# Will the sparks fly? The role of the European Union in the liberalisation of the electricity industry

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## 1. Introduction

The impact of the increasing liberalisation of the energy sector in general and electricity supply in particular is hard to deny. Yet just a few short years ago, such developments were almost unthinkable. A complex combination of factors has led to an increasingly favourable political and economic climate for market opening and competition. However, the benefits of these developments remain distinctly unevenly spread throughout Europe, while the potential difficulties that an unchecked liberalisation process can cause are slowly coming to the fore. The challenge faced by the European Union in this sector is to promote these developments while remaining alive to their potential social and environmental consequences. The recent Californian debâcle in the electricity supply industry has come at a particularly inappropriate moment for the European industry. Fears have been raised of the spectre of black-outs and security of supply; yet the European industry has not been structured in the same way by the regulatory environment and is unlikely to face such immediate calamities.[1] Nevertheless, the continued difficulties in creating more of a single market (rather than a rather fragmented area, still largely run on national or regional lines) need attention, as does the contribution that the electricity sector will have to make to achieving the environmental targets set by the Community for the near future.[2]

This sector is a particularly fast-moving and complicated one and much has happened in the past eighteen months or so that is worthy of discussion. This paper seeks to provide an overview of the major issues and developments that have arisen

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[1] Ofgem's Briefing for Journalists on 'The NETA Programme', 6 February 2001 (available at http://www.ofgem.co.uk/elarch/retadocs/neta_briefing6feb.pdf) stresses that there are very different circumstances on, for example, the market in England and Wales: 1. There is no capacity shortage; 2. There has been significant new plant commissioning since privatisation, so the average plant age is much lower; 3. There is little reliance on hydro-electricity; 4. No restrictions are placed on participants contracting forward; 5. There are no restrictions on the System Operator contracting forward and 6. No caps have been imposed on retail prices. However, recent reports suggest that Ireland may be heading into difficulties in this area, as it is experiencing worsening capacity shortages (due to a failure accurately to predict the extent of the increase in demand and caps on certain retail prices) (see Brown, J.M. 'Ireland battles to meet power demand' *The Financial Times*, Wednesday 21 February 2001, 8).

[2] Indeed, the Twelfth Report (1998-1999 session) of the House of Lords Select Committee on the European Communities ('Commission White Paper on Energy from Renewable Sources', 29 June 1999; see the electronic version available on the House of Lords website at: http://www.parliament.the-stationery-office.co.uk/pa/ld199899/ldselect/ldeucom/78/7801.htm) shows serious concern that the UK government's current approach will not achieve these environmental goals, despite their apparent technical feasibility. In this vein, the petrol protests of the autumn of 2000 in the UK showed the vulnerability of the environmental argument when massed commercial and social interests make their voices heard. Interestingly, the government did not with any great fanfare seek to justify high taxes on environmental grounds and shied away from suggesting this as a possibly valid reason for such a policy (perhaps because there is no concrete evidence that any of this extra taxation money is then directed towards solving just that sort of problem?).

during that time, delving more deeply into certain areas of more general legal interest and trying to pinpoint some of the key areas for future development.

## 2. The liberalisation Directive for the Electricity industry

The direct origins of the Directive can be traced back to the general philosophy underlying the Single Market initiative, launched by the Commission in its White Paper on June 15, 1985,[3] with its clear emphasis on the removal of barriers to the freedom of movement provided for by the Treaty, and the building of an internal market, without frontiers in the (then) EEC.[4] This change in philosophy, shifting from trying to achieve free movement to trying to overcome the *barriers* in the way of free movement, marked a new way of examining the 'familiar litany' of the four freedoms[5] and was not lost on those concerned with energy in Europe. This was especially so since it was clear that a more effective internal market in the Community would benefit tremendously from reduced energy costs and the potential improvement in security of supply which a more integrated EC energy market were expected to bring. After the inclusion in the Single European Act of 1986 of a clear commitment by the Member States to the achievement of the Single Market within a specified time frame, the Commission felt it was time to deal more explicitly with the question of an internal energy market.

The Commission Working Document on the Internal Energy Market of 1988[6] identified the need for transparency with regard to the barriers to developing such a market and promised wide-ranging consultation on the relevant issues. A clear concern was the general structure of the industry in Europe, but certain aspects were identified which (as the discussion below will show) are still key problems today, such as taxation and the interconnections between high-voltage systems. Further developments in the sector led to a growing degree of political will to achieve such reforms[7] and first the price transparency[8] and transit through transmission grids[9] Directives were passed. This was followed by the proposal for a Directive to create an internal market in electricity in 1992.

The negotiation process surrounding the Electricity Directive[10] was lengthy, complex and at times acrimonious. Tensions centred on the precise definition and mechanisms for third party access to the transmission grid, with France insistent that it would retain a system with a significant element of vertical integration. Finally, compromise was reached on the basis of the level of market opening to be achieved, in stages until 2003.[11]

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[3] COM(85)310, (1985).

[4] For an interesting account of the development of the Single Market Programme, see Lord Cockfield, *The European Union - Creating the Single Market*, (Wiley, 1994).

[5] *Ibid*, pp. 38-41.

[6] Commission Working Document on the Internal Energy Market, COM(88)232, (1988).

[7] See, for a brief discussion, Johnston, A.C. 'Maintaining the Balance of Power: Liberalisation, Reciprocity and Electricity in the European Community' 17 (1999) *Journal of Energy and Natural Resources Law* 121, 122-125.

[8] Directive 90/377/EEC (OJ 1990 L 185/16).

[9] Directive 90/547/EEC (OJ 1990 L 313/30).

[10] Directive 96/92/EC

[11] For detailed discussion of the proposals, problems, arguments and counter-proposals, see the Opinion of the Economic and Social Committee (93/C 73/10, OJ 1993 C 73/31), the Opinion of the European Parliament of 17 November 1993, the Commission's amended proposal (COM(93)643 final of 1993) and the commentary provided by Trepte, P-A. (1992) *Utilities Law Review* 18 and Hancher,

## 3. Implementation of the Directive

A full discussion of this issue is worthy of a book in its own right; however, one of the key aspects is that some Member States have chosen to move rapidly towards full market opening, while others have moved more slowly and some have done the bare minimum necessary to comply with the Directive. This has created imbalances in market opening and bad feeling among those Member States that feel that the laggards are providing an opportunity for their 'national champions' to use this state of affairs to gain a foothold in the markets in other Member States, without the possibility for other companies to make incursions in return. Furthermore, the expectations generated among consumers of lower prices and better service do seem to have been fulfilled in some areas, which has led to pressure to allow imports where such competition results in even greater consumer benefits. The Commission's most recent Communication on this issue[12] comments on the average reduction in prices[13] (around 6%) and the increase in cross-border trading (now amounting to around 8% of total electricity production in the Community).[14] Since 1999, the Commission has produced an annual summary of implementation on a state-by-state basis on its website for the Internal Market for Electricity, giving a summary of the nature of implementation chosen and the progress therewith.[15]

In the sections that follow, a discussion of the major obstacles that still stand in the way of the proper creation and functioning of an internal electricity market will be examined, as will some of the areas of general European Community law that could be (and are being) applied to achieve such goals. Some areas are given detailed treatment, while others receive a more cursory examination. This is largely due to constraints of space, but I have also endeavoured to take into account the extent of the legal developments at work and to give these areas more in-depth coverage.

## 4. The functioning of an Internal Electricity Market: barriers, legislative proposals and general developments

### *4(i) Transmission*[16]

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L. (1992) *Utilities Law Review* 133, (1993) *Utilities Law Review* 79, (1994) *Utilities Law Review* 64 and (1996) *Utilities Law Review* 217.

[12] 'Communication from the Commission to the Council and the European Parliament – Recent progress with building the internal electricity market' COM(2000)297 final (Brussels, 16 May 2000).

[13] See http://www.europa.eu.int/comm/energy/en/elec_single_market/prices.pdf for a summary of the January 2000 EUROSTAT reports on electricity prices, one on industry and one on household prices.

[14] This cross-border trading figure is, however, rather disappointing and indicative of the difficulties to be discussed below. The International Energy Agency, *Energy Statistics of IEA Countries*, (Paris: OECD, 1993) suggested that overall trade rose from only 3% of Member States' requirements in 1970 to nearly 7% in 1990, so an increase to 8% of total production seems less impressive, although it should be remembered that consumption and production in general are clearly on the increase, so in real terms the *quantity* (if one can use that expression with regard to electricity!) has increased. Nevertheless, more can be done here.

