as a declaration of political intent to promote energy cooperation, the Energy Charter Treaty is a legally-binding multilateral instrument. The fundamental aim of the Energy Charter Treaty is to strengthen the rule of law on energy issues, by creating a level playing field of rules to be observed by all participating governments, thereby mitigating risks associated with energy-related investments and trade.

9. See SANAM HAGHIGHI, *ENERGY SECURITY: THE EXTERNAL LEGAL RELATIONS OF THE EUROPEAN UNION WITH MAJOR OIL AND GAS SUPPLYING COUNTRIES* (2007).

property rights.¹⁰ Secondly, within the political discourse of the EU, questions are being raised as to why Europeans should bear the brunt of higher taxes and prices in order to engage with renewable energy strategies. There is a sharp divide between “east” and “west” or “old” and “new” Europe, with a mood of cynicism developing at the local level. The response at the EU has been to stress the need for a *global* response to the issue of renewable energy.

B. Competence Issues

Previously the creation of an EU renewable energy policy straddled two major policy areas of the EU: environmental policy and energy policy. Both policy areas must co-exist with the fundamental economic constitutional provisions of the Internal Market and Competition Law policy and the Lisbon process which attempts a regeneration of the EU to make it the most competitive, dynamic, knowledge-based society by the year 2010.

In recent years a major issue for mediating EU competence disputes has been how to balance the priority given to economic integration issues in the original EEC Treaty and policies in the early years with the growing acceptance of a wider set of social and fundamental rights values, recognised by the political community and the European Courts. The emphasis upon a wider range of social values has also begun to create new tensions between the balancing of these policies against or with each other, with environmental concerns impacting upon a number of the new policies.¹¹

C. Environmental Policy

The beginning of a coherent EU environmental policy is usually traced back to the Paris Summit of 1972 when the Heads of State or Government committed the EU to developing the social dimension of economic integration.¹² The fact that environmental concerns

10. This legal culture is better known as “NIMBYism” (Not In My Back Yard!).

11. MARIA LEE, *ENVIRONMENTAL LAW: CHALLENGES, CHANGE AND DECISION-MAKING* (2005).

12. Communique, First Summit Conference of the Enlarged Community, Oct. 21, 1972, Bulletin EC 10-1972, available at http://aei.pitt.edu/1919/02/paris_1972_communique.pdf. Prior to this the EEC had adopted *ad hoc* legislation which had an environmental dimension, for example, Council Directive

were an EU social issue is reflected in the external pressures to recognise environmental concerns as an aspect of international co-operation, starting with the 1972 UN Conference on the Human Environment in Stockholm. From 1973 onwards a series on Environmental Action Plans were drawn up.¹³ It was not until the Single European Act 1987 that a clear legal base for an environmental policy for the EU was introduced.¹⁴ This coincided with the Court declaring that environmental protection was “one of the Community’s essential objectives.”¹⁵ The 1980s saw a new pace to addressing environmental issues both within, and outside of the EU and a growing advocacy for environmental concerns.¹⁶

The legal base for an EU environmental policy is Article 175 of the EC Treaty, which allows for the adoption of the Action Plans and legislation.¹⁷ Article 176 of the EC Treaty allows the Member States to maintain or introduce more stringent measures than the measures at EU level under Article 175 EC.¹⁸ Article 6 of the Treaty, introduced by the Treaty of Amsterdam 1997, creates a constitutional mainstreaming principle that environmental protection

67/548, 1967 O.J. (L 196) 1, available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31967L0548:EN:NOT>.

13. The most recent is the Sixth Environmental Plan which covers the period 2002 – 2012. *Commission Communication on the Sixth Environment Action Programme of the European Community*, “Environment 2010: Our future, Our choice,” COM (2001) 31 final (Jan. 24, 2001), available at http://www.ff3.hu/upload/6_action_plan_en.pdf.

14. Single European Act, 1987 O.J. (L 169) 1, available at <http://www.unizar.es/euroconstitucion/library/historic%20documents/SEA/Single%20European%20Act.pdf>. Prior to this Article 94 and Article 308 of the Treaty Establishing the European Community were used as the legal base for environmental measures. Treaty Establishing the European Community, Nov. 10, 1997, 1997 O.J. (C 340) 3 [hereinafter EC Treaty], available at <http://eur-lex.europa.eu/LexUriServ/site/en/oj/2006/ce321/ce32120061229en00010331.pdf>.

15. Case 240/83, *Procureur de la République v. ADBHU*, 1985 E.C.R. 531 (1983).

16. Damian Chalmers, *Environmental Protection and the Single Market: An Unsustainable Development. Does the EC Treaty Need a Title on the Environment*, 1 LEGAL ISSUES OF EUR. INTEGRATION 65 (1985); DAMIAN CHALMERS, INHABITANTS IN THE FIELD OF EC ENVIRONMENTAL LAW, IN THE EVOLUTION OF EU LAW (Paul Craig and Graine DeBúrca eds., 1999).

17. EC Treaty, *supra* note 14. Legislation is usually adopted using the co-decision procedure except for areas covered by Article 175(2), which include measures of a fiscal nature and measures affecting town and country planning. *Id.*

18. *Id.* at art. 176.

requirements must be mainstreamed into the definition and implementation of all Community policies, in particular with a view to promoting sustainable development.¹⁹

A new dimension to EU environmental policy was introduced at the European Council in Gothenburg 2001. This was the *Sustainable Development Strategy* which added an environmental dimension to the Lisbon Process.²⁰ *The EU Sixth Action Programme (2002-2010) Environment 2010: Our Future, Our Choice* aims to implement this new strand of the Lisbon Agenda but it has been criticised for being too strategic without having clear and attainable objectives and time frames, focusing upon co-operation and agreement and less on centralised EU enforcement. This new dimension may be challenged by changes in the new Treaty of Lisbon.

By way of derogation from paragraph 2, *the Council, acting in accordance with a special legislative procedure, shall unanimously and after consulting the European Parliament, establish the measures referred to therein when they are primarily of a fiscal nature.*

D. Energy

1. Liberalisation and the Lack of a Competitive Energy Market²¹

In contrast to other sectors opened up to competition the liberalisation of the energy sector has been slow, and has met with resistance from some of the Member States. Once viewed as essentially local industries providing essential services, the energy utilities sector now finds itself subject to greater cross-border trade and a growing interest by foreign capital in national utilities. Since the period after the First World War, ideas of international regulation of utilities have been on the international agenda, but there has also been a countervailing tendency towards national protectionism to protect

19. *Id.* at art. 6. This has been implemented by soft law processes, most notably the Cardiff Process from 1998 which requires the different sectors to develop appropriate environmental strategies.

20. *Commission Communication, A Sustainable Future for a Better World: A European Strategy for Sustainable Development*, COM (2001) 264 final, available at http://eur-lex.europa.eu/LexUriServ/site/en/com/2001/com2001_0264en01.pdf; *The Sixth Environmental Plan*, *supra* note 13.

