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Energy Liberalization and EC Competition Law

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Abstract

Community competition policy utilizes four main instruments in order to contribute to the realization of these prerequisites: classical antitrust (prohibition of cartels and abuses of dominant positions), merger control, supervision of enterprises entrusted with special or exclusive rights, and State aid control. Energy liberalization requires the comprehensive use of all four instruments in order to bring about and ensure genuine competition on the European electricity and gas markets. It seems that energy liberalization is also unique in this regard. The close link between internal market and competition policy in the liberalization process means that both have to be seen together. The emphasis in the following discussion will, however, be on Community competition policy and its four instruments.

ENERGY LIBERALIZATION AND EC COMPETITION LAW

*Michael Albers**

I. *THE ROLE OF EC ANTITRUST LAW*

There have been fifteen national and largely isolated electricity and gas markets in the European Union ("EU") until recently. Other than for coal, petrol, and nuclear energy these markets had not been made part of the European common market. This situation changed with the adoption of liberalization directives for electricity¹ and gas² ("Directives") and their implementation in the year 1999 for electricity, and 2000 for gas, by almost all fifteen Member States.³ The Directives provide for the creation of Community-wide markets for electricity and gas as they exist already for other fuels and, indeed, almost all other goods and services. Monopoly rights at the national level had to be abolished, a legal framework to allow new market entry as well as access to the networks had to be created, and consumers had to be empowered to choose freely their suppliers throughout the EU. Energy liberalization thus means building single European electricity and gas markets out of fifteen isolated national markets through the introduction of competition between energy suppliers for customers.

Expectations are that competitive European energy markets will increase the efficient allocation of resources and enhance consumer welfare. Distortions of competition between substituting fuels should come to an end. Competition among suppliers should lead to a downward convergence of prices in Europe. These expectations seem to be well founded in view of the positive developments for European consumers in the relatively

* Head of Unit, European Community Commission, Brussels. All views expressed are personal. This Essay results from the Fordham Corporate Law Institute Twenty-eighth Annual Conference in International Antitrust Law and Policy, Oct. 25-26, 2001.

1. Council Directive No. 96/92/EC, O.J. L 27/20 (Jan. 30, 1997) [hereinafter Electricity Directive].

2. Council Directive No. 98/30/EC, O.J. L 204/1 (July 21, 1998) [hereinafter Gas Directive].

3. France has not yet implemented the Gas Directive. For a short history of energy liberalization, see the chapter by Levasseur, in *THE EC LAW OF COMPETITION* 735-37 (Faull & Nikpay eds., 1999).

short period of time since the Directives have been implemented; in particular, positive price developments, which are up to now more pronounced for electricity than for gas. Whereas electricity prices for consumers have gone down in almost all Member States, gas prices remained heavily influenced by oil prices because of the gas price linkage to oil.⁴ Other positive developments are the emergence of new services and offerings (for example, power exchanges and gas spot markets). The almost parallel liberalization of electricity and gas markets may mutually reinforce the respective processes. The availability of highly efficient and environmentally friendly gas-fired power stations is likely to facilitate new entry in electricity markets, whereas the accelerated growth of demand for gas may in turn create additional incentives for new entry in gas markets.

It is thus hoped that energy liberalization will produce similar positive results as other previous liberalization processes, such as in the telecommunication sector. The concrete result will of course be energy specific and this may mean that it will arguably only become visible in the long run given that the electricity and gas industries are characterized by large sunk costs and longer lead and construction times than the industry averages.⁵ It may also be that energy liberalization will not be as appealing for European consumers as has been, for instance, telecom liberalization through the competitive introduction of innovative and trendy products like mobile telephony. But, of course, you never know.

Liberalization is never launched in a "green field" situation. Electricity and gas liberalization take place in industries that developed for decades along national lines. Moreover, the number

4. Communication from the Commission to the Council and the European Parliament, Completing the Internal Energy Market, COM (2001) 125 Final, at 7-8 (Mar. 13, 2001) [hereinafter Energy Communication]; Commission Staff Working Paper, Completing the Internal Energy Market, SEC(2001) 438 (Dec. 3, 2001), at 18-26, available at <http://europa.eu.int/comm/energy/library/438.pdf>; 1st Benchmarking Report on the Implementation of the Internal Electricity and Gas Market, Commission Staff Working Paper, SEC(2001)/1957 (Mar. 12, 2001), available at <http://europa.eu.int/comm/energy/en/internal-market/library/report-en.pdf>; Luis de la Fuente, *Electricity Prices for EU Industry on 1 January 2000: Downward Trend*, EUROSTAT, Statistics in Focus—Environment and Energy, available at http://europa.eu.int/comm/eurostat/Public/datashop/print-product/EN?catalogue=Eurostat&product=KS-NQ-00-005-_-I-EN&mode=download.

5. INTERNATIONAL ENERGY AGENCY & OECD, COMPETITION IN ELECTRICITY MARKETS 17-19 (2001) [hereinafter IEA].

of electricity and gas enterprises operating in each national market is very limited. Most of these operators enjoyed a monopoly before liberalization and are now very often gatekeepers to the network and the customer base. The opening-up of markets for Community-wide competition will consequently lead to a transformation of the industry from a monopolistic towards a competitive structure. Given that electricity and gas have to be supplied through a network, which will remain a natural monopoly for most of its parts even after liberalization,⁶ the transformation forms a particular challenge for both industry and public authorities.

The European Community disposes of a variety of policy instruments to commence and govern the process of liberalization.⁷ The application of these instruments taking into account the principle of subsidiarity requires the Commission, however, to establish a consensus among all major political powers of the Community. Each liberalization process is unique in this regard and is built upon a specific policy mix. For the full liberalization of the energy markets it was clear from the start that the opening-up of national markets had to be accompanied by harmonization measures to be effective.⁸ The legal basis for the Directives of 1996 and 1998 adopted by the European Parliament and the Council, thus, form internal market rules (Article 95) and not competition rules (Article 86). The same holds for the new "Acceleration Directive" proposed by the Commission in March 2001, which has the objective of opening up fully the electricity and gas markets.⁹ This current orientation, in principle, however, does not exclude future adoption of directives and decisions on the basis of Article 86(3) by the Commission with the aim of pushing the transformation of the industries forward or

6. *See, e.g., id.* at 19-20.

7. Kurt Lennart Ritter, *EC Antitrust Law and Energy*, in [1995] *FORDHAM CORP. L. INST.* 131-37 (Barry Hawk ed.).

8. *Id.* at 137-42.

9. *See* Commission Proposal for a Directive of the European Parliament and of the Council amending Directives 96/92/EC and 98/30/EC concerning common rules for the internal market in electricity and natural gas, COM(2001) 125 final, [hereinafter *Acceleration Directive*], available at http://europa.eu.int/comm/energy/en/internal-market/library/directive_en_acte.pdf; Press Release, EU Commission, Towards a Single Energy Market in 2005, IP/01/356 (Mar. 13, 2001). All non-domestic electricity and gas customers shall enjoy free-supplier choice by 2003 and 2004 respectively. All domestic consumers of electricity and gas shall freely choose consumers by 2005.

quickly resolving specific issues that come up in the process.¹⁰

Community competition policy forms a cornerstone for full and comprehensive energy liberalization, even if the key legislative measures are instituted by internal market directives. This will be demonstrated in the following discussion of the three essential prerequisites for effective competition in network industries. The three prerequisites are:

- Free consumer choice of suppliers,
- Free supply competition, and
- Open access to networks.

Community competition policy utilizes four main instruments in order to contribute to the realization of these prerequisites: classical antitrust (prohibition of cartels and abuses of dominant positions), merger control, supervision of enterprises entrusted with special or exclusive rights, and State aid control.¹¹

Energy liberalization requires the comprehensive use of all four instruments in order to bring about and ensure genuine competition on the European electricity and gas markets. It seems that energy liberalization is also unique in this regard.¹² The close link between internal market and competition policy in the liberalization process means that both have to be seen together. The emphasis in the following discussion will, however, be on Community competition policy and its four instruments.

II. *FREE CONSUMER CHOICE OF SUPPLIERS*

The first essential prerequisite for the creation of competitive Community-wide electricity and gas markets is to empower individual consumers to freely choose their energy provider throughout the EU. The new European framework provides for full competition with all the risks and chances for market participants engaged in the supply of commodity products. It is not limited to periodic auctions for the supply of consumers in a

10. See Press Release, EU Commission, Commission Confirms Need to Tackle Cross-border Investment Restrictions and Energy Market Distortions, IP/01/872 (June 20, 2001).