[15] See http://www.europa.eu.int/comm/energy/en/elec_single_market/implementation/index_en.html, where the individual summaries for each Member State are accessible.

[16] Although there is no space to discuss this here, the role of the Florence Forum (and of the Madrid Forum in similar vein in the Gas sector) is worthy of detailed study, to draw out its position within the process of negotiating the future of the industry and to assess the strategy of the participants in their relations with the Commission and the Member States. The transparency of some of the arguments that have raged has been relatively high and it has been a focal point for bringing some of the difficulties of those in the industry into the open. Just how influential it has been may become clearer during the

In the absence of a mechanism for ensuring the ability to transport electricity, the aim of an Internal Energy Market is no more than a delusion of grandeur. Alongside the introduction of competition within national systems, the freedom to trade electricity from one Member State to another is a vital part of any attempt to develop a Europe-wide market. Two major issues in this area have been highlighted by the Commission: how is the price for transit of electricity to be calculated and set and how can transmission capacity be used most efficiently and increased? In each case, the focus has been on how this process can promote trade in electricity and in each case it has proved difficult to make significant progress against the background of the current transmission system operators. The European Electricity Regulatory Forum (or the Florence Forum, after the location of its twice yearly meetings) consists of national regulatory authorities, Member States, the European Commission, Transmission System Operators, electricity traders, consumers, network users and power exchanges.

> 'The Forum was set up to discuss issues regarding the creation of a true internal electricity market that are not addressed in the Electricity Directive. The most important issues addressed currently at the Forum concern cross border trade of electricity, in particular the tarification of cross border electricity exchanges and the allocation and management of scarce interconnection capacity.'[17]

However, in recent months frustration at the failure of this process to produce any significant agreements has been mounting, both in the Commission and among commercial interests.[18]

(a) Tariffs

The transmission tariff negotiations have been fraught with difficulties for a number of reasons and there is not sufficient time to go into the detail of the negotiations here. However, as of Christmas 2000 the Commission was still urging the European Transmission System Operators to come to a voluntary agreement on transmission charges, preferably by dropping the insistence of the German and Belgian representatives on an export charge of €2 per MWh.[19] There are undoubtedly some

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course of 2001: indeed, it may have had more influence than it suspects, although whether this will be a positive aspect (for the participants or the industry and consumers in general) remains to be seen.

[17] From the DG(TREN) website on the 'Florence Regulatory Process', at the following address: http://www.europa.eu.int/comm/energy/en/elec_single_market/florence/index_en.html.

[18] 'Commission to demand German energy regulator' 338 *Power in Europe* (2000) (24 November 2000), where the 9 – 10 November 2000 meeting of the Forum was told by the Commission's Director General for energy, Francois Lamoreux, of future proposals to push the liberalisation process by means of new European legislation. As he said, '…operators do not have a great interest in helping us. This is not a merger case here the parties want to press ahead; here the parties want the present situation to continue'. Furthermore, the same article quotes Dutch MEP Wim Van Velzen, who reported a number of complaints from Dutch industrial electricity consumers. 'They say they can buy power anywhere and get a guarantee of delivery to the Dutch border – but that's it. Nobody can get it any further because there is no capacity'. The International Federation of Industrial Electricity Consumers (IFIEC) has voiced similar complaints: '[t]here is little or no trade going on now. Our members are getting offers to supply that are pushed out by the [transmission] charge … - it kills competition' (David Williams of IFIEC).

[19] Originally, the French had also insisted on this transaction component (see 'Florence Forum: The threat of new regulation' 142 *EU Energy Policy* (2000) (31 October 2000), but the latest reports suggest that the French regulator has fallen into line with the general consensus that the export charge should be dropped, to be replaced by spreading the cost of transit flows across all network users ('Commission to demand German energy regulator' 338 *Power in Europe* (2000) (24 November 2000)).

difficult issues to be resolved in the calculation of such prices: 'physical flows of electricity do not follow contractual flows', which creates difficulty in devising a system of sufficient simplicity and transparency to encourage trade to supply eligible customers while allowing transmission system operators to operate an effective clearing system *inter se* (redistributing revenues according to actually metered flows).[20] With legislative proposals in the offing,[21] these differences are certain to resurface once political consideration of the Commission's ideas begins and even if agreement could be reached on a tarification system which is 'non-transaction-based and [which relies] on the principles of cost-effectiveness, non-discrimination, transparency and simplicity',[22] it would be at least two or three years before such changes would have to be introduced. These delays could be very damaging to the development of the Internal Energy Market.[23]

(b) Infrastructure

Bottlenecks between electricity systems can often occur when the relevant interconnector does not have sufficient capacity to offer transit to all requests for the transport of electricity. One of the difficulties is commonly that long-term contracts have gone hand-in-hand with capacity reservation agreements: in a competitive market, these contracts should have to compete with the 'short-term needs for the transactions of eligible customers and traders … [yet] … [i]n the absence of sufficient interconnector capacity and if the allocation rules are not harmonised … consumers will be confronted with higher costs and more refusals of network access than would be justified by the real physical constraints'.[24] To deal with these difficulties, action is needed both on the management of capacity currently available and on the development of increased interconnector capacity to meet likely future demand.

In the management of current arrangements, the Electricity Directive itself allows a refusal of a transmission request on capacity grounds,[25] but the Commission is at pains to point out that this applies only to a genuine lack of physical capacity and not to any such problems caused by contractual blocking or a failure of neighbouring operators to co-ordinate their activities properly.[26] This leaves significant scope for requiring such operators to conduct set-offs of dispatch across the interconnector, so that only the electricity that must use the capacity to fulfil the contract is *actually*

[20] 'Second Report to the Council and the European Parliament on the Harmonisation Requirements: Directive 96/92 concerning the internal market for electricity', (SEC 1999/470) – 16 April 1999 (Section II.2.1 on Cross-border tarification and settlement).

[21] See the discussion of the Commission's forthcoming proposals for the Internal Energy Market, coupled with complementary measures in fields such as transmission pricing and infrastructure, in the text accompanying n. 84, *infra*.

[22] Commission's Draft Conclusions presented to the Florence Forum of 9-10 November 2000.

[23] This is a necessarily brief and simplistic overview given constraints of space. For details of the Commission's analysis of the possible alternatives, see the 'Second Report to the Council and the European Parliament on the Harmonisation Requirements: Directive 96/92 concerning the internal market for electricity', (SEC 1999/470) – 16 April 1999 (Section II.2 on Cross-border tarification and settlement).

[24] 'Second Report to the Council and the European Parliament on the Harmonisation Requirements: Directive 96/92 concerning the internal market for electricity', (SEC 1999/470) – 16 April 1999 (Section I.1.1 on Available interconnector capacity).

[25] See Articles 17(5) and 18(4), Directive 96/92/EC.

[26] 'Second Report to the Council and the European Parliament on the Harmonisation Requirements: Directive 96/92 concerning the internal market for electricity', (SEC 1999/470) – 16 April 1999 (Section I.2.1 on Maximising available transmission capacity).

using the interconnector. The allocation of transmission capacity is also covered in part by the Directive, which requires criteria which are 'objective, published and applied in a non-discriminatory manner' (Article 8(2)). The current fear is that the existing prevailing conditions for the use of the interconnector may be such that bottlenecks still occur frequently: if the two states on either side of the border adopt significantly different access rules then trade between them may be distorted.[27]

However, the issue that has provoked most recent interest has been that of long-term reservation of transmission capacity. There is a danger that such contracts can exclude market entry by other competitors by blocking access to the interconnector in question. This is a particular problem (at least potentially) where a vertically integrated undertaking operates both at the trading and the transmission system operator level, as it can then grant itself such priority access. This is an area in which the Commission signalled its intention to use the competition rules of the EC Treaty to assess the restrictions that such reservations of capacity might create.[28] Its first big, successful use of this strategy came in a set of agreements involving the Danish – Norwegian and Danish – German interconnectors. The agreements involved the reservation of 100% of the only cable linking Denmark and Norway[29] and some 34% of the Danish/German interconnector in the German direction.[30] The duration of the agreements in question was between 20 and 25 years and given the strong competitive positions enjoyed by the respective parties in Germany and Denmark, the Commission took the view that '[i]mports of electricity through interconnectors are thus a crucial source of competition'. As a result of the Commission's concerns, from 1 January 2001, both interconnectors have freed up capacity entirely.[31] The Commission promised in its press release on this development to monitor other situations of congestion in interconnectors between France and Italy, France and Spain, the Netherlands and Germany and the Netherlands and Belgium.[32]

For the future, it is key to ensure that the correct incentives are given for the construction of increased interconnector capacity to meet the likely growing demand. The difficulty is to assess clearly whether or not the transmission system operator in a vertically integrated electricity undertaking has failed to act independently in the creation if such new capacity. The operator must be independent, at least in management terms, by virtue of Article 7(6) of the Directive, while Article 14

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[27] E.g. Germany might operate a 'first come, first served' system, while Denmark might give priority to electricity from renewable sources.