21. *See* SZYSZCZAK, *supra* note 7, at 164.

security of supply.²² Such forms of protection would take the form of the creation of national monopolies, exclusive rights and concessions, legal restrictions on energy imports and exports, rules limiting foreign ownership of essential energy providers and measures favouring the procurement of domestic energy resources over foreign resources. The organisation of a vital element of production along national lines, regulated by the state, created a number of adverse barriers for the European integration project. The demand for energy supplies and the need for cross-border coordination of energy policies in the post-war reconstruction of Europe is seen in the creation of the ECSC and Euratom, but the EEC Treaty did not include provisions for a common energy policy.²³ It was not until the oil crisis of the 1970s that policy-makers were aware of Europe's increased dependence upon imported supplies of energy, and this focused attention on the need for common policies as the Member States introduced even more protectionist national policies.²⁴

Liberalisation in the energy sector has been much slower and more piecemeal than in the telecommunications and the postal sectors. The EC Commission did not apply the competition rules in the energy sector and attempts to liberalise this sector were met with resistance from the Member States, alongside internal squabbles within the Commission between the Internal Market and Competition Directorates over jurisdiction.

The first stages of liberalisation took place between 1989 and 1995. The United Kingdom was the first Member State partially to privatise its electricity industry. Other Member States were reluctant to privatise, mainly because of issues of securing supplies in an essential sector. However during this initial period the idea that production and distribution of electricity was a natural monopoly was turned on its head as the state electricity monopolies were divided into smaller parts, comprising electricity generation, high voltage

22. See Martha Roggenkamp, *Implications of GATT and EEC on Network-bound Trade in Europe*, 12 J. ENERGY & NAT. RESOURCES L. 59 (1994).

23. N. J. D. LUCAS, *ENERGY AND THE EUROPEAN COMMUNITIES* 14 (Europa Press 1977).

24. See J. Hassan and A. Duncan, *Integrating Energy: the Problems of Developing an Energy Policy in the European Communities*, 23 J. EUR. ECON. HIST. 159 (1994); E Schumacher, *The Struggle for a European Energy Policy*, 2 J. COMMON MKT. STUDIES 199 (1964).

transmission systems, local distribution systems and retail to the final consumer.

The Single European Act 1987 provided the EC Commission with a new objective and a legal base from which to pursue a Community policy on energy. The EC Commission used a Working Document to set out its policies, and submitted a framework and set of common rules for the completion of the Internal Market in gas and electricity in February 1992.²⁵ The EC Commission identified the use of national grid networks as an obstacle to realising an Internal Market in energy.²⁶

The initial liberalisation proposal used Article 86(3) EC as the legal base. The Member States were unwilling to accept these proposals, even for partial opening up of the energy sector. They were concerned with the lack of protection for services of general economic interest and also how far they could take measures to ensure security of supply. Subsequent Treaty amendments allowed the EU to take greater control over an energy liberalisation policy. The EU 1993 added Article 3(t) EC which lists measures in the spheres of energy, civil protection and tourism to the Community's common policies and activities, and Article 129b EC on trans-European networks. The Treaty of Amsterdam 1997, in what is Article 16 EC, recognised the role of services of general economic interest in the integration process.

The lack of an Energy Charter or Chapter in the EC Treaty is often blamed for the lack of any Community-level progress in the energy sector in the 1990s.²⁷ The rules of the EC Treaty applies to the en-

25. *Commission Working Document on The Internal Energy Market*, COM (88) 238 final (May 2, 1988), available at http://aei.pitt.edu/4037/01/000179_1.pdf; 1992 O.J. (C 65) 4. These proposed the abolition of special and exclusive rights to open up markets; the unbundling or administrative separation of the functions of production, transmission, distribution and supply; a qualified, but compulsory, obligation on owners of transmission and distribution grids to offer access to third parties in return for reasonable compensation (the idea of access in a regulated manner to an "essential facility").

26. *Commission Communication on Electricity and Natural Gas Transmission Infrastructures in the Community*, SEC (92) 533 final (Mar. 27, 1992), available at http://aei.pitt.edu/4818/01/000973_1.pdf.

27. *Commission Green Paper: For a European Union Energy Policy*, COM (94) 659 final (Feb. 23, 1995), available at http://aei.pitt.edu/1185/01/energy_gp_COM_94_659.pdf; Cf. Claus-Dieter Ehlermann, *Role of the European Commission as Regards National Energy Policies*, 12 J. ENERGY & NAT. RESOURCES L. 342, 346-47 (1994).

ergy sector,²⁸ but the tight reins of control at the national level left little room for opportunistic litigation to challenge the way the national monopolies were run, thus the application of the free movement and competition rules has been problematic.²⁹ The Member States won an important point of principle in the *Campus Oil* ruling.³⁰ Oil companies challenged an order requiring that at least 35 per cent of their supplies of oil should be acquired at pre-determined prices from the state-owned monopoly in Ireland. The Irish government claimed that without this security of orders the refinery would not be viable and Ireland would be dependent upon imported supplies of oil and other petroleum products. The Court accepted that the order was contrary to Article 28 EC, but could be justified by reference to Article 30 EC. Although measures had been taken at the Community level to respond to the oil crisis of the 1970s, the Court accepted that these were not sufficient to give a Member State 'unconditional assurance that supplies will in any event be maintained at least at a level sufficient to meet minimum needs.'³¹

The Court ruled that a Member State may rely upon Article 30 EC to justify 'appropriate complementary measures' even where such measures would involve elements of economic policy not normally permitted under Article 30 EC.³² The case was interpreted as allowing the Member States a wide latitude over securing energy supplies and protecting national industry from the full rigours of the free movement (Internal Market) and competition rules. However, the Court insisted that the Member States must satisfy the proportionality principle and show why restrictive measures are necessary. The Court held that the exclusive rights to import and market gas and electricity granted to state monopolies could infringe Article 31 EC, and the EC Commission used this tool to bring infringement actions

28. See, e.g., LEIGH HANCHER, EC ELECTRICITY LAW (Chancery 1992); Leigh Hancher, EC State Aids and Energy, 2 O.G.T.L.R. 62 (1995); Piet Jan Slot, *Energy and Competition*, 31 C.M.L.R. 511 (1994).

29. See, e.g., EC Treaty, *supra* note 14 at art. 81(3) (allowing an individual exemption for a restrictive agreement in which German electricity undertakings and industrial producers should purchase a specific amount of German produced coal, which was supported through subsidies, when less expensive coal could be obtained from outside Germany, 1993 O.J. (L 50) 14).

30. Case 72/83, *Campus Oil Ltd. & others v. Minister of Indus. & Energy & others*, 1984 E.C.R. 2727.

31. *Id.* ¶ 31.

32. *Id.* ¶ 36.

against energy monopolies. In *Greek Oil Monopoly* the EC Commission brought an infringement action challenging the natural oil refinery monopoly and its exclusive import and commercial rights.³³ The Court held that the Greek government had not shown that without these restrictive rights the refineries would not be able to compete on the market.³⁴ Frustrated by the lack of progress towards even partial liberalisation of the energy sector the EC Commission brought infringement actions against Spain, The Netherlands, Italy and France.³⁵ In the case against Spain the EC Commission argued that the combination of legislative provisions conferred exclusive import and export rights on Redesa. This action was dismissed for lack of proof. The case against The Netherlands concerned the import ban on electricity; electricity intended for public distribution could be imported only by the designated company (SEP). The case against Italy concerned measures which reserved import and export of electricity to the state monopoly, ENEL. The case against France concerned the measures reserving import and export of natural gas to Gaz de France and two other concessionaires. The EC Commission alleged that the exclusive rights were contrary to Articles 28 and 31 EC.