11. Ritter, *supra* note 7, at 132-37.

12. See, e.g., Herbert Ungerer, *Use of EC Competition Rules in the Liberalisation of the European Union's Telecommunications Sector*, available at http://europa.eu.int/comm/competition/speeches/text/sp2001_009_en.pdf.

given area, even under the option of the "single buyer" procedure as foreseen in the Electricity Directive.¹³

A. *Gradual and Uneven Market Opening*

The Directives allowed Member States, however, to opt for the gradual opening-up of their markets. In this regard, the Community followed the British example of electricity liberalization.¹⁴ Not all consumers had to be given the right of free supplier choice at once. Member States could institute a phased process in which case they had to respect minimum opening levels for the liberalization of demand.¹⁵ In spite of this rather careful approach to market opening, the Community legislator was not able to fix a definitive date for the complete opening of electricity and gas markets in all fifteen countries. The Directives only announce further measures to be considered after 2007 for electricity and after 2008 for gas.¹⁶

Against this background it came as a pleasant surprise that only a minority of Member States opted for the "minimalist" approach of the Directives.¹⁷ Most Member States obviously wished to quickly reap the benefits of liberalization and opened up their markets fully. Some did so immediately; others will do it over a relatively short period of time. The result was that around sixty-six percent of European electricity demand and seventy-nine percent of total European gas demand are now legally completely open to Community-wide competition.¹⁸ This development encouraged the Commission to propose the so-called Acceleration Directive suggesting full market opening by 2005.¹⁹

The gradual market opening as foreseen in the Directives creates the critical mass for initiating the transformation of the

13. Electricity Directive, *supra* note 1, art. 18; IEA, *supra* note 5, at 58 (for a description of procurement model).

14. Ritter, *supra* note 7, at 142.

15. See Electricity Directive, *supra* note 1, art. 19(1); Gas Directive, *supra* note 2, art. 18(2). Regarding electricity, Member States had to open 28% of demand in 1999, and 35% by 2003. Regarding gas, Member States had to open a minimum of 20% of demand in 2000, and 28% by 2003.

16. See Electricity Directive, *supra* note 1, art. 26; Gas Directive, *supra* note 2, art. 28.

17. France, however, to this date has not implemented the Gas Directive in national law.

18. Details on the market opening of each Member State can be found in the Annex to this Essay.

19. See Acceleration Directive, *supra* note 9.

industries from monopolistic to competitive markets. The fact that large and mostly professional energy consumers become eligible first to select freely their suppliers creates economic incentives for the latter to compete for contracts. It also sets in motion the difficult process of developing functioning transmission markets that previously did not exist in almost all Member States. Finally, the gradual approach takes into account the fact that market participants need time to adapt to the new framework and to develop the tools and instruments for the proper functioning of competitive markets.

The policy choice made by the European legislator also entails risks, however, notably the risk of a lengthy transition period with imperfect competition even in the opened market segments. It seems already apparent that full market opening from the beginning serves consumers better in terms of price competition than phased introduction of competition.²⁰ Of paramount importance, however, is the risk of "imbalance" because of the uneven opening of fifteen national markets. While in most countries suppliers are subject to competition with their whole customer base, in a minority of countries suppliers are still partially protected against competition. Uneven market opening thus creates competitive advantages for some and disadvantages for others. Cross-subsidization from the captive to the competitive customer groups is only one example of a competitive advantage. The possibility to cross-subsidize affects the ability of suppliers to win customers in other geographic markets or, worse, to defend historic market positions against new entrants.

These imbalances cannot be effectively contained by sector-specific or competition law. It is true that the liberalization directives provide for a so-called reciprocity rule. This rule enables a Member State with 100% market opening to block certain exports from a country with only minimal market opening.²¹ However, the reciprocity rule only deals with cross-border trade. It does not address the other economic consequences of uneven market opening.²² In particular, it does not address the issue of

20. See Energy Communication, *supra* note 4, at 7.

21. See Electricity Directive, *supra* note 1, art. 19(5); Gas Directive, *supra* note 2, art. 19(1).

22. It may not even deal with the reciprocal trade issues effectively. See Energy Communication, *supra* note 4, at 5.

cross-border mergers and acquisitions.²³ This leads to what one might call the “*EDF experience*.” The French power supplier EDF belongs to the group of European companies pursuing an active acquisition strategy throughout the Community. This caused concerns for two reasons. Firstly, EDF originates from a Member State with a minimalist approach to liberalization. The company seems to take advantage of its protected home market in order to acquire competitors active in countries with a market opening of 100% and with a more pluralistic supply structure. Secondly, EDF is a State-owned company, which may benefit from the fact that its shareholders do not expect returns as high on investments as private shareholders would.

The whole liberalization process was imperiled in 2001 when two Member States made moves to freeze the voting rights in the two power suppliers that EDF was about to take over in the respective countries. The Commission reacted by proposing to accelerate market opening and quickly fix a date for full liberalization.²⁴ Only a rapid and complete opening up of energy markets for competition will effectively eliminate imbalances. To simply enlarge the “reciprocity” rule and include cross-border mergers and acquisitions, as has been advanced, misses the point. Reciprocity rules neither deal with the real cause of the imbalances nor do they remedy the competition issue. Besides, reciprocity rules are not even compatible with existing Community law and, more precisely, the rules on freedom of establishment.

B. *Locking-in of Customers*

Consumers, having been legally empowered to freely choose their supplier in the Community,²⁵ can be impeded in their freedom through private barriers erected by incumbent operators. It has always been a principal task of Community com-

23. The most prominent case for a company with an active Europe-wide acquisition strategy in this regard is *EDF*, a State-owned company originating from a Member State with a minimalist approach to liberalization. A list with its recent acquisitions in Europe can be found in *EDF/EnBW*, Commission Decision, Case No. COMP/M.1853, para. 85 (Feb. 7, 2001) (unofficial version), available at http://europa.eu.int/comm/competition/mergers/cases/decisions/m1853_en.pdf.

24. See Acceleration Directive, *supra* note 9.

25. The Directives define these consumers as “eligible customers.” Electricity Directive, *supra* note 1, art. 19; Gas Directive, *supra* note 2, art. 18.

petition policy to deal with private barriers where State barriers have been successfully abolished through internal market policy. The process of European market integration is thus supported by the enforcement of the competition rules.

The traditional practice of electricity and gas suppliers to conclude exclusive long-term contracts with their customers can have the effect of a private barrier to the free choice of consumers.²⁶ Exclusive purchasing agreements on a long-term basis may violate the competition rules, in particular if the supplier enjoys market power. A dominant supplier has a special responsibility not to impair emerging competition.²⁷ If a dominant firm obliges customers to purchase exclusively from the firm on a long-term basis, competition from actual and potential competitors is impeded. This commercial practice constitutes an abuse of a dominant position within the meaning of Article 82 if it ties a substantial proportion of demand, unless the dominant firm can objectively justify the practice.²⁸ Ties constitute an abuse irrespective of whether exclusivity is stipulated without further qualification or whether it is undertaken in consideration of the grant of a rebate.²⁹ Since exclusive long-term contracts are the exception rather than the rule on competitive markets with sufficient liquidity as can already be observed on effectively liberalized markets, this commercial practice is *prima facie* not objectively justified. It is therefore one of the priorities of Community competition policy to pursue such exclusionary conduct of former monopolists on liberalized markets. This can be demonstrated by the example of the *Gas Natural/Endesa* case.

The former Spanish gas monopolist Gas Natural concluded a long-term gas supply contract with the leading Spanish electricity generator Endesa that covered basically all of its gas requirements for the foreseeable future and thereafter in accordance

26. See Exxon/Mobil, Commission Decision, Case No. IV/M.1383, paras. 59, 95 (Sept. 29, 1999) (unofficial version), available at http://europa.eu.int/comm/competition/mergers/cases/decisions/m1383_en.pdf.

27. See NV Nederlandsche Banden Industrie Michelin (Michelin) v. Comm'n, Case 322/81, [1983] E.C.R. 3461, para. 57.

28. Commission Notice, Guidelines on Vertical Restraints, O.J. C 291/1 (2000), para. 107, [hereinafter VRG]; BPB Indus. PLC & British Gypsum Ltd. (BPB) v. Comm'n, Case T-65/89, [1993] E.C.R. II-389, para. 68.

29. Hoffmann-La Roche & Co. AG v. Comm'n, Case 85/76, [1979] E.C.R. 461, para. 89. The use of an English clause or of fidelity rebates constitutes a *per se* violation for dominant firms. See VRG, *supra* note 28, para. 152.

with its perceived share of Spanish power production. Potential entrants to the Spanish gas market were thereby losing an attractive client, as electricity generators belong to the large volume consumers of gas. After the parties had been informed of the Commission's competition concerns, they modified their contract in terms of volume and duration. The volume purchased was reduced to the extent necessary to ensure, on the one hand, that Endesa would remain an attractive client in volume terms for new market entrants. On the other hand, Endesa's minimum requirements for the supply of the new power stations it intended to build were respected. The duration of the contract was substantially shortened thereby taking into account that Endesa would still have to build the power stations for which it purchases the gas.³⁰

It should be underlined that the Commission vigorously pursues exclusionary conduct towards all eligible customers within the meaning of the Directives whenever it is brought to its attention. This includes industrial consumers like power generators and traders where they are admitted as well as distributors.³¹ Otherwise, their legal empowerment remains without practical effect and they cannot benefit from liberalization. Community competition policy thus contributes to ensure free consumer choice on electricity and gas markets that forms one of the three prerequisites for effective competition.