[28] 'Second Report to the Council and the European Parliament on the Harmonisation Requirements: Directive 96/92 concerning the internal market for electricity', (SEC 1999/470) – 16 April 1999 (Section I.2.3(1) on The evaluation of capacity reservation agreements).

[29] By means of two agreements: a 60% reservation between Statkraft of Norway and Elsam of Denmark and the remaining 40% by a deal between Statkraft and E.ON of Germany.

[30] Also under the Statkraft – E.ON deal, which included a further reservation of transit capacity through Western Denmark.

[31] In the E.ON case, this point was strengthened by the ongoing merger assessment of the *VEBA/VIAG* tie-up by the Commission (Approved, 'subject to stringent conditions': see Commission Press Release IP/00/613, Brussels, 13 June 2000), where similar concerns were raised. Furthermore, if the allegations by PreussenElektra concerning the *Stromeinspeisungsgesetz* (that 'feeding wind-produced electricity into the medium-voltage networks of the German regions close to the Danish border creates bottlenecks in electricity transmission between Germany and Denmark at the high voltage level' (see the Opinion of Advocate General Jacobs in case C-379/98 *PreussenElektra v. Schleswag A.G.* (26 October 2000), para 200)) are correct then this competition worry was even greater and thus the result achieved all the more welcome.

[32] 'Increased scope for electricity imports competition in Northern Europe – a step towards an internal market for electricity' (Commission Press Release IP/01/30, Brussels, 11 January 2001).

requires accounting separation according to generation, transmission and distribution and any other activities. Nevertheless, in formulating the appropriate incentives, care must be taken to ensure that the fees charged reflect the correct unbundling of accounts.[33]

*4(ii) Rate and extent of market opening*

(a) Unbundling

The foregoing sections illustrate that the co-existence of vertically integrated companies and undertakings operating at only one level of the electricity process can create significant difficulties in terms of transparency, non-discrimination and access to markets. Pressure from some quarters has been growing to intensify the unbundling of functions within the market: the Commission's Report on recent progress with building the internal electricity market marks this issue for re-examination, calling for a full material separation of commercial activities of the parent company from grid operation activities.[34] Meanwhile, Dutch MEP Wim Van Velzen has emphasised that the European Parliament will push strongly for 'the physical unbundling of the institutional elements – we must separate transport from generation and distribution. Chinese walls [do not] work'.[35] Furthermore, Transport and Energy Commissioner Loyola de Palacio has been busy making a number of speeches in January 2001, which have emphasised the strengthening of the unbundling requirements in both the Gas and Electricity Directives.[36] This issue promises to be a difficult battleground in the course of any negotiations on forthcoming Commission proposals in the sector.

(b) Reciprocity and market opening levels

A key factor in negotiating the liberalisation Directive was the question of the extent of market opening that was to be required. This would also determine the consumers who would become eligible freely to purchase their supplies, a key factor in bringing home any such market reform. The complex compromise which was finally reached is embodied in Article 19 of the Directive. The idea is to ensure that the single buyer and negotiated TPA systems will lead to an equivalent level of market access. This was to be achieved in the first phase by basing the calculation of market access levels on final consumers of over 40 GWh per year.[37] This was to be opened progressively after three years to 20 GWh, and after six years to 9 GWh.[38] However, Member States

[33] 'Second Report to the Council and the European Parliament on the Harmonisation Requirements: Directive 96/92 concerning the internal market for electricity', (SEC 1999/470) – 16 April 1999 (Section I.3.1 on Respecting unbundling): the Commission recognises (section I.1.4) that 'timely limited exceptions from the general rules under case by case regulatory control' may be necessary to encourage such construction.

[34] COM(2000)297 final, n. 12, *supra*, section II on State of play of the opening up of electricity markets.

[35] 'Commission to demand German energy regulator' 338 *Power in Europe* (2000) (24 November 2000).

[36] See, for example, her speech to the World Economic Forum in Davos, Switzerland on 29 January 2001 (summarised in 'Loyola de Palacio sets out the conditions for successful gas and electricity liberalisation', Commission Press Release IP/01/132, Brussels, 29 January 2001).

[37] Directive 96/92/EC (OJ 1997 L 27/20), Article 19(1), second paragraph.

[38] Directive 96/92/EC, n. 37 *supra* Article 19(2). The 20GWh threshold has since been implemented, while the 9 GWh level is currently required to be achieved by 2003. On the adoption of the Directive,

were left free to decide exactly which customers would be made 'eligible' so as to meet the market opening level required. This led to the difficulty that there would not necessarily be identical definitions of eligible customers operating throughout the European Community. This was especially problematic in light of the French refusal to agree to the Directive without the possibility of retaining a 'single buyer' for all electricity in its territory.[39] As the Commission had stated in its Working Paper of 1995,[40] 'reciprocity can only be assured between the systems if ... [b]oth systems [are] based on a common and transparent definition as regards categories of eligible customers. The opening of the market is realised via the coverage of these eligible customers'. Under the final wording of the Directive, it was clear that it was unlikely that any such common definition would be the result.

This potential difficulty was a source of annoyance to a number of other Member States and they sought to protect the position of those states that wished to move more quickly to liberalise their markets by means of a 'reciprocity clause' in the Directive.[41] I have documented at length the immense difficulties in the interpretation of this confusing provision elsewhere;[42] the major difficulty is that Article 19(5)(b) is drafted in such a way that, far from allowing the more liberalised Member States to keep out power from other countries, it seems to encourage eligible customers in more liberalised states to secure imports from countries with lower levels of market opening.[43] As a result, some Member States have introduced their own reciprocity provisions in national law[44] and recent discussions on the progress of implementation of both the Electricity Directive and the Natural Gas Directive[45] suggest an increasing willingness on the part of certain Member States to take action in this way.[46] Some

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the calculated market opening level required was 25.37%; the latest figures show a level of 30.2% (OJ 2001 C 27).

[39] In this proposed system, only one entity can purchase and sell electricity within the area in question: the single buyer. As a result of this, all producers must sell their electricity to the single buyer, and at the other end of the scale all consumers will have to meet their requirements through purchases from the single buyer. Further, the single buyer would be given control over calls for tender, and would only grant certain consumers the possibility of concluding contracts for the supply of power from abroad. It is clear that this system does not leave much room for any significant opening up of the electricity market for new producers, any more than it is likely to provide consumers with increased choice and greater efficiency savings. It is equally clear that the aim of the single buyer proposal was to allow a planned economy approach to persist in those countries which were not yet ready to abandon it. See Midttun, A. 'Electricity Policy within the EU: One Step Forward, Two Steps Back', Chapter IX in Midttun, A. (ed.), *European Electricity Systems in Transition: A Comparative Analysis of Policy and Regulation in Western Europe*, (Elsevier, 1996), 272.

[40] 'Working Paper on the Organisation of the Internal Electricity Market' of 22 March 1995 (which dealt with the question of the single buyer) (SEC (95) 464 final, (1995), printed in *Europe Energy* March 24 1995, No. 443, Sec V.).

[41] Indeed, the French proposed what they called a concept of 'positive reciprocity' in return for agreement on the inclusion of the single buyer idea in the Directive. In the Directive, see Article 19(5) and especially para (b) thereof.

[42] See Johnston, n. 7, *supra*.

[43] Johnston, *supra* n. 7 at 134-135. Article 19(5) (b) reads (so far as material): 'in cases where transactions … are refused because of the customer being eligible in only one of the two systems, the Commission may oblige, taking into account the situation in the market and the common interest, the refusing party to execute the requested electricity supply at the request of the Member State where the eligible customer is located'.

[44] See, for example, Articles 28 – 32 of the Dutch Electricity Act 1998.

[45] Directive 98/30/EC of the European Parliament and of the Council of 22 June 1998 concerning common rules for the internal market in natural gas (OJ 1998 L 204/1, 21 July 1998).