The Court examined the application of Article 31 EC first, concluding that the rights were in conflict with this provision. It was thus not necessary to examine the application of Article 28 EC. The Court then went on to discuss the applicability of Article 86(2) EC.³⁶ This was a bold move since it had been assumed since the *Campus Oil* judgment that Article 86(2) EC could not be read across in this way to provide a derogation from the free movement rules.³⁷ The Court was generous, stating that the Member States could take national policy objectives into account when defining a service of general economic interest, and that through necessity the state monop-

33. Case C-347/88, *Commission v. Greece*, 1990 E.C.R. I-4747.

34. *Id.*

35. Case C-157/94, *Commission v. Netherlands*, 1997 E.C.R. I-5699; Case C-158/94, *Commission v. Italy*, 1997 E.C.R. I-5789; Case C-159/94, *Commission v. France*, 1997 E.C.R. I-5815; Case C-160/94, *Commission v. Spain*, 1997 E.C.R. I-5851.

36. Note that the Court does not discuss the possibility of reading across the justifications found in Article 30 of the EC Treaty into Article 31. EC Treaty, *supra* note 14. *Cf.* *Commission v. Greece*, *supra* note 33.

37. *Supra* note 30.

lies must be able to perform the tasks assigned to them under economically viable conditions.³⁸ The threat of further intervention by the EC Commission persuaded the Member States to adopt liberalisation directives, using what is now Article 95 EC, the Internal Market legal base.³⁹

The first move to create a set of common rules liberalising the energy sector⁴⁰ allowed the Member States to liberalise their energy sectors at a different pace, resulting in an even more fragmented energy market.⁴¹ The use of informal *fora* for regulatory coordination was a new dimension to liberalisation whereby the Electricity Regulatory Forum (The Florence Forum/Process) and the Gas Regulatory Forum (The Madrid Forum/Process) were created by the EC Commission Directorate-General in charge of energy. The gas and electricity markets evolved in different ways and are different. Gas is a primary energy source and is capable of being stored, but is dependent upon large-scale investments in infrastructure (pipelines, for example) and the market is dominated by large, non-EU suppliers. To remedy these effects a new package of measures was adopted and became operational on July 1, 2004 for electricity and July 1, 2006

38. “[T]hese judgements—by maintaining certain monopolies—seem to herald the end of an era of progressive development towards a more market-oriented economy in the Community.” Piet Jan Slot, *Comment: Cases C-157/94, Commission v Netherlands; C-158/94 Commission v Italy; Case 159/94 Commission v France; C-160/94 Commission v Spain; C-189/95. Harry Franzén; judgments of 23 October 1997, Full Court, [1997] ECR I-5699, 5789, I-5815, I-5851, I-5909, 35 C.M.L.R. 1183, 1202 (1998)*; See also Piet Jan Slot, *Energy (Electricity and Natural Gas)*, in *THE LIBERALISATION OF STATE MONOPOLIES IN THE EUROPEAN UNION AND BEYOND* (Damien Geradin ed., Kluwer 2000).

39. See DONIMIQUE FINON & ATLE MIDTTUN, *RESHAPING EUROPEAN GAS AND ELECTRICITY INDUSTRIES* (Elsevier Science 2004).

40. Council Directive 96/92, 1997 O.J. (L 27) 20 (concerning common rules for the internal market in electricity); Council Directive 98/30, 1997 O.J. (L 27) 20 (concerning common rules for the internal market in natural gas); Council Directive 94/22, 1994 O.J. (L 1164) 3, 54 (on the conditions for granting and using authorizations for the prospecting, exploration and production of hydrocarbons).

41. The use of subsidiarity was justified given the divergent resource bases, legal structure, industry structure and policy choices. See PETER CAMERON, *COMPETITION IN ENERGY MARKETS* (Oxford University Press 2002); *Commission Communication on Completing the Internal Energy Market*, COM (2001) 125 final.

for gas.⁴² The EC Commission has also adopted a number of non-binding interpretative documents to accompany the Directives.

The package created a more detailed framework for the regulation of the energy market,⁴³ introduced new concepts,⁴⁴ and increased the role of NRAs alongside enhanced monitoring and reporting requirements for the Member States.⁴⁵ The Directives have two main aims: to increase *quantitative* market opening in order to achieve full liberalisation and to enhance *qualitative* regulation to increase consumer choice through uniformity and coordination of the Member States' energy markets.

Access to the gas and electricity networks was, and continues to be, a major issue in the liberalisation process. In the first set of liberalisation Directives the Member States were allowed a choice between negotiated and regulated third party access to the networks. This did not work and the EU soon realised that some Member States, such as Germany, enjoyed a strategic position in the energy trade which distorted the liberalisation processes in other states. Now, to secure competition in the wholesale market in the energy sector, the Member States must ensure that third party access to transmission and distribution is based upon published tariffs, applicable to all eligible customers, and is based upon an objective and non-discriminatory system. The NRA must approve the tariffs (or the methodology) in advance. Article 20(2) of Directive 2003/54/EC allows refusal of access where there is no available capacity. But conditions are attached to this refusal. Substantiated reasons must be given, taking into account any public service obligations, and the Member States must ensure that the transmission system operator or distribution

42. Council Directive 2003/54, 2003 O.J. (L 176) 37 (concerning common rules for the internal market in electricity and repealing Council Directive 96/92); Council Directive 2003/55, 2003 O.J. (L 176) 57 (concerning common rules for the internal market in natural gas and repealing Council Directive 98/30).

43. Gone is the flexibility of the earlier programme. Both Directives had to be implemented by the Member States by July 1, 2004. By this date there had to be freedom of choice for non-domestic customers with all customers enjoying freedom of choice by July 1, 2007. There are some derogations, but these are defined as narrow in scope. *See* Council Directives, *supra* note 42.

44. *E.g.*, enhanced consumer protection, universal service obligations, supplier of last resorts, green labeling and compliance programmes. *See* Council Directives, *supra* note 42.

45. The Gas Directive is less interventionist relying more heavily on the Madrid Forum.

system operator provides relevant information on measures that would be necessary to reinforce the network. Exemptions may also be given where there are major new infrastructure projects or significant increases in capacity in existing inter connectors.

In contrast, in the gas sector, third party access to transmission and distribution networks is to be provided on the basis of published and regulated tariffs, but for storage facilities access is to be on either a negotiated or regulated basis (or both). Access to upstream pipeline networks is to be separated out and Member States are given discretion over the arrangements adopted. Exemptions may be given for major new gas infrastructure investments.

Unbundling of vertically integrated undertakings addresses the structural constraints of the networks in three ways: legal unbundling, functional unbundling and accounting unbundling. *Legal unbundling* separates the transmission system operator and distribution system operator from other activities not related to transmission and distribution. Transmission and distribution are to be carried out by a separate network undertaking with a legal form chosen by the vertically integrated undertaking. *Functional unbundling* involves a separation of the transmission system operator and distribution system operator to ensure its independence from the vertically integrated undertaking. *Accounting unbundling* provides that separate accounts should be drawn up for network activities relating to electricity and gas.