III. FREE SUPPLY COMPETITION

The second essential prerequisite is free supply competition. The Directives provide in this regard a general obligation for Member States to create a new legal framework for the electricity and gas markets with "a view to achieving a competitive

30. See EU COMMISSION, ANNUAL REPORT: XXXTH REPORT ON COMPETITION POLICY 154-55 (2000); Press Release, EU Commission, Commission Closes Investigation on Spanish Gas Company Gas Natural, IP/00/297 (Mar. 27, 2001); Mariano Fernandez Salas, *Long-Term Supply Agreements In The Context Of Gas Market Liberalisation: Commission Closes Investigation Of Gas Natural*, 2 EC COMPETITION POLY NEWSL. 55 (2000), available at <http://europa.eu.int/comm/dg04/newsle/en/index.htm>.

31. Member States are entitled to exclude electricity traders from authorization on their territory. Electricity Directive, *supra* note 1, art. 17(1). Distributors are at least eligible customers themselves insofar as they supply eligible customers. Electricity Directive, *supra* note 1, art. 19(3); Gas Directive, *supra* note 2, art. 18(8).

market.”³² This led in practice to the abolition of monopoly rights, in particular monopoly import and export rights. The fifteen national electricity and gas markets are now open for trade. In addition, special or exclusive rights of incumbent energy suppliers had either to be lifted or modified by Member States in order to allow for competition. The grant of special or exclusive rights is closely linked to the provision of public services, for example, the right of final consumers to be connected to and supplied by the grid. Since the issue of public service obligations concerns not only suppliers but also network operators, it will be discussed separately below.³³

The Directives deal with the issue of supply competition not only in a general clause but also through the explicit regulation of new market entry. They stipulate that new entry must be permitted under the transparent, objective, and non-discriminatory terms of an authorization procedure.³⁴ Thus, the Directives create the fundamental conditions for supply-side competition between incumbent operators as well as between incumbents and new market entrants. Electricity and gas liberalization, however, has not been launched in a “greenfield” situation. The existing monopolistic supply situation will not evolve overnight into a competitive market structure.

A. *Electricity*

Many electricity markets in the fifteen Member States have been dominated by a generation monopoly before liberalization. Almost all national markets have been characterized by monopolistic supply areas.

The majority of suppliers active on the various national markets are vertically integrated transmission system operators and thus control the access to their traditional supply area. New market entry through the construction of power plants is gener-

32. Electricity Directive, *supra* note 1, art. 3(1); Gas Directive, *supra* note 2, art. 3(1).

33. *See infra* Part V.

34. *See* Electricity Directive, *supra* note 1, art. 4 (generation); Gas Directive, *supra* note 2, art. 4 (gas supply). Regarding electricity, Member States could also opt in favor of a tendering procedure instead of authorization; however, only one Member State did. *See* Acceleration Directive, *supra* note 9, new art. 5 (proposing to render the authorization procedure obligatory).

ally facilitated by new production technology³⁵ and the parallel liberalization of gas markets. These positive factors have to be balanced against the slow growth of consumption, existing overcapacity of generation in many Member States, and the persisting market dominance of the former legal monopolists, which probably discourage new entry. Import competition would thus seem to be the most promising source of supply competition at least in the shorter term. The sometimes very different price levels of the various national markets, which among other things, are being caused by the different fuel mix of generators, create a powerful incentive for trade. However, the grids of only a few Member States are sufficiently interconnected to allow for the rapid development of real cross-border markets or, at least, for substantial trade flows with an impact on the market conduct of incumbent suppliers.³⁶

In view of this situation, which is not conducive to effective supply competition, many Member States have not only implemented the provisions of the Directive but also engaged in the further re-organization of their domestic markets. Two approaches have become apparent. Some countries have been splitting up their power generation monopoly into several independent entities (mostly Member States with large domestic markets and State-owned generation) and have organized market places for the wholesale of electricity, for instance, through the creation of pools.³⁷ Other Member States opted for a "market expansion approach"³⁸ and created jointly through regulation larger geographical markets and thus increased the number of suppliers.³⁹ Most Member States, however, rely on market forces and the emergence of the internal Community market to develop genuine competition among electricity suppliers (among these are many countries with small domestic markets).

Although Community competition law does not allow the Commission to break up generation and supply monopolies without a violation of a competition rule, it can contribute to the amelioration of supply competition and the enlargement of mar-

35. IEA, *supra* note 5, at 19.

36. *See infra* Part IV.

37. *See* CEPR, A EUROPEAN MARKET FOR ELECTRICITY? 89-115, 164-80 (1999) (describing the UK and Spanish markets).

38. *Id.* at 229.

39. *See, e.g., id.* at 116-96.

kets. For example, there are generators that were forced before liberalization to sell all their electricity to the operator entrusted with statutory monopoly rights. These generators are very often still linked to former monopolists through long-term contracts, even after they have become competitors through liberalization. The former French legal monopoly EDF entertained such a relationship with Compagnie Nationale du Rhône (“CNR”). This company is a significant French producer of hydropower that remained economically independent after the nationalization of the French power industry some fifty years ago. The Commission took up the case and succeeded in cutting the contractual links so that CNR is required to gradually assume the sales function itself and enter into actual competition with EDF for customers.⁴⁰

Community competition law also comes into play in the restructuring process of the European power industry through mergers, acquisitions, and the formation of joint ventures. Many of these transactions are pro-competitive when they lead, for example, to new entry in product or geographic markets.⁴¹ Whenever a transaction has an impact on the market position of a former statutory monopolist, however, the competition effects have to be assessed very carefully. The Commission then has to examine the concrete state of development of the liberalized supply and transmission markets as well as the possibilities and likelihood of new market entry. In doing so, the Commission applies a dynamic approach. Foreseeable and imminent improvements of the conditions for competition as well as substantial remedies offered by the merging parties in order to either eliminate or compensate for negative competition effects are considered and may lead to the approval of an operation that would have been prohibited under a static view of existing market conditions and positions. This can be illustrated with the examples of the *VEBA/VIAG* and *EDF/EnBW* cases.

40. The case began as an antitrust procedure but was concluded in the merger procedure. *See infra* note 47.

41. *See* *EDF/London Electricity*, Commission Decision, Case No. IV/M.1346, O.J. C 92/10 (1999) (Jan. 1, 1999); *ENDESA/CDF/SNET*, Commission Decision, Case No. COMP/M.2281, O.J. C 179/09 (2001) (Apr. 17, 2001); *RWE/Karntner Energie*, Commission Decision, Case No. COMP/M.2513, O.J. C 286/03 (2001) (Aug. 2, 2001).

The first case, *VEBA/VIAG*,⁴² concerns the merger of two leading energy companies active on the already concentrated German power market with eight generators holding a combined market share of ninety percent. In its competition assessment, the Commission regarded the entire territory of Germany as the relevant market, although many suppliers still largely limit their activities to their previously protected monopoly supply areas. The Commission took a dynamic view of market development because the essential requirement for the nation-wide sale of electricity, the ground rules for third-party access to all networks, albeit still imperfect, had been adopted.⁴³

The Commission established that the consolidation would significantly increase concentration and create a dominant duopoly of two generators controlling sixty-eight percent of supplies. Underlying market conditions such as the homogeneity of the product, the transparency of the market, and the limited growth in demand would favor parallel behavior of the two members of the duopoly. Of particular relevance were the numerous corporate links between them and with other competitors. In addition, the Commission found that the German system of negotiated third-party access to the grid gave the duopoly members competitive advantages over competitors.⁴⁴

In order to avoid a prohibition of their envisaged transaction, the parties offered to the Commission a number of commitments with the aim to remedy the established competition problems. Firstly, the companies undertook to reduce the corporate interrelationships between them. This undertaking eliminated the grounds for a common interest of the market leaders in peaceful parallel behavior and removed a tool for privileged access to information about the corporate strategy of the other member of the duopoly. At the same time these divestitures would have the positive effect of rendering a joint venture, called VEAG, which would otherwise been jointly controlled by the duopolists, a new independent competitor with significant competitive potential. Apart from these undertakings, the enterprises also committed themselves to less conventional remedies

42. See Commission Decision, Case No. COMP/M.1673, O.J. L 188/1 (2001) [hereinafter *VEBA/VIAG*].

43. *Id.* at 5-7, paras. 32-46.

44. *Id.* at 11-26.

and undertook, for instance, to drop the t-component surcharge for certain power transmissions within Germany that adversely affected competition from traders and smaller generators.⁴⁵ Another example of an unusual commitment is the undertaking of the merger partners to issue separate bills for network charges and energy prices in order to increase price transparency for their customers and to inhibit any cross-subsidization by the network monopoly in favor of the power sales department being under competitive pressure.⁴⁶ The Commission regarded these commitments together as sufficient to remove the competition concerns arising out of the envisaged consolidation and allowed it consequently to go ahead.