[46] See among many such statements, 'Editorial Comment: Power Struggle', *Power in Europe*, 19 October 2000, which reported that the German economics minister was considering resorting to

producers have sought to get around this difficulty by acquiring electricity (or even electricity producing companies) within the Member State of importation, so that power stamped with a 'national label' can be delivered to the grid, since in practice it is impossible to identify the source of electricity actually on the grid.[47] Furthermore, the Swiss company Atel has raised the interesting point that, under WTO rules, electricity is also a good and thus cannot be made subject to any reciprocity clause due to the national treatment requirement.[48] This echoes the comment made by an official in the then DG XVII of the Commission that obligations under the Energy Charter Treaty might be construed as having a similar disabling effect upon reciprocity provisions, whether national or in any Directive.[49] Clearly, in the transitional period before full market opening, these issues may yet prove extremely difficult to resolve.

*4(iii) Environmental issues*

(a) Identifying the barriers

In the Commission's White Paper on Renewable Energy,[50] attention was drawn to the need to integrate electricity produced from renewable sources into the general internal market for electricity. Many different types of scheme were under consideration by the Member States during their implementation of Directive 96/92/EC and the fear was that significant differences might result in trade distortions.[51] The need to promote[52] the use of such energy in the light of the Kyoto commitments was keenly felt both in the White Paper and in the Commission's first report on Harmonisation requirements for the internal electricity market:[53] as the role of renewables looked set to increase, so would the trade distortions suffered. This report concluded that 'it is appropriate to move towards the definition of some common rules in this area as rapidly as practicable', envisaging a proposal by the end of 1998. However, the process of gathering and analysing information concerning such schemes took rather

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reciprocity to limit French power to competing for around only 30% of the German market, in an attempt to 'shock France into abandoning its absurd protectionism'.

[47] 'How to duck the reciprocity clause' 124 *EU Energy Policy* (1999) (20 April 1999).

[48] 'How to duck the reciprocity clause', n. 47 *supra*. It has proved difficult to come to any agreed interpretation of the meaning of the reciprocity clause in Directive 96/92/EC, as different players in the game are more or less exposed to such problems due to the policies of the Member States on their (immediate) borders.

[49] This suggestion was made, *arguendo*, during a presentation to the Annual European Energy Law Seminar in Noordwijk, The Netherlands on 11 and 12 May 1998.

[50] 'Energy for the Future: Renewable Sources of Energy – White Paper for a Community Strategy and Action Plan' COM(97)599 final (26 November 1997).

[51] E.g. where a producer of renewable electricity trades from a country offering state aid into one offering 'green certificates', there is the danger of double support, by acquiring a certificate in the importing country; meanwhile, trade in the other direction may leave the producer from the other Member State with no support at all. More generally, different levels of support may encourage those customers who are free to seek power abroad to avoid paying the renewables subsidy, thus pushing up prices at home and undermining the policy of supporting renewable electricity production in the first place. These examples are drawn from COM(1998)167 (see n. 53, *infra*).

[52] The essential point being that renewable power needs to be supported in some way, as it tends to appear more expensive than conventionally generated electricity, due to the failure of prices for the latter to factor in their environmental consequences (emissions, etc.).

[53] 'Commission Report to the Council and the European Parliament on Harmonisation Requirements. Directive 96/92 concerning rules for the internal market in Electricity' COM(1998)167 (16 March 1998).

longer than had been expected. An interim Working Paper on the subject appeared in 1999, discussing the different schemes in force in the Member States. This disclosed sizeable disparities both in terms of available natural resources and of the extent of support offered to renewables. Subsidies for research and development are widely available, while support for capital investment is also provided in some countries. Guaranteed prices, coupled with purchasing obligations on suppliers, is another form of support, although the price levels vary significantly between countries.[54] Consumers in some countries seem willing to pay a premium for renewable electricity by means of a voluntary green pricing scheme, while other Member States provide support for renewables via the tax system (exemptions, lower rates, special taxes on the emission of certain gases, etc.). Finally, in May 2000 a Commission proposal for a Directive in this area was unveiled.

(b) The legislative proposal

The Commission's Proposal for a Directive[55] to promote renewables in the electricity sector had been a long-awaited document, produced after lengthy investigations and consultations. A public hearing was held, the Advisory Committee on Energy was involved and Member States both provided information on current schemes and were consulted, as were those in the industry. The opinion of the Economic and Social Committee, while broadly supportive of the proposal, considers it to be 'flawed in a number of key respects'. The Opinion adopted by the European Parliament[56] is similarly favourable in its general thrust, while packed with a mass of proposed amendments to the proposal.

The basic structure of the proposal is to require Member States to set annual domestic targets for renewable electricity consumption, aiming to reach a level of 22.1%[57] of total electricity use by 2010, to meet the contribution required of the electricity sector to achieving the overall target agreed at Kyoto of a 12% share of the gross inland energy consumption for the Community.[58] The domestic objectives that the Member State pursues[59] and measures taken to achieve those goals must both be published annually. Thus, the definition of these objectives is left up to the Member State in question, subject to compatibility with any national commitments in the Kyoto context and to the overall 12% target. The European Parliament would like to see it emphasised that these targets must be *binding* and are only a *minimum* level to be achieved: 'Only if the targets are legally binding is it possible to guarantee that all necessary efforts are made by the Member States to develop renewable energies'. However, its Opinion does go on to state that '[e]nergy is not a matter falling within

[54] See, e.g., the German *Stromeinspeisungsgesetz* of 1998 and the litigation concerning its impact in Case C-379/98 *PreussenElektra v. Schleswag A.G.* discussed below (Opinion of Advocate General Jacobs, 26 October 2000).

[55] 'Proposal for a Directive of the European Parliament and of the Council on the promotion of electricity from renewable energy sources in the internal electricity market' COM(2000)279 final, 10 May 2000 (OJ 2000 C 311/320 (31 October 2000)).

[56] Minutes of 16 November 2000, following in large part the Report adopted by the Committee on Industry, External Trade, Research and Energy of 30 October 2000 (FINAL A5-0320/2000).

[57] The European Parliament would retain the figure of 23.5% laid down in the White Paper, believing that this still remains a realistic target, in spite of the Commission's belief that a lower level of energy savings is to be expected by 2010.

[58] 'Indicative figures for Member State targets' are provided in the Annex to the proposal, which when taken collectively aim to reach the White Paper's objective.

[59] Article 3(2) of the proposed Directive.

the Community sphere of responsibility, and targets, which, although they might be given for guidance, would be binding in practice, would therefore clearly conflict with the Treaty'. This seems to be a recognition of the power of the Member States, rather than the Community, to set such targets, yet it is difficult to square with the proposed Article 3(4), which the Parliament seems happy to leave intact. This allows the Commission to propose legislation to the Council and Parliament 'with respect to individual and mandatory national targets' if the 'national targets are liable to prove inconsistent with the established objectives'.[60]

In the scheme of Article 4 of the Directive, national 'support measures' for renewable electricity are to be monitored by the Commission over 5 years from the entry into force of the Directive, to gather experience in their operation and in the interaction of different support schemes. Once reported on, the Commission will present a proposal for a Community framework for such schemes, responding to the fears canvassed above that increasingly significant distortions of trade and competition could occur without such harmonisation in the medium to long term. Ultimately, the aim supported by both the Commission and the European Parliament is to integrate renewable electricity fully into the internal electricity market, by means of trade in such power and competition between its suppliers. Such pressures can be expected to increase the efficiency of such production, bringing down costs and exploiting the full potential of renewable energy for the future.[61] Equally, it is clear that such schemes are still subject to the general rules of EC law laid down in the Treaty: Articles 87 and 88 EC are mentioned explicitly here and as the *PreussenElektra* litigation discussed below[62] shows, both state aids and more general issues of free movement may prove difficult in this sphere. This is especially likely to be the case given the clear recognition that it 'will be necessary to continue and reinforce these schemes within the limits set by the Treaty … to achieve the national objectives that Member States will be obliged to set pursuant to this Directive and as long as electricity prices do not fully reflect the full social and environmental costs and benefits of the energy sources used'.[63]

Getting electricity to reflect the full social costs that its production imposes is at the heart of many of the amendments proposed by the European Parliament:[64] by

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[60] Furthermore, Article 3(u) EC expressly provides that '…the activities of the Community shall include … measures in the sphere of energy' and this is given some specific expression in Article 175 EC (ex-Article 130s), which provides for the consultation of (*inter alia*) the European Parliament (as opposed to the use of the co-decision procedure of Article 251 EC (ex-Article 189b) when the Council seeks to adopt '…measures significantly affecting a Member State's choice between different energy sources and the general structure of its energy supply'. Surely, this provides an ample legal basis for such mandatory measures, provided that their proposal is not viewed as disproportionate to the aim to be achieved (I am grateful to Joanne Scott for drawing the resolution of this point to my attention).