A significant change in the new Directives is stronger commitments to the public service obligation (also known as the universal service obligation in the liberalisation Directives of the EU). This is seen as a fundamental requirement in the Recitals to each Directive. In the Electricity Directive there is a right to a universal service, which is the right of all households⁴⁶ to be supplied with electricity of a specified quantity within the territory of the Member State at reasonable, easily and clearly comparable and transparent prices. A similar obligation is not found in the Gas Directive. Alongside the universal service requirements are strengthened consumer protection rights covering the handling of complaints, protection against misleading selling and unfair contract terms.

46. Council Directive 2003/54, *supra* note 42. Member States have a discretion to extend this obligation for small and medium-sized enterprises.

Cross-border trade in the electricity sector is regulated by Commission Regulation 1228/2003 which entered into force on July 1, 2004.⁴⁷ This is an Internal Market measure, based upon Article 95(1) of the EC Treaty.⁴⁸ It builds upon the work of the Electricity Regulatory Forum to increase cross-border trade through increased harmonisation of tariffs and charges. The Regulation uses inter-transmission systems and operators' compensation mechanisms to compensate for costs incurred as a result of hosting cross-border flows of electricity on their networks by transmission systems operators from which those flows originate and the systems where they end. It encourages consistent charging for network access by outlawing "pancaking"⁴⁹ and distance-related charges, thereby avoiding distortions of trade. Finally it sets out general measures to improve capacity allocation including congestion management. In contrast there is a significant amount of cross-border trade in gas, and here the regulation focuses upon third party access to networks.

The new Directives created a different regulatory culture, setting out minimum requirements and creating new obligations for regulatory bodies at the national level. Part of this new role is an obligation to coordinate horizontally, at a trans-national level, as well as at the vertical level with the EC Commission. In 2003 the EC Commission established an independent European Regulators' Group for Electricity and Gas. The Directives created regulatory committees governed by the comitology procedure. The NRAs are to ensure non-discrimination, effective competition and the efficient functioning of the market. Competition authorities may also play a role in the liberalisation process. There is a requirement in the Electricity Directive that each Member State must provide a report to the EC Commission by 31 July each year on market dominance, predatory and anti-competitive behaviour.

47. 2003 O.J. (L176) 1.

48. *Supra* note 14.

49. "Pancaking" is the accumulation of tariffs to be paid by a shipper on energy transactions between two locations using two or more transmission system operators with their own set of tariffs.

2. Post-Liberalisation: a New *Energy* Policy

In its Report on the internal market for electricity and gas, adopted in November 2005,⁵⁰ the EC Commission identified the delay in applying the 2003 Gas and Electricity Directives as one of the main causes for the shortcomings in the European internal energy market. Not all of the Member States are at fault, and in Austria, The Netherlands and the United Kingdom liberalisation is advanced. However, in other states there are problems in adapting deep-seated features of the national energy market to the liberalisation process. For example, France continues to attach importance to public security issues and the provision by the state of public service obligations; in Germany *ex ante* regulation is difficult to reconcile with the preference for the market mechanism.⁵¹ Infringement actions were taken against Estonia, Ireland, Greece, Spain and Luxembourg in 2005,⁵² and in 2006 infringement proceedings were commenced against 17 Member States for failure fully to implement the Energy Liberalisation Directives.⁵³

Within the context of the revived Lisbon Process,⁵⁴ and in response to growing concerns voiced by consumers over significant price rises in 2004 and 2005⁵⁵ and complaints from new entrants unable fully to access grids, the EC Commission launched an inquiry into the competitiveness of the EU energy sector on 13 June 2005. This was initiated by a Communication from the Commissioner for Competition (Neelie Kroes), in agreement with the Commissioner for Energy (Andris Piebalgs),⁵⁶ and the adoption of a Decision pursuant to the EC Commission's powers under Article 17 of Council

50. *Commission Sector Inquiry pursuant to Article 17 of Regulation 1/2003 EC in the European electricity and gas markets*, COMP/B-1/39172, available at http://ec.europa.eu/comm/competition/sectors/energy/inquiry/communication_en.pdf.

51. See MARTHA ROGGENKAMP, EUROPEAN ENERGY LAW REPORT III (Martha Roggenkamp ed., Intersentia 2006).

52. Press Release, European Commission, IP/06/853 (July 6, 2005).

53. Press Release, European Commission, IP/06/430 (Apr. 4 2006); Press Release, European Commission, IP/06/1768 (Dec. 12, 2006).

54. *Commission Communication to the Spring European Council—Working Together For Growth and Jobs—A New Start for the Lisbon Agenda* at 8, 19 COM (2005) 24 final (Feb. 2, 2005).

55. See *Commission Sector Inquiry: Energy Sector*, Nov. 11, 2005, available at http://europa.eu.int/comm/competition/antitrust/others/sector_inquiries/energy/issues_paper15112005.pdf.

56. See *Commission Sector Inquiry*, *supra* note 50.

Regulation (EC) No 1/2003. The preliminary findings of the inquiry were published in February 2006.⁵⁷ Five major obstacles to competitiveness were identified.

The first obstacle was the intense market concentration, with the energy market dominated by incumbents with very few new entrants. The gas incumbents tend to control imports and/or domestic production of gas, whereas electricity incumbents control generation assets.⁵⁸ Against the background of the structured opening up of energy markets the EC Commission has used the competition provisions to regulate the processes and to ensure that dominant firms do not enhance their market strength. For example, in Portugal electricity markets are open to competition but gas markets are moving at a slower pace. Under the Second Gas Directive Portugal benefits from a derogation that allows it to begin gas liberalisation at the later date of 2007 for the opening up of the natural gas to power generators, the gas market for non-residential customers by 2009 and the date of 2010 set for residential customers. On December 9, 2004 the EC Commission declared the joint acquisition of Gas de Portugal (GDP) (the incumbent Portuguese gas undertaking) by Energias de Portugal (EDP) (the incumbent electricity undertaking) and Eni SpA, an Italian energy undertaking, to be incompatible with the common market, pursuant to Article 8(3) of the Merger Regulation.⁵⁹ Despite commitments undertaken by the parties, which were made at a very late stage in the proceedings, the EC Commission concluded that the proposed concentration would strengthen EDP's dominant position on the electricity markets in Portugal, as well as EDP's dominant

57. *Commission Communication on the Functioning of the Internal Market in Electricity and Gas*, COM (2005) 68 final (Jan. 10, 2007).

58. Press Release, Greenpeace, *Whose Power is it Anyway?* (Apr. 27, 2005). The report analyzes the market shares of Europe's 10 largest electricity utilities (EdF, E.on, RWE, ENEL, Vattenfall, Electrabel, EnBW, Endesa, Iberdrola and British Energy) and argues that the liberalization process has worked in favour of these large established utilities, as demonstrated by the wave of takeovers that ensued after the opening of the market. Thus new, "green" utilities have little chance to compete on an equal footing as the "Big 10" have enough influence in the sector to control prices, especially in the electricity sector.