The second case, *EDF/EnBW*, concerned the acquisition of a potential competitor from another Member State by a former national monopolist. EDF, the leading electricity generator in France, intended to acquire EnBW, a member of the group of the four largest German generators that had been formed after the already mentioned VEBA/VIAG merger.⁴⁷ The Commission found that the target company, which has its historic supply area adjacent to the French-German border, was one of the few potential entrants particularly well placed to enter the French market. EnBW had an incentive to enter at a significant scale and, indeed, the company had already participated in tenders launched by French eligible customers, through a Swiss generation subsidiary.⁴⁸ Furthermore, it was established that EDF would become in general less exposed to competition in France after the acquisition. It would be in a position to use its presence in Germany to deter its rivals from pursuing aggressive competition in the French market. Moreover, it would control a large part of the Swiss generation and supply of peak load, the access of which is not only important for EDF itself, but also for its competitors on the French market. Finally, through the entry into the German market, EDF would further strengthen its already

45. See *infra* Part IV.A.

46. See *VEBA/VIAG*, *supra* note 42, at 38-41.

47. See *EDF/EnBW*, Commission Decision, Case No. COMP/M.1853 (Feb. 7, 2001) (unofficial version), available at http://europa.eu.int/comm/competition/mergers/cases/decisions/m1853_en.pdf

48. Approximately 30% of French consumption or 1,206 company sites are open for competition. *Id.* para. 14.

outstanding position as a pan-European supplier of large business customers with production sites all over Europe.

The Commission approved the envisaged transaction only after EDF had made several major commitments. Of particular interest is the innovative commitment to make available to its competitors, via auctions, access to generation capacities located in France, which amount to thirty to thirty-two percent of the national market for eligible customers. It was the prognosis of the Commission that access to virtual power plants in France will facilitate foreign suppliers to become active on the French market and improve their potential to conclude pan-European supply contracts. German suppliers especially will be in a position to gain a foothold and will thus be able to cope with EDF's increased retaliation potential after the acquisition. EDF will also divest the Swiss generation subsidiary of the target company in order to avoid any improvement of EDF's access to Swiss peak supplies. The *EDF/EnBW* case demonstrates that even a former monopolist can expand through acquisitions and thus try to make good on other markets any losses of revenues in the traditional sales area.

The Commission is not only concerned about the elimination of new entry by competitors from neighboring markets. It aims also at protecting *ex novo* entry through new power generation. Gas is one of the energy sources from which electricity will increasingly be produced in the future because of its economic and environmental advantages. It is expected that the growth of the gas market in the next decade will to a considerable extent be driven by the use of gas as a fuel for electricity generation.⁴⁹ A merger between the dominant electricity supplier and the dominant gas wholesaler, both active on the same geographic market, may thus allow the electricity supplier to gain control over one of the most important sources of competition for the electricity supply market. The Commission has already intervened twice against transactions threatening to foreclose access of new entrants to the gas market.⁵⁰

49. See Directorate-General for Energy, *Economic Foundations for Energy Policy*, Special Issue, ENERGY IN EUROPE, at 27, 98 (Dec. 1999), available at http://europa.eu.int/comm/energy/library/executive_sum.pdf.

50. See Tractebel/Distrigaz, Commission Decision, Case No. M.418, paras. 47-49 (Sept. 1, 1994); Neste/IVO, Commission Decision, Case No. IV/M.931, paras. 47-61 (June 2, 1998), available at <http://europa.eu.int/comm/competition/mergers/cases/>

Other competitive advantages that a dominant supplier endeavors to obtain through a merger may also trigger the Commission's attention. For example, the leading French supplier EDF envisaged forming a joint venture for the trade of electricity and other forms of energy with a well-established trading company. France had not implemented the liberalization Directive at the time of the formal notification of the joint venture. The conditions and terms of third-party access to the French electricity grid as well as the identity of eligible customers in France were not known. EDF would not only have been the sole electricity generator but also the only energy trader in France until the effective opening up of the French market. The company would thus have been able to gain a significant first mover advantage over its competitors that were still barred from entry. In order to avoid a prohibition decision, EDF had to concede to the Commission that it would offer energy trading services in France only after the market has really been opened up for competitors.⁵¹ This case shows that even a dynamic approach, which takes into account all short-term improvements of the current market situation reaches its limits under EC merger control where the date of entry into force of the new legal framework is not known.

Finally, the emergence of supply competition on electricity can also be impeded by the grant of State aid. The control of financial aid given to enterprises by Member States is therefore another important instrument of Community competition policy in the liberalization context. A particular issue is the grant of State aid to compensate companies for so-called "stranded costs."⁵² Prior to market opening, some electricity undertakings, at times under the direction of the State, invested in assets or entered into contracts, which may prove to be unprofitable. However, the existence of a fixed tariff established by the State

decisions/m931_en.pdf. An additional ground for the intervention in these cases was that the dominant electricity producer would be able to influence the choice of industrial consumers whether to engage in own-production of electricity or to continue purchasing from the incumbent. *Id.*

51. EDF/Louis Dreyfus, Commission Decision, Case No. COMP/M.1557 (Sept. 28, 1999), O.J. C 323, at 11 (Nov. 11, 1999), available at http://europa.eu.int/comm/competition/mergers/cases/decisions/m1557_fr.pdf.

52. The Electricity Directive also provides for transitional measures if a Member State sees difficulties arising for its electricity industry in the timely implementation of all obligations for market opening. See Electricity Directive, *supra* note 1, art. 24.

gave them the assurance that these investments or contracts would be financed by their customers. Following the opening of the electricity sector for competition and the drop in electricity prices, some of these investments and contractual commitments may lose all prospects of being recovered—they become “stranded.”

The Commission currently is investigating a series of cases where Member States set up aid schemes for electricity suppliers.⁵³ It acknowledges in principle that stranded costs may appreciably affect the competitiveness of companies and considers that State aid that merely compensates stranded costs for a certain period of time may be authorized under the EC Treaty (Article 87) in circumstances where such aid favors the transition of its beneficiary to competitive markets. It must be assured, however, that the financial support really is limited to what is necessary to compensate for stranded investments. Otherwise, the distortion of competition would not be acceptable. In addition, the methods of financing aid intended to offset stranded costs chosen by Member States must not have the effect of deterring new market entry. For instance, aid should not be recouped from levies on cross-border transmissions of electricity. This would only have the detrimental effect of creating another hurdle for import competition. A methodology for the analysis of the compatibility of such State aid has been elaborated by the Commission in cooperation with the Member States and was recently adopted.⁵⁴ It will guide Member States when adopting aid schemes and allow the Commission to coherently analyze the cases already under investigation.

The control of public support schemes always requires the qualification of the support as State aid within the meaning of the EC Treaty. Recently the European Court of Justice had to deal with this problem in the context of a certain German act,

53. The Commission is analyzing cases related to Belgium, Denmark, Germany, Greece, Italy, and the United Kingdom. The Austrian, Dutch, Spanish, and British cases have recently been concluded. The decisions are available at [http:// europa.eu.int/comm/secretariat_general/sgb/state_aids/industry](http://europa.eu.int/comm/secretariat_general/sgb/state_aids/industry). See also Press Release, EU Commission, Commission Gives Green Light to “Stranded Costs” Compensation by Spain, Austria and the Netherlands, IP/01/1079 (July 25, 2001).

54. See Press Release, EU Commission, Commission Adopts Document on “Methodology for State Aid Linked to Stranded Costs” in the Electricity Sector, IP/01/1077 (July 25, 2001).

the so-called *Stromeinspeisungsgesetz*.⁵⁵ This law foresaw that energy companies—irrespective of whether they are private or public—had to buy “green electricity” at fixed prices exceeding market prices. The financial assistance was thus not handed out by the State but by companies. The Court ruled that the scheme did not constitute State aid as long as the company obliged to buy green electricity is a private one, which was the case in the matter before the Court. The Commission is at present examining the precise consequences of this decision for its State aid policy. The issue of stranded costs shows that the Commission actively and comprehensively applies all instruments of Community competition policy in order to improve the conditions for free supply competition on European electricity markets.

B. Gas

The pre-liberalization situation for supply competition on gas markets in the fifteen Member States is in many respects very similar to that of electricity. Gas is, however, a natural resource not found in every Member State. The EU as a whole is a net importer of gas. Since almost all Member States import gas, gas production markets have always had a wider than a national dimension.