[61] The so-called 'green certificates' are often seen as a first step to introducing such trade and competition, by requiring consumers to purchase a certain amount of green certificates in their overall electricity use. Producers would then compete to sell such certificates to the consumers.

[62] Case C-379/98 *PreussenElektra v. Schleswag AG*, delivered on 26 October 2000: see, *infra*, the text following n. 92.

[63] COM(2000)297, n. 12 *supra* at 6.

[64] E.g. in Article 4, the Parliament would also require the Commission to report upon 'the competitiveness of renewable energy sources on the energy market and progress in internalising external costs, as well as the status of subsidies to other energy forms.' Any proposal for legislation following on from this report would have to 'satisfy the need for internalising external costs' (proposed new Article 4(a)a), while in an addition to Article 8(5), 'No legislative initiative restricting support for renewable energies shall be taken until full internalisation of external costs has been achieved'. Finally, the Parliament calls on the Commission, in the redrafting of the Community framework for State aid for the environment, 'to take into account the need for internalising external costs and removing the

focusing on this issue, it is stressed that the objective is not to *distort* competition in favour of renewables, but rather to level the playing field that has been tilted due to the failure of the market to take the true costs of conventional energy into account. As its Opinion comments: '[t]he real purpose of the Directive should be to provide a transitional derogation from the full application of internal market rules'.[65]

The proposed Directive also addresses the issue of planning and administrative difficulties facing potential renewable electricity generators. While no specific harmonisation is envisaged, Member States would be required by Article 6 to review their existing measures and 'determine which action … can be taken to reduce the regulatory barriers to increasing [renewable electricity] production'. A report must then be published outlining the conclusions of such a study and the Commission would then produce a 'best practice' report based upon the experience of the various Member States. A further key practical element identified in the proposed Directive is access for renewable electricity to the grid. Under Article 7(1), Member States would have to ensure that system operators granted priority access to the transmission and distribution grid to electricity from renewable sources. All costs criteria must be made transparent and non-discriminatory and future benefits, both to the system and to subsequent generators connecting to the grid, must be taken into account in calculating costs or providing compensation for money paid up front.[66] The European Parliament stresses the grid access issue very strongly in its Opinion, placing the responsibility on the grid operator to provide the necessary infrastructure 'as part of the process of equal treatment with other forms of energy production'. A similar point is made in the context of access costs being 'non-discriminatory': '[e]lectricity producers who want to exploit the potential of renewable energies in the peripheral regions of the Community, in particular in island regions and regions of low population density, must benefit from reasonable connection costs. This is so that they are not disadvantaged in comparison with producers situated in more central, more industrialised and more densely populated areas'. Furthermore, the Parliament would only charge distribution grid costs for renewable electricity and not those relating to the transmission grid, citing unreasonable transmission costs as one of the most important barriers to access to the grid for renewable electricity. It is not wholly clear whether these encouragements would apply across the board or only in cases where some justification could be made. However, given the general centrality of the transit fees issue in the sector, it is unlikely that such a sweeping exception will slip into the Directive without a fight from (some of) the European Transmission System Operators.

In general, it can be stated that this proposal shows great caution on the part of the Commission and a realisation that certain developments will need careful monitoring and planning before they can be realised. The Economic and Social Committee's disappointment seems to be centred around the failure of the proposal to set any limits in principle to the *level* of support available to renewable electricity producers, on the basis of 'the true environmental quality, efficiency and availability of power produced by each technology'.[67] The European Parliament's amendments

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competitive disadvantages for renewable energies, and to permit on a long-term basis the national support schemes pursuant to this directive' (see the Explanatory Statement accompanying the Report adopted by the Committee on Industry, External Trade, Research and Energy, *supra*, n. 56).

[65] In its justification for the amendment suggested to Recital 16 of the proposed Directive.

[66] Renewable electricity producers often suffer disproportionately under connection and transmission pricing due to their generally smaller scale and often remote location *vis-à-vis* the grid.

[67] *EU Energy Policy*, Issue 141, 29 September 2000.

seek mainly to secure a full assessment of the social and environmental costs of any electricity generation, in the interests of the relatively speedy establishment of a level playing field for all sources of electricity in the internal market. This is a laudable aim and one reflected in much of the reasoning behind the Commission's proposal.[68] One valuable contribution of the Parliament's amendments is to extend the principle of the clear identification of the *origin* of electricity[69] to cover *all* power, rather than just renewable electricity. While the problems of fraud in this area are most acute in the renewables context (given the possible eligibility for support measures as a result), the general increase in transparency on the market is likely to result in overall benefits for consumers.

The Council reached a political agreement on the Commission's proposal in December 2000.[70] The Swedish Industry Minister, Mr Lars Rekke, in his address to the European Parliament's Committee on Industry, External Trade, Research and Energy on 23 January 2001, heralded this agreement as a 'major step forward' and a significant commitment by the Member States. He asked the Parliament not to demand too much in its second reading of the proposal and hoped for a speedy agreed position so that Member States could press ahead with its implementation.[71] However, the Council's detailed, formal Common Position text is still under preparation: it seems that the political agreement was reached without a consideration of the Parliament's Opinion, which did not arrive in time, so a re-examination of the text proved necessary. Early indications are that 'no significant account was taken of Parliament's Opinion', suggesting that the conciliation procedure may well be pressed into service under the Belgian Presidency later in 2001 to secure agreement.[72] There may well be some difficult negotiations ahead.

*4(iv) Taxation*

As long ago as March 1997, in response to a request from the ECOFIN Council of March 1996, the Commission produced proposals that recognised the need for some equivalence of taxation levels for energy in the Internal Energy Market.[73] This recognised that the restriction of common minimum tax levels to mineral oils only left a great deal of scope for the distortion of competition in the market due to different national energy tax regimes and the different energy sources available. The proposal intended to introduce minimum levels for all the various energy products, including electricity, to be introduced over three stages of two years each so as to achieve a gradual convergence of Member State rates while taking care to ensure the time to prevent an increase in the overall tax burden. The tax in electricity would in principle have been paid at the final consumption stage, with the implication that electricity could thus be traded across borders without taxation and tax would only be paid in the country of consumption. Certain measures to aid in the promotion of renewable electricity production were also envisaged: additional taxation could be applied to

[68] See COM(2000)297, n. 12 *supra* at 6: 'electricity prices do not fully reflect the full social and environmental costs and benefits of the energy sources used'.
[69] Article 5 of the proposed Directive.
[70] 'Green light from the Council for the promotion of renewable sources of energy in the electricity market', Commission Press Release IP/00/1413 of 6 December 2000.
[71] *EC Inform-Energy*, No. 90 – February 2001, 10. Mr Rekke was outlining the priorities of the Swedish Presidency in the energy sector.
[72] *EC Inform-Energy*, No. 90, n. 71 *supra* at 15.
[73] 'Proposal for a Council Directive on Restructuring the Community Framework for the Taxation of Energy Products' COM(97)30 final, 12 March 1997.

inputs for environmental purposes, which could then be paid back to the producer, subject to the state aid rules of the Treaty.

That these proposals are still a live issue is illustrated by the Commission's Second Harmonisation Report,[74] which includes a discussion of both indirect and direct taxation (the latter concerning possible special exemptions in the Member States for electricity companies from the normal rules of corporate taxation). The proposed new Directive on renewables also reiterates the Commission's determination to secure progress in this field.[75] Furthermore, the Budget Commissioner Michaele Schreyer went out of her way to highlight the issue in her address to the recent '2001 Environment Conference' of the German Green Party in the *Bundestag*.[76] Recent reports indicate growing impatience in the Commission's Internal Market Directorate General with the continuing Spanish refusal to agree to the 1997 proposals. Since their presentation, it seems that Madrid has refused to sign up to the measure and continues to stonewall even in 2001.[77] In the face of such resistance, these proposals remain on the table but have gathered more than a few layers of dust and still seem a while away from adoption. Indeed, in the rather charged aftermath of the tetchy Nice Intergovernmental Conference, it is unsurprising that issues such as indirect taxation, which are so close to governments' heart, are still difficult to resolve. In the light of this, Schreyer went so far as to suggest that energy taxation might be a matter for enhanced co-operation between those Member States in favour of the proposal.[78] Finally, on the political front, the recent ECOFIN Council of 12 February 2001 reached political agreement on a Decision to allow all fifteen Member States to exempt or apply a lower rate of excise duty to certain categories of fuels (e.g. environmentally-friendly) or categories of user (e.g. public transport). This agreement was reached after a warning from Internal Market Commissioner Frits Bolkestein that the Member States would receive letters of formal notice under Article 226 EC concerning such duties, as the previous Decision in this field expired on 31 December 2000.[79] Bolkestein expressed his satisfaction with the 'admirable flexibility' shown by the Member States in acceding to the proposal,[80] while reiterating the Commission's commitment to its 1997 tax harmonisation proposal. This all illustrates a great and express degree of unanimity on the part of the Commission on this issue, although it must be questioned whether the aggressive approach taken by Bolkestein on the excise proposal will bear similar fruit on the more general taxation proposal.