59. Case No. COMP/M.3440 - ENI/EDP/GDP. For a wider discussion of the limitations of the Merger rules in combating the problems created by "national champions," see Andrew Scott, *National Champions and the Two-thirds Rule in EC Merger Control*, (Centre for Competition Policy, University of East Anglia, Working Paper 06-6, 2006), available at <http://www.ccp.uea.ac.uk/publicfiles/workingpapers/CCP06-6.pdf>.

positions on the Portuguese gas markets from the date these markets were opened up to competition, leading to the situation where competition would be significantly impeded in a substantial part of the Common Market. EDP challenged the EC Commission's decision under the fast track procedure of the Court of First Instance (CFI).

The CFI dismissed the challenge. The CFI confirmed the way in which the EC Commission assesses remedies by examining, first, competition concerns raised by the concentration, and then the commitments offered in relation to these concerns. The EC Commission could not within the time constraints imposed by the Merger Regulation recommence its assessment of the merger in the light of any commitments made. This would appear to be seeing the commitments as a fresh notification. Such an approach would be in conflict with the requirement of speedy decisions that characterises the aims of the Merger Regulation. In relation to the substance of the challenge the CFI considered that the EC Commission had not erred in law when it concluded that the concentration would strengthen EDP's dominant position.⁶⁰

A second obstacle to liberalisation is the vertical foreclosure caused by the vertically integrated incumbents acting at different levels of the supply chain, from wholesale to distribution of energy products. Long-term contracts have posed problems for the state aid rules and the lack of liquidity make access difficult for new entrants to the energy market. One problem which emerged from the opening-up of the gas sector to competition was the risk of foreclosure of the downstream market through long-term gas supply contracts between traditional suppliers and distribution companies and the industrial and commercial users. Long-term contracts inhibit consumer choice by preventing consumers from switching to alternative suppliers.

As a third obstacle the EC Commission found that there was a lack of market integration in Europe. The gas and electricity markets remain largely national. New entrants have difficulty in gaining access to what are perceived to be inadequate transmission systems. The EC Commission found an endemic lack of transparency in the energy markets. There was, for example, a lack of information on capacity available on gas networks and the wholesale electricity market, with data being shared with affiliates, putting new entrants at a disadvan-

60. Case T-87/05, *EDP v. Commission*, 2005 E.C.R. II-3745.

tage. This lack of information undermines confidence and prevents informed choices from being made by potential entrants to the market.

Finally, the EC Commission found that prices had increased dramatically since liberalisation and questioned whether there was anti-competitive behaviour on the market. In the gas sector the EC Commission noted that long-term gas supply contracts traditionally link prices to oil or oil derivatives but do not react to changes in supply or demand. In the electricity sector consumers had alleged that prices on spot and forward wholesale markets do not result from fair competition.

In addition to commencing infringement actions against the Member States,⁶¹ the EC Commission used competition law powers to conduct a series of dawn raids on gas companies in Germany,⁶² Italy, France, Belgium and Austria⁶³ and electricity companies in Hungary.⁶⁴

Both the energy and gas markets display high levels of concentration, but there are differences in the different stages of liberalisation of each sector and different production structures. The sectors are interconnected since gas is increasingly used as a primary fuel for electricity generation. In the electricity sector the inquiry focuses upon price formation mechanisms on the electricity wholesale markets, electricity generation and supply and factors determining generators' dispatching and bidding strategies. A special focus is directed at the issue whether electricity generators possess significant market power and can influence electricity wholesale prices. A further issue is the existence of entry barriers and barriers to cross-border flows, for example arising from long-term supply agreements

61. Austria, Belgium, the Czech Republic, Germany, Estonia, Spain, Finland, France, Greece, Ireland, Italy, Lithuania, Latvia, Poland, Sweden, Slovakia and the United Kingdom.

62. A second wave of dawn raids, unconnected to the first wave, took place involving German electricity undertakings in Dec. 2006. Memorandum from the European Commission, Competition: Commission has carried out inspections in the German electricity sector, Memo/06/483 (Dec. 12, 2006), available at <http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/06/483&format=HTML&aged=1&language=EN&guiLanguage=en>.

63. The EC Commission believes the companies may be restricting access to infrastructure and dividing markets.

64. The focus is upon long-term power purchase agreements (which are also the subject of a state aid investigation) and import contracts.

in certain Member States and the legal and operational regimes for the inter-connectors that link national electricity grids. In the gas sector the inquiry focuses on long-term import contracts, swap agreements and barriers to cross-border flows of gas. The balancing requirements for gas network users and gas storage are also being investigated, alongside downstream long-term contracts and the effects they may have on switching costs and market entry.

A third package of legislative proposals was adopted by the Commission on 19 September 2007.⁶⁵ The package promotes sustainability by stimulating energy efficiency and guaranteeing that even smaller companies, for instance those that invest in renewable energy, have access to the energy market. A competitive market will also ensure greater security of supply, by improving the conditions for investments in power plants and transmission networks, and thus help avoid interruptions in power or gas supplies. Guarantees of fair competition with third country companies are also strengthened.

To make the Internal Market work for all consumers whether large or small, and to help the EU achieve more secure, competitive and sustainable energy, the Commission is proposing a number of measures to complement the existing rules. First, the separation of production and supply from transmission networks: Network ownership and operation should be "unbundled." This refers to the separation between the network operation of electricity and gas from supply and generation activities. The proposals make it clear that the Commission's preferred option in this respect is ownership unbundling: a single company can no longer own both transmission and be occupied in energy production or supply activities. This may prove problematic from a legal perspective since it is not entirely evident what sort of legal powers or competence could be used to demand unbundling. In addition, the Commission proposes a second option, the "independent system operator" which makes it possible for existing

65. Press Release, European Commission, Energizing Europe: A real market with secure supply (Sept. 19, 2007), *available at* http://ec.europa.eu/energy/electricity/package_2007/index_en.htm. To date the electricity proposals comprise a set of Common Rules for the Internal Market in Electricity (COM (2007) 528 final (Jun. 26, 2003)) which are in the form of a proposal for a Directive and a proposal for a Regulation on Cross-Border Exchanges in Electricity (COM (2007) 531 final (Sep. 19, 2007)). The Gas proposals comprise a set of Common Rules for the Internal Market in Natural Gas (COM (2007) 529 final (Sep. 19, 2007)) and a proposal for a Regulation on Access Conditions to the Gas Transmission Network (COM (2007) 532 final (Sep. 19, 2007)).

vertically integrated companies to retain network ownership, but provided that the assets are actually operated by a company or body completely independent from it. Either one of these options will create new incentives for companies to invest in new infrastructure, inter-connection capacity and new generation capacity, thereby avoiding black-outs and unnecessary price surges.

Secondly, the Commission recognizes the strategic importance of Energy Policy. Therefore the package contains safeguards to ensure that in the event that companies from third countries wish to acquire a significant interest or even control over an EU network, they will have to demonstrably and unequivocally comply with the same unbundling requirements as EU companies. The Commission can intervene where a purchaser cannot demonstrate both its direct and indirect independence from supply and generation activities.

A third idea is to facilitate cross-border energy trade: The Commission proposes to establish an Agency for the cooperation of National Energy Regulators, with binding decision powers, to complement National Regulators. This will ensure the proper handling of cross-border cases and enable the EU to develop a real European network working as one single grid, promoting diversity and security of supply. To complement this aim is the creation of more effective national regulators: the Commission proposes measures to strengthen and guarantee the independence of national regulators in Member States.