Gas fields are mostly developed jointly by several companies. Joint development is very often coupled with joint selling. Some gas exporting countries favor the joint selling of all gas produced on their territory. Producers form the top of the “gas column.”⁵⁶ They sell traditionally to one importer or import organization per Member State. Importers are regularly vertically integrated transmission companies and also take care of transport of the purchased gas over long distances through high-pressure pipelines; at least once it has reached the border of their Member State.⁵⁷ There, importers sell the gas on to power generators, regional and local distributors, and industrial customers. Distributors are, again, vertically integrated with a distribution network operator, which transmits the gas to the final consumers. Distributors may be separate and independent from importers. They are, however, as the other members of the vertical chain,

55. See *PreussenElektra AG v. Schleswag AG*, Case C-379/98, [2001] E.C.R. I-2099.

56. See *Exxon/Mobil*, *supra* note 26, paras. 48-51.

57. Some importers are also vertically integrated gas producers.

closely linked to importers through long-term supply contracts. There existed little, if any, "gas-to-gas" competition within the vertical chain led by an importer. Indeed, like in the electricity sector most gas companies enjoyed a monopoly in their historical supply area. Each vertical chain operated in isolation from parallel chains in other Member States before liberalization.⁵⁸ The isolation of the national supply chains forms a stark contrast to the fact that approximately fifty percent of all gas consumed in the EU crosses at least one border. After liberalization, new entry is attracted by the high growth potential of gas consumption and significant possibilities for price arbitrage, but impeded by the insufficient liquidity of the downstream supply markets and the long-standing supply relationships between producers and importers upstream.

Member States are generally taking lesser measures to improve the conditions for competition on gas supply markets than they have been engaged in the organization of electricity markets. Some have introduced gas release programs (i.e., gas purchased under long-term contracts from producers is transferred to interested wholesalers), capped the market share of the incumbent importer, or have done both. Most Member States rely, as for electricity, on market forces and the internal market to bring about effective competition.

Community competition policy contributes to the development of gas-to-gas competition at a Community-wide scale through a review of the contractual arrangements at all levels of the supply chain. One particular focus of enforcement activity is the joint selling agreements between gas producers. Technical and commercial constraints do not seem *prima facie* to require joint selling. Import monopolies are no longer justified, even if they may have been a valid justification under the competition rules.

The Commission therefore had serious doubts whether to exempt from the prohibition of Article 81(1) the envisaged collaboration of owners of a newly discovered gas field west of Ireland in the Atlantic. The parties decided subsequently to with-

58. The gas market is not equally developed in all countries. In Greece and Portugal, for instance, a natural gas industry is only emerging. This explains why these countries have been given special derogations from the obligations of the Directive. See Gas Directive, *supra* note 2, art. 26(2).

draw the notification of their intended joint selling agreement and declared that they would market their gas separately.⁵⁹ Furthermore, the Commission initiated formal proceedings against the participants of the Norwegian Gas Negotiation Committee ("GFU"). The organization was created in the early 1980s and was in charge of negotiating all contracts with European importers for the supply of gas produced by some twenty companies on the Norwegian Continental Shelf. It was the GFU that decided who could buy Norwegian gas and under what conditions. The Commission considered the GFU to be a cartel falling under the prohibition of Article 81(1). It is true that the Norwegian State was closely involved in the organization of Norwegian gas exploration and production. The State was aware of the existence of the GFU and supported it to a certain degree. It remains to be seen, however, to what extent the involvement of the State and the State interest in the management of natural resources contravenes or mitigates the Commission's initial assessment of the GFU falling under the cartel prohibition as claimed by the Norwegian gas producers.

The Commission initiated formal proceedings even after the Norwegian government announced that the GFU would be abolished. The abolishment of the GFU may have a very positive effect on competition among gas producers for future gas sales. The activity of the GFU in the past, however, probably will have a long-lasting adverse effect well into the future that may have to be addressed as well.⁶⁰

The aim of the on-going Commission review of horizontal arrangements among gas producers clearly is to put an end to the tradition of artificially reducing the number of independent players through joint selling arrangements. Price fixing is considered one of the most harmful restrictions of competition under Community competition law and is therefore almost always prohibited.⁶¹

Another focus of enforcement activity concerns arrangements that restrict cross-border competition between the mem-

59. See Press Release, EU Commission, Enterprise Oil, Statoil and Marathon to Market Irish Corrib Gas Separately, IP/01/578 (Apr. 20, 2001).

60. See Press Release, EU Commission, Commission Objects to GFU Joint Gas Sales in Norway, IP/01/830 (June 13, 2001).

61. See Commission Guidelines on the applicability of Article 81 of the EC Treaty to horizontal cooperation agreements, O.J. C 3/2 (2001), para. 25.

bers of the vertical gas supply chain existing in each Member State. A series of pending cases concerns direct territorial sales restrictions. These restrictions have been found in long-term supply contracts between producers and European importers. A so-called destination clause prevents the importer from reselling the purchased gas outside his traditional supply area, normally being the Member State in which he is located. Its main purpose seems to be to protect the pricing formula for gas called the "market value principle." According to this principle, the gas is priced differently depending on the alternative energy sources available to gas buyers in each individual Member State.⁶² Since producers agree to discount from the market value price the costs of bringing their gas to the country of consumption (net-back),⁶³ they have their own interest in maintaining the clause.

The clause is directly opposed to the internal market goal of the Community and is considered to be a "hard core" restriction of competition.⁶⁴ The measure has the object and effect of segregating the fifteen national markets and maintaining prevailing price differences. There is no doubt, the destination clause is void under Article 81 and its observance may be pursued with fines (Article 15, Regulation 17). Given the absolute incompatibility of territorial sales restrictions with the internal market goal, the Commission will of course also pursue all indirect measures aimed at inducing a gas purchaser not to re-sell to customers outside his traditional supply territory, such as refusal or reduction of bonuses or discounts.⁶⁵ The Commission is aware of other restrictions of effective gas-to-gas competition within the vertical supply chain. It may have to tackle these one by one in collaboration with national competition authorities in order to bring about a change to what seems to be the commercial traditions of the sector.

Another example of the limitation on supply competition is use restrictions. It was established that a dominant gas importer imposed use restrictions in a sales contract with an electricity

62. Exxon/Mobil, *supra* note 26, paras. 52, 62.

63. *Id.* para. 101.

64. *See* VRG, *supra* note 28, para. 49.

65. *Id.* *See* Volkswagen AG v. Commission, Case T-62/98 [2000] E.C.R. II-2707 (July 6, 2000); Glaxo Wellcome, Commission Decision, Case No. COMP/36.957, May 8, 2001, O.J. L. 302/1 (Nov. 17, 2001).

generator. The generator was only allowed to use the purchased gas for power production. He was neither permitted to sell the gas to final consumers through his own gas distribution network, nor was he allowed to sell it to other industrial consumers. The Commission intervened against the use restriction. It considered the restraint to constitute an abuse of a dominant position because it enables the supplier to practice price discrimination in accordance with the demand flexibility of his various customer groups. Moreover, use restrictions artificially reduce market liquidity when a generator does not require all gas purchased for power production. The restraint thus forms an obstacle to the development of gas spot markets.⁶⁶

The emergence of effective gas-to-gas competition can finally be hampered by mergers and acquisitions. The Commission therefore took care that the take-over of Mobil by Exxon did not produce negative competition effects. The transaction mainly had an impact on the global oil and gas sectors, of course. However, it also affected the downstream gas markets in the Netherlands and Germany. Both markets are characterized by a supply structure that was not very favorable for competition even before the intended operation. The Dutch wholesale market was dominated by a single company, whereas the German market was controlled by a narrow oligopoly. Exxon was indirectly active on both markets through major equity stakes in the market leaders. In contrast, Mobil was one of the few outsiders with a certain competitive potential because of its own gas production and not yet fully committed reserves. The take-over would have diminished if not completely eliminated the competitive potential of Mobil and thus resulted in the strengthening of the dominant incumbents to which Exxon belonged.⁶⁷ The merger parties agreed therefore with the Commission to re-establish the *status quo ante* on the Dutch market and sell Mobil's Dutch gas business to an interested third party. The remedy for the competition problem on the German market consisted in the divestiture of one of Exxon's stake holdings in a German wholesaler that compensated for the loss of competition through the integration of Mobil's gas business.⁶⁸

66. See Commission Closes Investigation on Spanish Gas Company Gas Natural, *supra* note 30.

67. Exxon/Mobil, *supra* note 26, paras. 205-23, 230-58.

68. *Id.* paras. 828-34.

In the case of the gas supply markets, at present the transition from monopoly to competition is mainly accompanied by the two instruments of EC antitrust rules and merger control. The success of the transition seems to depend to a significant extent on the successful transformation of the gas column into a supply chain where each member is free to compete with other members at all levels and throughout the Community. Free supply competition (the second prerequisite for effective competition on the European electricity and gas markets) is obviously much more difficult to accomplish than the first prerequisite (free consumer choice of suppliers).

IV. OPEN ACCESS TO NETWORKS

The third prerequisite for effective competition concerns a particular feature of the electricity and gas sector: the network. Deliveries of electricity and gas are effectuated through an energy-transmitting network connecting suppliers with their customers. Most components of the electricity grid and gas pipeline systems constitute natural monopolies because their duplication would be inefficient due to the large fixed costs of the investment.⁶⁹ Open access to the network for suppliers and consumers is thus essential for free supply competition and free consumer choice of suppliers. Similarly, exporters and their customers must have open access to the lines connecting distinct networks of different Member States.⁷⁰

The Directives oblige Member States accordingly to open up all existing networks for suppliers and eligible customers located "either inside or outside the territory covered by the interconnected system."⁷¹ Most countries created a regulated system of access procedure (so-called regulated third-party access ("TPA")), granting users a right of access on the basis of published tariffs approved by a regulatory authority.⁷² Since in al-

69. IEA, *supra* note 5, at 19-20.

70. For electricity these cross-border lines are called interconnectors. *See* Electricity Directive, *supra* note 1, art. 2, at 10.