The Court of Justice has made a small contribution to this field in the *Outokumpu Oy* case,[81] in which the Court refused to allow Finland to apply a flat rate

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[74] 'Second Report to the Council and the European Parliament on the Harmonisation Requirements: Directive 96/92 concerning the internal market for electricity', (SEC 1999/470) – 16 April 1999.

[75] 'The Commission insists that progress has to be made in adopting its 1997 proposal …[!]' ('Proposal for a Directive of the European Parliament and of the Council on the promotion of electricity from renewable energy sources in the internal electricity market' [2000] O.J. C 311/320 (31 October 2000), section 2.2.1, at 7).

[76] *EC Inform-Energy*, No. 90 – February 2001, 15.

[77] *European Voice* 8 – 14 February 2001, 23.

[78] *EC Inform-Energy*, No. 90 – February 2001, 15: an interesting suggestion in the light of obvious enthusiasm among certain Member States for the idea of closer co-operation, which has been made clear during Intergovernmental Conference negotiations at both Amsterdam (1997) and the Nice (2000).

[79] The press release concerning the Council's agreement is accessible on the Commission's website: http://www.europa.eu.int/comm/internal_market/en/finances/general/ecofin.htm.

[80] See Commission Press Release IP/00/1296 and MEMO/00/79 for the original proposal.

[81] Case C-213/96 *Outokumpu Oy v. Finnish Customs* [1998] E.C.R. I-1777.

tax to imported electricity. The Court accepted that differentiated taxation on the basis of objective criteria was possible under Article 90 EC (ex-Article 95) even where the products are similar, so that such distinctions on environmental grounds were justifiable. However, following its case law on the comparison to be drawn,[82] the Court was concerned that there were some situations where imported electricity faced a higher tax burden than the domestically produced output. The Finnish government had argued 'that in view of the characteristics of electricity, the origin and consequently the method of production of which cannot be determined once it has entered the distribution network, the differential rates applicable to electricity of domestic origin cannot be applied to imported electricity. … [I]n those circumstances [the] application of a flat rate, calculated so as to correspond to the average rate levied on electricity of domestic origin, is the only logical way of treating imported electricity in an equitable manner'. The Court accepted that such difficulties might exist, but commented that imports under the Finnish rules did not even have the chance to prove that they fell within the 'environmentally friendly production' category regarded by Finnish law as qualifying for a lower rate. The rather draconian result was that the legislation was regarded to be precluded by the Treaty, as the Court seemed to require the 'abolition' of the duty as that would be 'the only way of avoiding direct or indirect discrimination against the imported products'.[83] This is a potentially far-reaching result that lacks the nuances that the Commission's proposal seeks to offer to Member States in this complex and controversial policy area. Will the Court's legal 'will' be pressed into service more frequently to overcome the governmental 'won't'? Only time will tell.

*4(v) Forthcoming reform proposals and the (Draft) Communication*

In the light of the foregoing, it is clear that we are on the verge of a significant new round of legislative proposals in the energy field. Just as this paper was being completed, a Draft Communication, intended to accompany Draft Proposals to amend the Electricity and Gas Directives, was leaked to the trade press during the period of inter-service consultations.[84] Obviously, its current contents are subject to final adoption by the Commission and should thus be treated with some caution. However, they are in line with Commissioner de Palacio's recent public pronouncements and are thus worthy of our attention here. The Communication discusses the existing legal framework and then the implementation thereof by the Member States, concluding that there are 'several weaknesses in the current legal framework' that will need to be remedied. The importance of monitoring the market is underlined in a third section, including prices, competition indicators[85] and tariffs for distribution and transmission.

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[82] See case C-152/89 *Commission v. Luxembourg* [1991] E.C.R. I-3141, paras 20-22, where the relevant comparator is deemed to be the lowest domestic tax rate, so that the fact that some domestic production is taxed at a higher rate is said to be immaterial.

[83] Para 40 of the judgment, citing case 21/79 *Commission* v *Italy* [1980] ECR 1, para 16. Interestingly, Advocate General Jacobs had advised that Article 90 EC did not preclude such a system, in the situation where the method of production of the imported electricity was impossible to determine.

[84] 'Details of forthcoming proposals for full opening of the Internal Energy Market' No. 90 *EC Inform-Energy* – February 2001, 8.

[85] A subject on which the United Kingdom and The Netherlands made a concerted effort to produce some starting points: see the study that they jointly commissioned from OXERA (Oxford Economic Research Associates) on monitoring competition in the European Electricity and Gas markets (reported in 'Electricity competition 'league table'' 138 *EU Energy Policy* (2000) (15 June 2000). This was presented to the Council of Ministers for Energy on 30 May 2000, with the intention of encouraging

The main section of the Draft Communication concerns how trade in the internal market might be developed further. Significantly, reference is made to 'the proposed Regulation on cross-border transmission tarification and congestion management'. In her Davos speech,[86] de Palacio was quick to stress that 'any such mechanism must ensure the permanent involvement of national regulators' but went on to state that 'the Commission should act to deal with cross-border issues that can only be effectively dealt with at the European level'. This regulatory instrument 'must be complemented by the construction of new infrastructure where technically feasible and economically justified'. In the remainder of the Draft Communication, issues such as public service obligations,[87] security of supply, the environment and its relationship with market opening, the effects of competition on employment and trade with third countries are covered. In the case of the last of these, the Commission intends to pursue bilateral agreements with non-Member States to secure reciprocal treatment.[88] Overall,[89] it seems that the Commission's firm intention is to seek full liberalisation for non-domestic consumers in the electricity market by 2003 and in the gas market by 2004 and full liberalisation for all consumers in both sectors by 2005. Moreover, the proposals will seek to require the use of regulated third party access, where tariffs are fixed and regulated by an independent regulatory authority (a clear message to Germany, where the competition authorities are still relied upon to regulate the sector, and to Belgium, where the position of the regulator *vis-à-vis* Electrabel has been questioned).[90]

These proposals are the logical culmination of the monitoring process in which the Commission has been engaged ever since the adoption of the Electricity Directive. They represent an ambitious programme of increasingly far-reaching measures on a European level to secure the eventual prize of the Internal Energy Market. There is little doubt that many of these ideas will meet with some fierce resistance, yet the political climate seems to be ever more favourable to the liberalisation process.[91] If France can be persuaded of the utility of these measures then the package may have a good chance of reaching the 'statute book' more or less intact. This, however, is a *big* 'if'.

## 5. The application of EC law to achieve these goals in the liberalisation process

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debate and assessment: perhaps the Draft Communication shows that the Commission has taken this idea firmly on board.

[86] As quoted in 'Details of forthcoming proposals for full opening of the Internal Energy Market' No. 90 *EC Inform-Energy* – February 2001, 8.

[87] This issue will be discussed further below: see the text accompanying n. 159, *infra*.

[88] Interestingly, this proposal seems to follow the pattern eventually established under the Second Banking Directive 89/646/EEC (OJ 1989 L 386/1), where Article 9(3) provides that the Commission can seek to secure equivalent market access under a Council negotiating mandate, while Article 9(4) allows the Commission to seek *de facto* national treatment of its own volition. See Johnston, n. 7 *supra* at 130-131 for discussion of the policy aims of such reciprocity provisions.

[89] Reading de Palacio's recent speech to the World Economic Forum (n. 36, *supra*) together with the leaked Draft Communication.

[90] See 'Commission to demand German energy regulator' 338 *Power in Europe* (2000) (24 November 2000).

[91] The Lisbon European Council (23 – 24 March 2000) requested the Commission, the Council and the Member States ('each in accordance with their respective powers') to investigate ways of speeding up the liberalisation of the electricity and gas sectors, with the aim of achieving a fully operational market (Presidency Conclusions, Lisbon European Council, 24 March 2000). This progress is to be examined at the Stockholm European Council in March 2001 (according to COM(2000)297, n. 12 *supra*).