A fourth aim is to promote cross border collaboration and investment: The Commission proposes a new European Network for Transmission System Operators. EU grid operators would cooperate and develop common commercial and technical codes and security standards, as well as plan and coordinate the investments needed at EU level. This would also ease cross border trade and create a more level playing field for operators.

A fifth aim is to secure greater transparency: this involves steps to improve market transparency on network operation and supply will guarantee equal access to information, make pricing more transparent, increase trust in the market and help avoid market manipulation.

Finally, there is the aim of increased solidarity: by bringing national markets closer together, the Commission foresees more potential for Member States to assist one another in the face of energy supply threats.

Customers will also benefit from a new Energy Customers' Charter to be launched in 2008. This will include measures to address fuel poverty, information for customers to choose a supplier and supply

options, actions to lower red tape when changing energy suppliers and to protect citizens from unfair selling practises. A separate information campaign will inform customers of their rights.

The proposed package of measures was anticipated in the Commission's Energy Policy for Europe which was endorsed by the European Council in March 2007. This set out the need for the EU to draw up a new energy path towards a more secure, sustainable and low-carbon economy, for the benefit of all citizens. Fully competitive markets are an essential pre-requisite to reaching this goal. From 1 July 2007, citizens across the EU already have a right to choose their supplier. The new package aims to ensure that all suppliers fulfil high standards of service, sustainability and security. Germany, in particular has been critical of the measures.

III. EXTERNAL CHALLENGES FOR THE EU

The Kyoto Protocol 2001 to the UN Framework Convention on Climate Change, adopted at the Rio Earth Summit in 1992, was approved by the EU in April 2002.⁶⁶ The EU committed to a higher target of an 8% reduction in annual greenhouse gas emissions across the EU. The Member States agreed to distribute the target in what is known as the EU "bubble." So, for example, Denmark and Germany are to cut their emissions by 21% while, at the other end of the scale Greece can actually increase emissions by 27% and Portugal by 25%. The prime solutions posed for meeting the Kyoto challenge are energy conservation and the use of renewable energy sources. The use of renewables has also be linked to a wider issue of finding a sustainable energy solution to the rising global population demands for energy and the gradual exhaustion of fossil fuels (especially oil and gas) predicted by the end of this century.

At this time the EU was not a significant leader in research and development in renewable energy and lagged behind the United States in this field. Germany was the largest contributor to research and development, followed by Italy, The Netherlands, Spain, Sweden and the United Kingdom. These Member States did however, have a

66. Kyoto Protocol to the United Nations Framework Convention on Climate Change, Kyoto, Japan, Dec. 11, 1997. The Kyoto Protocol set a target of 5.2% compared with 1990 levels by the period 2008-2010 in the first commitment period.

more diversified approach to research and development of renewable energy than the US and Japan, with approximately one third for photo-voltaics, one quarter for wind energy and one-quarter for bio-energy. The US and Japan tended to focus upon photo-voltaics.

Despite the EU framework that has been adopted since the White Paper, renewable energy policy in the EU is still very much a national policy. In some Member States, especially in southern Europe, research and development of renewables is still very under-developed.

IV. THE LEGAL FRAMEWORK FOR THE PROMOTION OF RENEWABLE ENERGY

In a *White Paper on Renewable Sources of Energy*, the EC Commission suggested that by 2010 the share of primary energy produced from renewables should be increased from 6% to 12% and this indicative target was approved by the Council Resolution in 1998.⁶⁷ The Commission also published a *Proposal on the Promotion of Electricity from RES*. The main piece of legislation to emerge was a Framework Directive, the Renewables Directive of 2001⁶⁸ using Article 175(1) EC as its legal base. To summarise, the main points of the Directive are to describe “renewable energy sources” as renewable non-fossil - wind, solar, geothermal, wave, tidal, hydro-power, biomass, landfill gas, sewage treatment plant gas and biogases. Member States commit to specific targets for renewable energy. They must introduce accurate and reliable certification of green electricity to ensure guaranteed access to green electricity and ensure that the calculation of costs for connecting new producers of green electricity to the grid is transparent and non-discriminatory. Member States are required to establish individual RES-E targets that are consistent with reaching the Commission’s target of 21% indicative share of electricity produced from renewable energy sources in total EU electricity consumption by 2010.

Member States are required to report to the Commission towards their green electricity consumption targets every two years. The Commission must report *via* a Communication on how the national

67. 1998 O.J. (C 198) 1.

68. Council Directive 2001/77, 2001 O.J. (L 283) 33 (on the promotion of energy from renewable energy sources in the internal electricity market).

schemes are applied in practice and how cost-effective they are in promoting renewable energy sources. The EU common policy consists of supporting technology research and development, setting medium and long-term targets and providing boundary conditions, for example, a system of guarantees of origin.

A major weakness has been the lack of incentives for market penetration of renewable energy. But there is also a lack of co-ordination, for example, there is a strong focus on wind energy and solar energy at the expense of under-development of bio-energy policies. A fairly recent Eurobarometer poll concluded that a majority of EU citizens (47%) would prefer the EU to take decisions at the EU level to meet the challenges of energy supply security, growing energy consumption and climate change.⁶⁹

The EU Sustainable Development Strategy has raised the stakes even higher. For example, by 2010 12% of energy consumption, on average, and 21% of electricity consumption, as a common but differentiated target, should be met by renewable sources with the Member States considering raising their share to 15% by 2015.⁷⁰ It is difficult for the EU to create an effective enforcement mechanism for the reaching of targets. The soft law processes rely on a “naming, shaming and faming” peer group pressure approach, with very little role to play for sanctions.⁷¹

A. *A New Energy Policy for Europe*

On 10 January 2007 the Commission made proposals for a new Energy Policy for Europe. These included a renewable energy road-map proposing a binding 20% target for the overall share of renewable energy in 2020; the effort to be shared in an appropriate way between Member States; a binding 10% target for the share of biofuels in petrol and diesel in each Member State in 2020, to be accompanied by the introduction of a sustainability scheme for biofuels.⁷²

69. Press Release, *supra* note 6.

70. See Council of the European Union, Review of the EU Sustainable Development Strategy, 10917/06 (adopted June 16, 2006), available at http://ec.europa.eu/sustainable/docs/renewed_eu_sds_en.pdf.

71. See Erika Szyszczak, *Experimental Governance: The Open Method of Coordination*, 12 EUR. L. J. 486 (2006).

72. *Communication From the Commission to the European Council and the European Parliament An Energy Policy for Europe*, COM (2007) 1 final (Oct. 1, 2007).

The Commission is now drafting proposals to incorporate these targets into legislation, taking into account the views of stakeholders as expressed in the 2006 consultation exercises on heating and cooling and biofuels and the recent consultation exercise on administrative obstacles to the increased use of renewable energy in electricity generation.