71. *Id.* art. 17; Gas Directive, *supra* note 2, arts. 15, 16.

72. *See* Electricity Directive, *supra* note 1, art. 17(4); Gas Directive, *supra* note 2, art. 16. Some Member States opted for the alternative system of negotiated third-party access—also permitted by the Directives. This trend was more pronounced for gas than for electricity. Electricity Directive, *supra* note 1, art. 17(1); Gas Directive, *supra* note 2, art. 15. The Commission proposes in the Acceleration Directive to admit in future

most all Member States network operators are vertically integrated with electricity or gas supply businesses, the opening of networks for all interested users means that operators have to give access not only to their network but *de facto* also to their traditional customer base for the supply of electricity or gas. This creates a risk of discrimination in favor of their own supply interests whenever an operator receives an access request.

The Community legislator was aware of the discrimination risk and obliged vertically integrated electricity and gas enterprises therefore to “unbundle” their network from supply interests. Unbundling means separation of accounts,⁷³ creation of “Chinese Walls” to preserve the confidentiality of commercially sensitive information of network users⁷⁴ and, for electricity networks, the separation of management through designation of a system operator who acts independently from supply interests.⁷⁵

The Directives obviously fall short of ordering ownership unbundling of the network. Instead network operators are obliged not to discriminate in favor of their or their shareholders’ supply interests when dealing with third-party access requests.⁷⁶ The observance of this non-discrimination obligation has to be monitored by a competent and independent “dispute settlement” authority established in each Member State.⁷⁷

Most Member States in practice have gone further than the Directives and have required legal or ownership separation.⁷⁸ From a competition policy point of view, further unbundling than that foreseen by the Directives would seem to be not only appropriate but also necessary. Behavioral obligations and regulatory supervision arguably are always second best to structural separation in order to effectively eliminate economic incentives for discrimination. Stricter unbundling appears all the more appropriate if it is true that the loss of economies of vertical inte-

regulated third-party access (“TPA”) only. See Acceleration Directive, *supra* note 9, new art. 16.

73. See Electricity Directive, *supra* note 1, art. 14; Gas Directive, *supra* note 2, art. 13.

74. See Electricity Directive, *supra* note 1, arts. 9, 12; Gas Directive, *supra* note 2, arts. 8, 11.

75. See Electricity Directive, *supra* note 1, arts. 7, 10.

76. See *id.* arts. 7(5), 11(2); Gas Directive, *supra* note 2, arts. 7(2), 10(2).

77. See Electricity Directive, *supra* note 1, art. 20; Gas Directive, *supra* note 2, art. 21.

78. This has been more pronounced in electricity than in gas.

gration is small in the electricity and gas industries.⁷⁹ The Commission has recently proposed to go one step further and make the legal separation of network and supply interests compulsory.⁸⁰ It acknowledges that ownership separation would lead to “a more rapid and equitable development of an effective internal market.” The Commission intends however to further monitor whether “effective and non-discriminatory access develops” under legal unbundling before it will consider complete unbundling.⁸¹

A. *Development of Transmission Tariff*

Community competition policy applies its legal instruments to effectively ensure open access to networks for suppliers and consumers. In particular, the EC antitrust rules are enforced to deal with the two principal issues of exploitative conduct of network monopolies and discriminatory practices of vertically integrated network operators.

One of the major issues has been the development of fair tariffs for the provision of transmission services to third parties. Before liberalization, transmission in almost all Member States was an internal transaction within the same firm or was not even regarded to be an activity separate from energy supply. To establish a price and terms for the use of networks therefore has been of paramount importance for the introduction of supply competition. The Commission has contributed to the tariff development through the creation of regulatory fora where national regulatory authorities, industry participants, and other interested parties are discussing methods to calculate appropriate tariffs and measures to organize the cross-border transmission of electricity and gas.⁸² When necessary the Commission has also intervened on the basis of competition law against tariffication systems that are discriminatory, not cost-reflective, or both.

The German network operators, for example, decided to introduce a tariff for electricity transmissions, which among other factors, was based on the distance between the feed-in point of

79. IEA, *supra* note 5, at 25-26.

80. See Acceleration Directive, *supra* note 9, new art. 10(4).

81. *Id.* at 6. The proposal is explicitly only for gas, but applies to electricity networks, too.

82. See Energy Communication, *supra* note 4, at 10 (for the fora of Florence and Madrid).

the generator and the off-take point of his customer.⁸³ The Commission objected to the so-called distance component of the German tariff because the path for the physical delivery of electrons in densely meshed networks is not determined by the individual contract path between the generator and his customer. In this regard electrons are not comparable to other goods. They do not travel like coal, for instance, but obey the "law of the least resistance." A dominant network operator charging a tariff on the basis of an erroneous parallel to other goods is committing an abuse within the meaning of Article 82 because his tariff charge is not related to the actual cost incurred. Moreover, the distance component discriminates in favor of generators in the vicinity of consumers. The Commission therefore had serious doubts whether the German tariff was compatible with the Community competition rules.⁸⁴

German network operators decided subsequently to abolish the distance component and introduced a non-transaction-based tariff. The price for transmissions depended now on the consumption of each individual consumer. This held at least for transmissions within a newly created Northern and Southern zone in Germany. Exports and imports as well as domestic transmissions from one zone into another, however, were charged an additional price, called "t-component." The Commission objected again because of the discrimination of exports and imports as well as certain domestic long-distance transmissions. It regarded the t-component as arbitrary and therefore not cost-reflective as required for dominant firms in accordance with Article 82.⁸⁵

It is not the aim of the Commission to require a uniform tariff without any locational component for all electricity transmissions within Europe. However, tariffs of dominant network operators for the transport of electricity should be in line with the laws of physics and, accordingly, the actual cost incurred in

83. Germany is the only Member State with a negotiated TPA system for electricity transmissions. Industry associations have therefore been negotiating tariffs and terms for electricity transmissions. The so-called association agreement is, however, not compulsory for individual network operators.

84. See COMMISSION OF THE EUROPEAN COMMUNITIES, XXVII REPORT ON COMPETITION POLICY 156-59 (1998); Levasseur, *Développements les plus récents*, 3 COMPETITION POL'Y NEWSL. 43-46 (1998).

85. The t-component was later dropped for inter-zonal transmissions as a condition for the approval of the VEBA/VIAG merger. See *VEGA/VIAG*, *supra* note 42.

the network that is used for transmission. The Commission is therefore of the opinion that tariffication systems should not be based on the individual commercial transaction between a supplier and his customer. Instead of being "transaction-based," charges should relate to the connection or network access. Furthermore, for cross-border transmissions "pancaking" should be avoided. Pancaking occurs, if each country located between a supplier and his customer imposes a charge for the transmission through its grid. This would seriously impede trade between Member States. The Commission is therefore opposed to any additional charge for exports or imports of electricity. It favors a system where network operators compensate each other for the cost of transmissions in their networks. The compensation mechanism should be based on the actual net physical flow of electricity between networks within a certain period of time. The network hosting such flows should be remunerated by the network causing such flows.⁸⁶ The users of the network causing the flows should indirectly, but ultimately have to bear the cost for cross-border transmissions. Competition policy could not introduce such a system. However, it should be considered whether it could be created by internal market policy.⁸⁷

B. *Dealing with Congestion*

The other major network issue of EC competition policy apart from tariffication has been congestion management.

Electricity networks have been built in the past to serve a national, not a European market. Before liberalization almost all of the electricity produced in the fifteen Member States was also consumed in each of these countries. Approximately eight percent of total Community production has been traded between Member States.⁸⁸ This situation changes through market opening. The existing significant price differences between national markets provide a strong incentive for cross-border trade. It has already been pointed out how important import competition is for the improvement of the prevailing supply structure in

86. See Energy Communication, *supra* note 4, at 11.

87. See Proposal for a Regulation of the European Parliament and of the Council on Conditions for Access to the Network for Cross-border Exchanges in Electricity, COM (2001) 125/4; Conclusions of the 7th Forum of Electricity Regulators at Florence in February 2002.

88. See Energy Communication, *supra* note 4, at 9.

many Member States.⁸⁹

The European network infrastructure, however, has to be substantially improved to allow trade to grow and import competition to have a substantial impact on the market conduct of incumbent suppliers. Many lines connecting the distinct grids of Member States have quickly become congested after market opening. Transmission system operators are introducing special procedures for the allocation of bottleneck capacity because demand for cross-border transmissions has become constantly higher than supply. The procedures most frequently applied are auctions, *pro rata* rationing, and "first come, first served."⁹⁰

Auctions have been criticized because they allow network operators to gain windfall profits on top of their regular transmission income. The additional revenue for the use of the bottleneck facility tends to equal the difference between the average prices for electricity in the exporting and importing Member State. Import competition is thus likely to be deprived of most of its procompetitive impact on high-price markets. A vertically integrated supplier and network operator may thus benefit not only from his dominant position on the national supply market, but also from his auction income that is likely to be influenced by the national price level mainly determined by him. Auctioning of bottleneck capacity has therefore been criticized as an abuse of a dominant position.