*5(i) Free movement of goods and the electricity sector*

The German *Stromeinspeisungsgesetz* lays down a system to ensure that energy produced from renewable sources can gain access to the grid and thus to the national market. In line with the policy to support renewable energy, all 'electricity supply undertakings which operate a general supply network' are obliged to purchase all of the renewable electricity[92] produced within their area of supply.[93] Furthermore, they must pay a fixed minimum price for that electricity, calculated on the basis of the average nationwide sales price for electricity. These prices are set at such a level as to provide, in effect, a subsidy to generators of renewable electricity. This aspect had aroused some concerns under state aid law and the Commission had been keeping a close eye on these developments. Under the original incarnation of this law in 1990, price levels had been set at 90% of the average sales price for wind-generated electricity[94] and 75% for other sources (increased to 80% by an amendment passed in 1994).[95] Over time, the level of subsidy in real terms had risen as production levels and efficiency, particularly in the wind power sector, had increased. The Commission had expressed doubts that this situation was compatible with the state aids rules and had suggested changes to the calculation of the subsidies involved.[96] Changes wrought by the 1998 legislation[97] implementing Directive 96/92/EC provide for a new compensation mechanism for the distributor in cases of 'hardship'. Much of the Opinion in *PreussenElektra v. Schleswag* dealt with this issue and it is sufficient for our purposes to note that Advocate General Jacobs concluded that this complex of duties that provides support for renewable energy producers does not amount to state aid. This was basically because the support came directly from the utilities and not from state resources.[98]

However, I would like to focus here on the discussion of the compatibility of this purchasing obligation with the free movement of goods.[99] The original legislation referred only to the obligation on the electricity suppliers to purchase electricity generated from renewable sources 'within their area of supply', which could only cover power produced in Germany. The introduction in 1998 of a new rule concerning 'off-shore installations' seems to underline the national focus of this obligation: renewable electricity produced in an installation situated outside a supplier's area must be purchased by the operator of the network located closest to that installation.[100] When read with the new Paragraph 1 of the 1998 law, it is clear that the obligation applies only to electricity that has been generated in Germany. Advocate General Jacobs rightly emphasised some of the difficulties of making an

[92] From specified sources: water, wind, sun and biomass (Para 1 StrEG 1998).
[93] Para 2(1), StrEG 1998 (BGBl. 1998 I, 730).
[94] Para 3(2), StrEG 1990 (BGBl. 1990 I, 633).
[95] BGBl. 1994 I, 1618.
[96] Letter to the German Government, 25 October 1996, following complaints by the electricity supply undertakings about the impact of the renewables purchasing obligation upon them.
[97] *Gesetz zur Neuregelung des Energiewirtschaftsrechts* (Law reforming the Law on the Energy Supply Industry) (BGBl. 1998 I, 730).
[98] Environmental campaigners have welcomed this ruling, although for them the logic behind such support measures is that 'electricity prices do not reflect the environmental costs incurred by other forms of power generation' (*EU Energy Policy*, Issue 142, 31 October 2000).
[99] That electricity is treated as a good for the purposes of the E.C. Treaty is clear: see Case 2/64 *Costa v. ENEL* [1964] E.C.R. 1, Case C-393/92 *City of Almelo v. Energiebedrijf Ijsselmij* [1994] E.C.R. I-1477 and Cases 157, 158, 159 and 160/94 the '*Energy Cases*' (enforcement actions by the Commission against the Netherlands, Italy, France and Spain respectively).
[100] Para. 2(2), StrEG 1998.

assessment of the purchasing obligation under Article 28 EC: the exact impact of the 1998 law on the importation of electricity from other Member States is at best unclear; it is difficult to establish whether imports of renewable electricity are even technically feasible and it is especially tricky to distinguish such power from that generated from conventional sources.[101] Nevertheless, given the earlier conclusion concerning the allegation that the system amounted to an illegal state aid, the free movement issue could be 'decisive for the outcome of the main proceedings'.[102]

On the basis of established case law, there is little difficulty in establishing that such a measure has an effect equivalent to a quantitative restriction: *Campus Oil* made clear that any obligation to purchase a certain amount of products from a national source acts so as to restrict the ability of importing that same product from another Member State. By its restriction to German-produced renewable electricity, the StrEG favours the marketing of German electricity: indeed, Schleswag asserted that it had been offered Swedish renewable electricity at a reasonable price, but had been forced to decline to purchase it due to its obligation to take all of the wind-generated electricity from its own supply area.[103] Without arguing the point, Advocate General Jacobs advised that, even if a *de minimis* rule does exist under Article 28 EC, the figure of 1% of total German electricity consumption provided by renewables could not be viewed as negligible. Hence, the mechanism of the StrEG was in principle an infringement of Article 28 EC.

Could this infringement be justified? Any argument based on maintaining the security of supply would seem to be doomed in this context. Jacobs's remarks on the *Campus Oil* case are fully in line with the clear analysis of Advocate General Cosmas in his Opinion on the *Energy Cases*.[104] He stressed the dangers of an *interruption* in oil supplies that could threaten the *very existence* of the country, so that the fact that the Irish rules were designed to ensure the availability of a minimum supply would allow a public policy justification. These strict criteria are reflected in Advocate General Jacobs's swift dismissal of the argument, who comments that 'wind as an energy source is not yet as important for the modern economy as petroleum products. The special economic role of petroleum products was a decisive factor in the Court's rather exceptional judgment in *Campus Oil*'.

Of both greater interest and difficulty is the argument that environmental protection could justify the restriction. First of all, it is important to characterise the nature of the restriction in question: here, it is clear that renewable electricity of foreign origin is treated differently, both in law and in fact, from that produced in Germany.[105] This suggests that there is direct discrimination under the StrEG against foreign electricity. This conclusion has a number of important consequences. The provisions of Directive 96/92/EC do allow Member States to adopt certain provisions for the promotion of renewable electricity. However, Article 3(2) (which refers to public service obligations relating to, *inter alia*, environmental protection) requires that any obligations imposed must be non-discriminatory. Meanwhile, Articles 8(3) and 11(3) allow distinctions to be drawn by the transmission and distribution system operators to give priority to renewable energy sources; unfortunately for the StrEG,

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[101] Para 195 of the Opinion of Advocate General Jacobs in Case C-379/98 *PreussenElektra v. Schleswag AG*, delivered on 26 October 2000 (hereafter, 'the Opinion'). N.B. The opinion uses the old EC Treaty numbers, while this paper uses those in force after the Amsterdam Treaty for convenience.
[102] Para 194 of the Opinion.
[103] Paras 200-202 of the Opinion.
[104] Delivered on 26 November 1996, [1997] ECR I-5701, paras 69-85, esp. para 81ff.
[105] Para 220 of the Opinion.

these distinctions must be based only upon the different modes of production and not on grounds of nationality.[106,107]

Mandatory requirements such as 'environmental protection'[108] are in principle available only in cases of 'indistinctly applicable rules'.[109] On this basis, it would seem that the StrEG could not be saved by invoking environmental protection, despite the fact that the 'StrEG undoubtedly pursues environmental objectives of considerable importance[:] … the reduction of the emission of greenhouse gases and ... the preservation of finite conventional energy sources'.[110] However, in a series of recent cases, many of which have concerned the issue of environmental protection, the Court of Justice seems to have relaxed this requirement that the measure must be indistinctly applicable. The (in)famous *Walloon Waste* case[111] provides a celebrated example, where the Court managed to allow the application of an environmental justification, for a measure that clearly and on its face treated foreign (and indeed Belgian, non-Wallonian) waste differently from the home-grown variety, by reclassifying the 'good' in question by reference to the principle that it should be disposed of at source. This meant that waste produced in different places did have different characteristics, so that the rule prohibiting the storage, tipping or dumping of non-Wallonian waste in Wallonia could not be said to be 'discriminatory'.

Cases involving an even more flexible interpretation have followed. In the *Dusseldorp* ruling,[112] the Court was prepared to consider the possibility that a prohibition on the export of certain types of waste (clearly a distinctly applicable rule at best) might be justified by the mandatory requirement of environmental protection.[113] *Aher-Waggon*[114] presents a similarly confusing picture. The German measure in question required compliance on first registration of aircraft with stricter noise standards than those laid down by Directive 80/51/EEC.[115] However, aircraft already registered in Germany before the new measure were exempted (until they were modified technically), while those registered abroad had to meet the stricter

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[106] Furthermore, this rejection of Article 8(3) as a possible basis accords with the Commission's interpretation (in its 1999 Working Paper 'Electricity from renewable energy sources and the internal electricity market'), which stresses that Article 8(3) concerns dispatching priority only without any reference to further financial support.