The Commission is aiming for a longer term target for renewable energy. In 1997, the European Union started working towards a target of a 12% share of renewable energy in its overall mix by 2010, a doubling of 1997 levels. Since then, renewable energy production has increased by 55%. Nevertheless the EU is set to fall short of its target. The share of renewable energy is unlikely to exceed 10% by 2010. The main reasons for the failure to reach the agreed targets for renewable energy are the higher costs of renewable energy sources compared to “traditional” energy sources and the lack of a coherent and effective policy framework throughout the EU and a stable long-term vision. As a result, only a limited number of Member States have made serious progress in this area and the critical mass has not been reached to shift niche renewables production into the mainstream. The EU needs a step change to provide a credible long term vision of the future of renewable energy in the EU, building on the existing instruments, notably the renewable Electricity Directive. This is essential to realize present targets and trigger further investment, innovation and jobs.

The challenge for a renewable energy policy is to find the right balance between installing large scale renewable energy capacity today, and waiting until research lowers their cost tomorrow. Finding the right balance means taking a number of factors into account. Firstly, using renewable energy today is generally more expensive than using hydrocarbons, (but the gap is narrowing – particularly when the costs of climate change are factored in). Economies of scale can reduce the costs for renewables, but this needs major investment today. Secondly, renewable energy helps to improve the EU's security of energy supply by increasing the share of domestically produced energy, diversifying the fuel mix and the sources of energy imports and increasing the proportion of energy from politically stable regions as well as creating new jobs in Europe. Thirdly, renewable energies emit few or no greenhouse gases, and most of them bring significant air quality benefits. In the light of the information received during the public consultation and the impact assessment, the Commission proposes in its *Renewable Energy Roadmap* a binding target of increasing the level of

renewable energy in the EU's overall mix from less than 7% today to 20% by 2020. Targets beyond 2020 would be assessed in the light of technological progress. Meeting the 20% target will require a massive growth in all three renewable energy sectors: electricity, biofuels and heating and cooling. But in all sectors, the policy frameworks set up in particular Member States have achieved results which show how this is possible. Renewables have the potential to provide around a third of EU electricity by 2020. Wind power provides approximately 20% of electricity needs in Denmark, today, as well as 8% in Spain and 6% in Germany. Costs in other new technologies - photovoltaic, solar thermal power, and wave and tide, are projected to decrease from currently high levels. In the heating and cooling sector, progress will have to come from a number of technologies. Sweden, for example, has over 185,000 installed geothermal heat pumps. Germany and Austria have led the way on solar heating. If other Member States matched these levels, the share of renewable energy in heating and cooling would jump by 50%. As for biofuels, Sweden has already achieved a market share of 4% of the petrol market for bioethanol, and Germany is the world leader for bio-diesel, with 6% of the diesel market. Biofuels could make up to 14% of transport fuels by 2020. This 20% target is ambitious and will require major efforts by all Member States.

The contribution of each Member State to achieving the Union's target will need to take into account different national circumstances and starting points, including the nature of their energy mix. Member States should have the flexibility to promote the renewable energies most suited to their specific potential and priorities. The way in which Member States will meet their targets should be set out in National Action Plans to be notified to the Commission. The Plans should contain sectoral targets and measures consistent with achieving the agreed overall national targets. In practice, in implementing their Plans, Member States will need to set their own specific objectives for electricity, biofuels, heating and cooling. These would be verified by the Commission to ensure that the overall target is being met. The Commission will set out this architecture in a new renewable energy legislative package in 2007.

A particular feature of this framework is the need for a minimum and coordinated development of biofuels throughout the EU. While biofuels are today and in the near future more expensive than other forms of renewable energy, over the next 15 years they are the only

way to significantly reduce oil dependence in the transport sector. In its *Renewable Energy Roadmap*⁷³ and *Biofuels Progress Report*⁷⁴ the Commission therefore proposes to set a binding minimum target for biofuels of 10% of vehicle fuel by 2020 and to ensure that the biofuels used are sustainable in nature, inside and outside the EU. The EU should engage third countries and their producers to achieve this. In addition, the 2007 renewables legislative package will include specific measures to facilitate the market penetration of both biofuels and heating and cooling from renewables.

The Commission will also continue and intensify the use of renewable energy through other policies and flanking measures with the aim of creating a real internal market for renewable energy in the EU. To achieve a 20% share for renewable energy will result in an additional average annual cost of approximately € 18 billion – around 6% extra on the EU's total expected energy import bill in 2020. But this assumes oil prices of \$ 48/barrel by 2020. If these rose to \$ 78/barrel, the average annual cost would fall to € 10.6 billion. If a carbon price of more than € 20 is factored in, the 20% would cost practically no more than relying on “traditional” energy sources, but create many jobs in Europe and develop new, technology driven European companies.

V. CONSTRAINTS ON THE MEMBER STATES

A. *Compatibility with the State Aid Rules*

One of the main ways in which Member States can promote and encourage renewable energy sources is through the use of subsidies, known as State Aids in the EU. State aid has long been a sensitive issue in the EU and the Commission and the Member States have accepted that intelligent use of State Aid may be beneficial in meeting Community objectives contained in the EC Treaty as well as the Lisbon goals.⁷⁵ The use of less and better targeted aid is one policy line being pursued as part of the Lisbon Agenda. From the *The State*

73. *Commission Communication on the Renewable Energy Road Map, Renewable Energies in the 21st Century: Building a More Sustainable Future*, COM (2006) 848 final (Oct. 1, 2007).

74. *Commission Communication, Biofuels Progress Report*, COM (2006) 845 final (Oct. 1, 2007).

75. See SZYSZCZAK, *supra* note 7.

Aid Action Plan,⁷⁶ the Commission built upon existing practice by formalising a balancing test which is applied to the design of the State Aid rules as well as assessing individual cases. The test attempts to balance out the positive and negative effects of State Aid when looking at individual exemptions. State Aid for environmental objectives has also been addressed through Commission soft law processes. The 1994 Guidelines on State Aid for Environmental Protection were replaced in 2001. They apply to all sectors, even those sectors which have sector specific state aid rules, but they do not affect the specific rules relating to *de minimis*. Their role is to provide *ex ante* guidance to the Member States when deciding “whether, and under what conditions, state aid may be regarded as necessary to ensure environmental protection and sustainable development without having disproportionate effects on competition and economic growth.” The Guidelines do not apply to stranded costs but are essentially concerned with investment aid and operating aid to promote renewable energy sources.

Investment aid must be strictly necessary to attain environmental objectives but spending on technology transfer is allowed, for example, acquisition of operating licences, patented know-how could qualify. Operating aid is more complicated. There are different rules depending upon whether the aid is to promote waste management and energy saving; the aid is to promote the combined production of electric power and heat; the aid is to be in the form of tax reductions or exemptions; or the aid is for renewable energy sources where special treatment applies to help these sources compete against conventional sources. Operating aid may be justified to cover the difference between the cost of producing energy from renewable sources and the market price of that energy. Member States may grant aid in only three situations.