It is true that *pro rata* rationing of transmission requests and the allocation of capacity in accordance with the timely order in which requests arrive keep the price for transmission lower and allow imports to exercise a stronger constraint on electricity prices in the import market. Both allocation methods suffer, however, also from certain weaknesses. *Pro rata* rationing does not function effectively when demand massively surpasses supply. The capacity attributed to each individual request may be-

89. See *supra* subsection III.A.

90. The Scandinavian Members States organized an electricity market that encompasses all their previously national markets and introduced a market splitting mechanism. This means that as a reaction to the occurrence of congestion, there will be different market prices on either side of the bottleneck. Thus, electricity in the area that is oversupplied becomes cheaper than electricity in the undersupplied area. Consequently market participants are relatively less interested in purchasing from the area that becomes more expensive and the resulting flow over the bottleneck is reduced. See Commission of the European Communities, Second Report to the Council and the European Parliament on Harmonization Requirements, COM (1999) 164 Final, at 37.

come so small that it is no longer commercially interesting. The allocation of capacity on the basis of "first come, first served" lacks transparency and increases significantly the risk of discrimination, if the allocating network operator has himself export interests.

In contrast, the auctioning of scarce transmission capacity is a transparent allocation method, operational under all demand conditions. It provides price signals to market participants and should permit the lowest cost supplier to obtain transmission rights. Auctioning thus does not constitute by itself an abuse of the dominant position of the interconnector operator. Regular auctions generate, however, additional income for the operator. Collecting the additional income as a profit may therefore be abusive, if proceeds are not used to reinforce the transmission capacity of a constantly congested bottleneck facility or to reduce the cost of cross-border transmissions for exporters.⁹¹

Congestion is at some borders further aggravated by the transmission capacity permanently reserved for large import contracts that have been concluded before liberalization. These long-term contracts reduce the technically already limited capacity even further, which is available for new entrants. The Commission is currently investigating the import contracts and capacity reservations that incumbent operators enjoy at the most congested borders between Member States. To grant priority rights to transmissions of former monopolists may constitute discrimination and thus is an abuse of the dominant position of the allocating interconnector operator. The Commission will, of course, consider objective justifications for alleged priority rights, in particular if the parties to an import contract have made investments in order to execute their agreement that have not yet been amortized.

Some import contracts pre-dating liberalization have already been modified by the parties while the Commission was investigating them. A long-term contract for the transmission of electricity between Norway and Germany via Denmark has, for instance, been changed to the effect that the full capacity of the line is now open to third parties.⁹² Similarly, the interconnector

91. See *supra* subsection III.A.

92. See EU COMM'N, ANNUAL REPORT, XXXTH REPORT ON COMPETITION POLICY 155-56 (2000); Press Release, EU Commission, Increased Scope for Electricity Import Com-

between France and the UK has been made available for all market participants because the parties previously using the full transmission capacity of the submarine cable decided not to extend their existing reservation contract.⁹³

All measures taken to make the best use of the existing cross-border transmission capacity, however, cannot hide the fact that significant investments are necessary to adapt the European network infrastructure to the requirements of competitive, Community-wide supply markets. Fifteen national network systems have to be transformed into a Trans-European network.⁹⁴ To increase the capacity of an existing interconnector or to build a new link between networks that have been operating in isolation from each other in the past will therefore normally be procompetitive. The Commission encourages such investments. Competition problems may arise, however, if third parties are restricted in the use of new transmission capacity.

The Commission intervened in the case of a new interconnector where the TSO originally granted a power supplier priority rights for up to 100% of the available transmission capacity for fifteen years. The reservation had been concluded some years before the adoption of the Electricity Directive and had therefore not been awarded in an open and transparent procedure. The network operator, who is solely responsible for the construction of the new link between previously not interconnected grids, received funds from the European Community for the project. The Commission regarded the long-term reservation as excessive in terms both of capacity utilization and duration even when considering that it concerned a new submarine cable. After discussions with the competent national regulatory authority, the parties informed the Commission of modifications to their agreement reducing the reserved capacity utilization to fifty percent for the duration of less than six years. This enabled the Commission to approve the modified agreement.

Even the reservation of the full capacity of a new line for the

petition in Northern Europe—A Step Forward Towards an Internal Market for Electricity, IP/01/30 (Jan. 1, 2001).

93. See Press Release, EU Commission, UK/France Interconnector Opens Up, Increasing Scope for Competition, IP/01/341 (Mar. 12, 2001).

94. Communication from the Commission to the European Parliament and the Council, *European Energy Infrastructure*, COM(2001) (Dec. 20, 2001), available at <http://europa.eu.int/comm/energy/library/commu-infra-en.pdf>.

constructing parties may be compatible, however, with Community competition law, where the already existing interconnector capacity satisfies market demand for transmissions for the foreseeable future.⁹⁵

C. Cooperation with National Regulators

The creation of an open access regime for networks also constitutes a very good example of the close cooperation of the Commission with sector-specific regulatory authorities that most Member States specifically set up for the liberalized electricity and gas markets. The collaboration within the regulatory fora of Florence and Madrid where Community and national authorities meet to discuss cross-border transmission issues has already been mentioned. Another area of cooperation concerns the treatment of individual network access cases. The Directives provide that Member States empower their energy regulators with the authority to deal expeditiously with disputes concerning third-party access.⁹⁶ Community competition law and sector-specific regulation⁹⁷ will therefore very often apply in parallel in access cases, in particular if they concern access to cross-border lines. Multiple proceedings might lead, however, to unnecessary duplication of investigative efforts by the Commission and national authorities. In order to avoid such duplication, the Commission and national competition authorities have developed certain principles for the allocation of cases. It has been agreed, for instance, that the Commission should concentrate its enforcement efforts on cases having a particular political, economic, or legal significance for the Community.⁹⁸ It seems appropriate that this general principle applies also to the energy sector as it does with regard to other liberalized sectors.⁹⁹ Moreover, it has to be taken into account that national authorities have been especially called upon by the Community legislator to

95. See Commission Notice, O.J. C 247/11 (2001), art. 19(3) (publication of the Viking Cable project).

96. See Electricity Directive, *supra* note 1, art. 20; Gas Directive, *supra* note 2, art. 21.

97. In some Member States national competition law may apply instead of sector-specific regulation.

98. See Commission Notice, O.J. C 313/3, at 3 (1997) (on cooperation between national competition authorities and the Commission).

99. See Commission Notice, O.J. C 265/2, paras. 6, 18 (1998) (on the application of the competition rules to access agreements in the telecommunications sector).

deal with access disputes. It would therefore also appear to be reasonable that the Commission does not tackle access disputes with priority while there are related actions before a relevant national authority or court.¹⁰⁰ This seems even more justified in view of the duty of national authorities not to approve any practice or agreement contrary to Community competition law.¹⁰¹ This obligation has explicitly been confirmed for the electricity and gas sector by the Directives.¹⁰² The Commission thus does not have to intervene itself in every case in order to protect the Community rule of law and ensure a level playing field in the European electricity and gas markets. At the same time, case allocation and close cooperation between the Community and national instances should lead to a mutual reinforcement of both sets of rules through the close cooperation of all authorities involved.

It depends very much on the development of functioning transmission markets whether consumers can actually switch suppliers and whether suppliers can genuinely compete against each other. The Commission and national authorities make a combined effort to support the development of cost-reflective tariffs and proper congestion management on the basis of the Community competition rules and sector-specific regulation. It appears however that additional legislative measures as proposed by the Commission in the draft Acceleration Directive and Regulation on access conditions for electricity networks are indispensable to succeed in effectively open up networks.

V. *PUBLIC SERVICE OBLIGATIONS AND COMPETITIVE ENERGY MARKETS*

The provision of public services has always been a characteristic feature of the European electricity and gas industries. In order to ensure that the supply of electricity and gas responds best to the needs of consumers, large Member States traditionally impose obligations on suppliers to that effect. Such obligations can be grouped generally into three categories: security of

100. *See id.* para. 28.

101. Ahmed Saeed Flugreisen and Silver Line Reisebüro GmbH v. Zentrale zur Bekämpfung unlauteren Wettbewerbs, Case 66/86, [1989] E.C.R. 803, 838.

102. *See* Electricity Directive, *supra* note 1, art. 22; Gas Directive, *supra* note 2, art. 22.

supply, protection of the environment, and maintenance of service standards.