The Guidelines expired in 2007. On 10th May 2007 the Commission issued a Preliminary Draft of a Staff Paper (which is a Consultative Document) entitled *Community Guidelines for State Aid for En-*

76. Commission Communication, *State Aid Action Plan: Less and Better Targeted State Aid: A Road Map for State Aid Reform 2005-2009*, COM (2005) 107 final (June 7, 2005), available at http://ec.europa.eu/comm/competition/state_aid/reform/saap_en.pdf.

vironmental Protection.⁷⁷ However, the Commission embarked upon a modernisation and consolidation of the State Aid rules in 2005 and environmental issues have also been subsumed into the draft State Aid Block Exemption Regulation.⁷⁸

The most positive ruling of the European Courts in support of State measures to encourage the use of renewable energy came in an Article 234 EC ruling in *Preussen Elektra*.⁷⁹ The case concerns both the Internal Market and the State Aid rules. The case concerned a German law (*Stromeinspeisungsgesetz*) that placed an obligation on energy providers to source a proportion of their supplies from local renewable energy installations. The German utility companies were not happy with the feed-in schemes developed in Germany from 1998-2000, and one way of challenging them was to claim that the feed-in schemes were contrary to the EU State Aid rules. The Court held that there was no State Aid present in the German scheme. This was because consumers paid for the electricity and therefore there was no transfer of State funds which benefited individual firms.

On the Internal Market rules the Court appears to indicate support for policies which promote renewable energy. The Court found that there was discrimination but that the German measure could be justified on environmental grounds. The Court's reasoning in the case can be criticised because Article 30 EC (which is the basis for derogations from the free movement provisions) does not contain an explicit protection of the environment provision. A derogation which satisfies the principle of proportionality can be found in the clause which refers to measures which protect the health and life of humans, animals and plants. Under the *Cassis* principle, the protection of the environment has become one of the accepted mandatory requirements,⁸⁰ but the *Cassis* principle should, *strictu sensu* apply only to indistinctly applicable measures. The Opinion of AG Jacobs'

77. *Staff Paper, Preliminary Draft, Community Guidelines for State Aid for Environmental Protection* (May 10, 2007), available at http://ec.europa.eu/comm/competition/state_aid/reform/guidelines_environment_en.pdf.

78. *Draft Commission Regulation on Articles 87 and 88 of the EC Treaty*, 2007 O.J. (C 210) 10, available at http://eur-lex.europa.eu/LexUriServ/site/en/oj/2007/c_210/c_21020070908en00140040.pdf.

79. Case C-379/98, *Preussen Elektra v. Schleswang*, 2001 E.C.R. I-2099.

80. Case 302/86, *Commission v. Denmark*, 1988 E.C.R. 4607.

casts some light on the problem. He argued that limiting the ground of protection of the environment to indistinctly applicable measures:

“... national measures for the protection of the environment are inherently liable to differentiate on the basis of the nature and origin of the cause of harm, and are therefore liable to be found to be discriminatory, precisely because they are based on such accepted principles as “environmental damage should as a priority be rectified at source” (Article 130r(2) EC). Where such measures necessarily have a discriminatory impact of that kind, the possibility that they may be justified should not be excluded.”

The Court’s ruling left unanswered the effect of the German trade of green electricity to other Member States since the buying-in obligation was limited to green electricity produced in Germany. Was this an import-restriction? Germany justified the scheme as increasing the supply security from national renewable sources, arguing this is a justifiable derogation in free movement of goods. It also referred to Article 6 EC that environmental protection is a goal in all Community policies, including trade between Member States.

B. Competition Law

Within EU competition (anti-trust) law there is debate as to how far non-economic values are taken into account in making and applying Community law and policy. The Commission has addressed consumer welfare and non-economic considerations in its assessment of agreements and other forms of co-ordination which may have anti-competitive effects under Article 81 EC. The EC Treaty itself demands that Community-based policies should be taken into account in decision-making. Environmental protection in Article 6 EC is one of these policies.⁸¹ Thus, in the Guidelines on Horizontal Agreements the Commission states that it will exempt agreements under Article 81(3) EC which reduce environmental pressure provided that the net contribution to the improvement of the environmental situa-

81. EC Treaty, *supra* note 14 at art. 6; *see also Id.* at arts. 127(2) (employment), 151(4) (culture), 152(1) (health), 153(2) (consumer protection), 157(3) (industrial policy), and 159 (economic and social cohesion).

tion overall outweighs increased costs.⁸² Some examples of this policy can be seen in CECED when the Commission exempted an agreement between washing machine manufacturers which phased out washing machines which had a high electricity consumption. The improved environmental conditions outweighed the anti-competitive effects of the agreement. In an article in the 2002 Competition Policy Newsletter, two comfort letters are discussed where the Commission reveals it will not pursue agreements where the benefits which the society at large derives from the agreement as well as the benefits for individual consumers are a factor.⁸³

In *DSD*⁸⁴ the Commission granted an individual exemption under Article 81(3) EC because an agreement gave direct practical effect to environmental objectives set out in Directive 94/62 on Packaging and Packaging Waste.⁸⁵ The Commission has encouraged voluntary agreements which pursue environmental objectives.⁸⁶ However, in analysing the reasons given for clearing or exempting certain agreements efficiency gains, for example lower production costs, the use of new technology and increased production capacity are also important factors, alongside the environmental objectives.⁸⁷ Since the decentralisation of the enforcement of competition law in Regulation 1/2003 the Commission has issued conflicting guidance, stating that efficiencies are the sole factor in applying Article 81(3) EC.⁸⁸

82. *Commission Notice, Guidelines on the Applicability of Article 81 of the EC Treaty to Horizontal Cooperation Agreements*, 2001 O.J. (C 3) 2, ¶ 179.

83. Manuel Martinez Lopez, *Commission Confirms Its Policy Line in Respect of Horizontal Agreements on Energy Efficiency of Domestic Appliances*, 1 COMPETITION POL'Y NEWSLETTER 50, 52 (2002).

84. 2001 O.J. (L 319) 1, ¶¶ 143-45.

85. 1994 O.J. (L 365) 5.

86. Council Decision 2179/98m art. 3(1)(f), 1998 O.J. (L275) 1; *Commission Communication*, *supra* note 13.

87. Exxon-Shell, 1994 O.J. (L 144) 21, ¶ 67; Philips-Osram, 1994 O.J. (L 378) 37, ¶¶ 25-26.

88. *Commission Notice, Guidelines on the Application of Article 81(3) of the Treaty*, 2004 O.J. (C 101) 97; see Gerwin Van Gerven, *The Application of Article 81 in the New Europe*, in FORDHAM CORPORATE LAW INSTITUTE, INTERNATIONAL ANTITRUST LAW & POLICY 429 (Barry Hawk, ed., Juris 2003).

VI. CONCLUSION

The new energy policy, unwrapped in 2007, is a fascinating case study revealing how new forms of economic governance are being used to pull together what were once flanking (or horizontal) policies of the EU, to turn them into a mainstream, and yes, I dare say this to an American audience - a fundamental, constitutional EU policy. The new governance techniques are novel in that they set binding targets for the Member States. How these will be enforced is not addressed. Alongside the usual “naming, faming and shaming” techniques currently deployed in new forms of economic governance the Commission will be able to use its normal enforcement powers, using infringement actions under Article 288 EC. Will this really coerce Member States, who maybe do not have the resources (both physical and financial) to create new forms of renewable energy? Now energy, through the use of the Lisbon Process, has emerged as a mainstream policy. This policy brings a new set of values to the balance, which is maintained in European integration between economic and social aims, with the core Internal Market rules and Competition policy rules adapted to accommodate the tensions that this new policy area brings.