Before liberalization the provision of public services had been ensured through State ownership of energy enterprises or via sector-specific regulation. The opening of the electricity and gas markets for Community-wide competition created many concerns, mainly on the side of the beneficiaries of the previous market organization, as to the future of these services and their quality. Potential entrants in the liberalized markets, on the other hand, fear that enterprises entrusted with public service obligations will be granted special rights or public funds, which give them an unfair advantage in the competition for customers.

The liberalization of energy markets and the provision of public services neither exclude each other, nor are both objectives necessarily in conflict with each other. The Directives are a clear demonstration of this. They require Member States to open up their markets for all European competitors and, at the same time, confirm the existence of public services.¹⁰³ They leave the freedom of Member States to introduce public services untouched and intact. Some public services typical for both energy sectors are even mentioned in the Directives, for example, the obligation of distributors to connect and supply all consumers in a given area,¹⁰⁴ or the duty of network operators to give priority to environmentally friendly or indigenous fuel-using power installations when dispatching generating installations.¹⁰⁵

The Directives also rule how the competition and public service objectives can co-exist with each other. Both refer to the EC Treaty and in particular to Article 86(2). This means mainly that, if Member States wish to maintain or create new public services, they have to define and explicitly entrust enterprises with such a mission. It no longer suffices to instruct State-owned companies to perform public services. Furthermore, any restriction of competition introduced by a Member State in order to support the performance of a public service must not exceed what is necessary to guarantee effective fulfillment of the mis-

103. See Electricity Directive, *supra* note 1, art. 3(2); Gas Directive, *supra* note 2, art. 3(2).

104. See Electricity Directive, *supra* note 1, art. 10(1); Gas Directive, *supra* note 2, art. 9(2).

105. See Electricity Directive, *supra* note 1, art. 8(3)-(4).

sion.¹⁰⁶ The grant of special or exclusive rights to one or a limited number of enterprises has to be proportionate to the public service mission with which they have been entrusted. A Member State having the intention to uphold any of the existing monopoly rights in the electricity or gas sector and thus not implementing all of the key requirements for the creation of competitive Community-wide markets must notify the Commission of this plan.¹⁰⁷ The fact that to date no Member State has found it necessary to derogate from any of these key requirements after liberalization¹⁰⁸ demonstrates in practice that in the electricity and gas sectors competition and public services are compatible with each other.

This will not change when liberalization progresses and all consumers including all households can freely choose among suppliers. The Commission itself proposes in the draft Acceleration Directive to combine full market opening with the compulsory introduction of a number of public service obligations in the interest of final consumers. Among these are transparency requirements and low-cost dispute settlement mechanisms.¹⁰⁹ Additional minimum service standards as well as other public services can be secured through sector-specific regulation, the observation of which is monitored by regulatory authorities. Even the obligation to supply electricity at affordable and reasonable prices to final consumers¹¹⁰ can be guaranteed without maintaining existing supply monopolies. The total exclusion of competition in order to guarantee low prices for a particular group of consumers would seem to be disproportionate and not compatible with Article 86(2). Instead of maintaining monopolies, one consideration is to involve energy suppliers in financing the net extra cost of the universal service through a system of additional charges or a public service fund. Alternatively, State aid could cover the cost of the public service.¹¹¹ Prices re-

106. See Commission Communication on Services of General Interest in Europe, O.J. C 17/4, at 8, paras. 22-23 (2001). The term services of general interest covers market and non-market services that the public authorities classify as being of general interest and object to specific public service obligations. See *id.* at 23, Annex II.

107. See Electricity Directive, *supra* note 1, art. 3; Gas Directive, *supra* note 2, art. 3.

108. See Energy Communication, *supra* note 4, at 19.

109. See Acceleration Directive, *supra* note 9, new art. 3(3).

110. As being proposed by the Commission in the draft Acceleration Directive. See Acceleration Directive, *supra* note 9, new art. 3(3).

111. See Energy Communication, *supra* note 4, paras. 15, 26.

present, however, one of the principal areas upon which electricity suppliers compete, as the example of some fully liberalized markets shows. The introduction of genuine EC-wide competition may thus indeed be the best mechanism to improve the quality of services also for final consumers.¹¹²

CONCLUSION

The EU has successfully launched the liberalization of the electricity and gas markets. The creation of an internal energy market forms an important part of the Lisbon strategy for economic reform of the European Council.¹¹³ A new legal framework for a new competition-oriented market order is now in place. The economic transition process of the electricity and gas industries from monopoly to competition has begun in all fifteen Member States and is irreversible. We are already in the third year of electricity liberalization and the second year of gas liberalization.

It is also true, however, that the difficulties of the transition become more visible as the process advances. Transmission markets are beginning to work but only imperfectly. Competition between suppliers is emerging but has been hampered by the many advantages of incumbents, in particular those owning a network. Some new entrants are already withdrawing from the newly opened markets. Prices show a tendency to increase again after a period of price reductions. The "California experience" or, the "accident waiting to happen,"¹¹⁴ raised concerns about the new regulatory environment. Moreover, the political climate appears to be no longer as favorable for liberalization after the failure of the European Council in Stockholm in March 2001 to agree on a definite date for full market opening.¹¹⁵ The continuing imbalances in market opening and the public perception that some State-owned companies are taking advantage of the

112. See Commission Communication, *supra* note 106, at 22, Annex I.

113. See Lisbon European Council, Conclusions of the Presidency, E.U. BULL., no. 3, para. 17 (2000).

114. Paul L. Joskow, *California's Electricity Market Meltdown*, Working Paper, MIT Center for Energy and Environmental Policy Research (Sept. 28, 2001), at 29, available at <http://web.mit.edu/ceep/www/2001-006.pdf>.

115. See Stockholm European Council, Conclusions of the Presidency, E.U. BULL., no. 3, para. 17 (2001).

uneven liberalization further contributed to the negative development of the political climate.

The difficulties of the transition process must be taken seriously, but they can be overcome. The Acceleration Directive proposed by the Commission already deals with the imperfections of the first Directives. It suggests apart from rapid and full market opening additional qualitative measures like further unbundling of networks and the compulsory introduction of regulated third-party access in order to create a more level playing field for all market participants. Furthermore, Community competition policy will continue to support the liberalization process with all its instruments. The Commission will continue to enforce the competition rules against restrictive practices, market power increasing mergers, and distorting State aid. It will act in close cooperation with the national competition and regulatory authorities in order to enhance the effectiveness of the competition as well as the new sector-specific rules.

Moreover, it should be noted that the European Council is still fully committed to the objective of market opening. The Council failed in Stockholm to agree on a date for full market opening but did not fail to underline once again the importance of energy liberalization for the modernization of European industry and decided in March 2002 in Barcelona as a next step that all European non-household consumers shall enjoy freedom of choice of suppliers as of 2004 for electricity and gas. Furthermore, the governments of the fifteen Member States expressed their full support for the vigorous application of the competition rules against all obstacles to the internal energy market.¹¹⁶

Finally and most importantly, European consumers will continue to press for further liberalization. Even the only emerging competition on European electricity and gas markets has already demonstrated to their satisfaction that consumer choice significantly increases and supply offerings substantially improve through competition and the creation of Community-wide markets. After all, it should be the consumer that counts, shouldn't it?

116. See Stockholm European Council, *supra* note 115; Barcelona European Council, Conclusions of the Presidency, para. 37, available at <http://europa.eu.int/council/off/conclu/>.

ANNEX*

EU Electricity Market Opening

| | 2000 | 2003 | Later |
|----------------|------|-------------|-------------|
| Austria | 32% | 100% (2001) | 100% |
| Belgium | 35% | 50% | 100% (2007) |
| Denmark | 90% | 100% | 100% |
| Finland | 100% | 100% | 100% |
| France | 30% | 35% | n.a. |
| Germany | 100% | 100% | 100% |
| Greece | 30% | 35% | n.a. |
| Ireland | 30% | 40% | 100% (2005) |
| Italy | 35% | 70% | 70% |
| Luxembourg | 40% | +56% | 75% (2005) |
| Netherlands | 33% | 100% | 100% |
| Portugal | 30% | 35% | n.a. |
| Spain | 54% | 100% | 100% |
| Sweden | 100% | 100% | 100% |
| United Kingdom | 100% | 100% | 100% |
| EU—Average | 66% | 75% | 83% |

EU Gas Market Opening

| | 2000 | 2008 |
|----------------|-------|-------|
| Austria | 49% | 100% |
| Belgium | 58.7% | 100% |
| Denmark | 30% | 43% |
| Finland | 90% | 90% |
| France | 20% | 33% |
| Germany | 100% | 100% |
| Greece | 0% | 33% |
| Ireland | 75% | 100% |
| Italy | 96% | 100% |
| Luxembourg | 51.1% | 83.4% |
| Netherlands | 45% | 100% |
| Portugal | 0% | 33% |
| Spain | 72% | 100% |
| Sweden | 47% | 100% |
| United Kingdom | 100% | 100% |
| EU—Average | 78,9% | 91,5% |

* Extract from Commission Staff Working Paper, *Completing the internal energy market*, SEC(2001) 438.