[107] Given the current proposals for a Directive on the promotion of electricity from renewable energy sources in the internal electricity market (COM(2000)279 final, n. 55 *supra*), Advocate General Jacobs correctly declined to view the measures in Directive 96/92/EC as exhaustive harmonisation. This is welcome clarity, compared to some of the confusion on the status of harmonisation directives engendered by cases such as *Compassion in World Farming* (case C-1/96 [1998] E.C.R. I-1251), *viz*: 'exhaustively common minimum standards', which Notaro has described as a *contradictio in termimis* (see (2000) 25 E.L.Rev. 467, 474).

[108] Confirmed in Case 302/86 *Commission v. Denmark* [1988] E.C.R. 4607.

[109] See, e.g., Cases C-1/90 and C-176/90 *Aragonesa de Publicidad Exterior and Publivía* [1991] E.C.R. I-4151, para 13.

[110] Para 217 of the Opinion.

[111] Case C-2/90 *Commission v. Belgium* [1992] E.C.R. I-4431.

[112] Case C-203/96 *Dusseldorp and others v. Minister van Volkshuisvesting, Ruimtelijke Ordening en Milieubeheer* [1998] E.C.R. I-4075.

[113] Athough the Court ruled that the Dutch government's reasoning (that the restriction was necessary to safeguard the viability of the designated sole end-processor) was in fact a purely economic justification. As both Van Calster ((1999) 25 E.L.Rev 178, 183) and Notaro ((2000) 25 E.L.Rev. 467, 479) have noted, the Court could simply have rejected the claim by stating that the measure was directly discriminatory. Furthermore, the rejection on economic grounds alone is problematic: the economic considerations could be seen as purely ancillary to good waste management (Notaro).

[114] Case C-389/96 *Aher-Waggon v. Germany* [1998] E.C.R. I-4473.

[115] [1979] O.J. L18/26, as amended by Directive 83/206/EEC (O.J. 1983 L 117/15).

standards immediately. In *PreussenElektra*, Advocate General Jacobs was clear that the rule in *Aher-Waggon* amounted to direct discrimination against foreign registered aircraft,[116] yet the Court in *Aher-Waggon* appears not even to have referred to the distinction between Article 30 E.C. and mandatory requirement justifications. Instead, it seemed to apply the grounds of public health and environmental protection together and found the measure to be both necessary and proportionate. Finally, the *Laesø Brown Bee* case[117] shows a rather odd fact situation (the prevention of keeping any species of bee on the island of Laesø apart from the *Apis mellifera mellifera* (the eponymous brown bee)) concerning the maintenance of the indigenous insect population. Aside from the pedant's quip that a bee surely cannot benefit from an exemption protecting the 'health and life of *animals*', the Court's application of the Article 30 EC justification here seems to be a rather extensive interpretation of the derogation that is usually strictly interpreted. After all, if the point was the protection of biodiversity and the individual species, this 'is done to achieve the much wider objective of safeguarding the very essence of the environment as a whole'.[118]

In most of these cases, the Court has found itself in the potential strait jacket of the discriminatory character of the measure in question and has chosen to escape by a variety of means.[119] As Advocate General Jacobs points out, these cases show 'that it is desirable that even directly discriminatory measures can sometimes be justified on grounds of environmental protection'.[120] In the situation in the *PreussenElektra* case, where national governments seek to exercise the very freedom that they are still accorded under EC law to regulate the detailed aspects of their electricity industries, there may be very strong arguments in favour of a more flexible approach to the use of environmental protection as a justification. The considerations concerning a longer-term threat to the ecosystem may be highly relevant, even in the absence of any immediate threat to the health of humans or animals: in the context of the new environmental focus introduced by the Amsterdam Treaty, to ignore the environmental component of any overall European policy would fail to observe the obligation laid down in Article 6 EC.[121] Furthermore, there is a danger that the limitation of environmental protection to cases of indistinctly applicable rules may defeat the very purpose of such measures, especially given the commitment to rectify environmental damage 'at source'.[122] Despite the failure to amend the wording of

[116] Para 227 of the Opinion. It might be suggested that there was in fact no discrimination here, because the owners of the pre-registered German aircraft might be said to have had a legitimate expectation that their current registrations would not be nullified without some transitional scheme, given the costs they had incurred in the registration and maintenance of such aircraft under the previous regime, in reliance on their (under German law) fundamental right of property to be able to use their aircraft as before. However, it is unlikely that this would prove a successful argument before the Court.

[117] Case C-67/97 *Bluhme* [1998] E.C.R. I-8033.

[118] Notaro (2000) 25 E.L.Rev. 483.

[119] In Case C-120/95 *Decker v. Caisse de Maladie des Employés Privés* [1998] E.C.R. I-1831 a similar issue arose (undermining the balance of the social security system) and this has parallels in the other areas of the free movement case law (see Case C-204/90 *Bachmann v. Belgium* [1992] E.C.R. I-249, where, in a case concerning a provision that was arguably directly discriminatory, the public interest in the 'cohesion of the Belgian tax system' was held to be a sufficient justification for the measure in question). These cases show that the strait jacket imposed by the narrow list of grounds in Article 30 EC can cause difficulties in a number of areas that were not considered to be a potential restriction on trade or movement when the E(E)C Treaty was first drafted: the problem is not unique to the environmental sector, but is well illustrated thereby.

[120] Para 226 of the Opinion.

[121] 'Environmental protection requirements must be integrated into the definition and implementation of Community policies … including … the internal market'.

[122] Para 233 of the Opinion.

Article 30 EC at either the Amsterdam or the Nice Intergovernmental Conference, it is submitted that the importance of the issue at stake requires the Court to adopt a flexible attitude to environmental protection.

This sentiment would extend to the point of allowing environmental protection to be available to justify any restriction, provided that the measure in question could be proved to be necessary to achieve that end and proportionate to the objective. These caveats do provide some means of control: in the *PreussenElektra* case itself, Advocate General Jacobs questioned whether the achievement of a reduction in the emission of gases from conventional electricity generation would not be served just as well by allowing foreign-produced renewable electricity access to the German grid in a similar fashion.[123] Furthermore, there is the possibility that any claimed energy saving by stopping the transmission of such electricity over long distances, by feeding it into the local distribution network, may in fact not be made out in individual circumstances.[124] Imagine a producer just across the German border in France, the Netherlands or Denmark: in many instances, the transmission distance for these producers of renewable energy may be much shorter than that of German producers in the region of the German electricity supplier. Perhaps these difficulties would best be resolved by some form of harmonised conditions for the access of renewable energy to the grid, rather than by the admittedly imprecise vehicle of an Article 28 EC claim, which provides a further interesting example of the relationship between negative and positive harmonisation in European law. Only so much can be achieved by the judicial control of certain apparently beneficial practices.

Interestingly, in the Explanatory Memorandum to the Commission's proposed Directive on the promotion of renewable electricity, some of these trade issues are explored in the context of possible future harmonisation. The danger of the suggestion of Advocate General Jacobs that the nationality ground be removed and foreign electricity allowed access to the German grid on similar terms 'is that the co-existence of different schemes, even if open to foreign producers, may lead to distortions of the market, e.g. when all [renewables] producers will try to benefit from the national system offering the best conditions, e.g. in terms of prices paid'.[125] Furthermore, there is a generally perceived wisdom shared among those in the drafting and negotiation process that we are still at too early a stage to propose the exact shape of any more comprehensive harmonisation of these schemes – the Commission, the Economic and Social Committee and the European Parliament are at one on this issue. In the interim period, *PreussenElektra* illustrates that the Court may be placed in a very difficult position *vis-à-vis* these measures for the support of renewable electricity. This may be a further argument for a more flexible attitude to environmental justifications for restrictions on free movement such as those at stake here.

### *5(ii) Competition law*[126]

It has become apparent from the foregoing discussion that there are many areas where the application of the competition rules of the EC Treaty may be a useful tool for

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[123] Para 236 of the Opinion.

[124] Para 237 of the Opinion.

[125] COM(2000)279 final, n. 55, *supra* at 6.

[126] For a general discussion of some of the relevant competition law issues in the sector, see Hancher, L. 'Competition policy catches up with the energy sector' 139 (2000) *EU Energy Policy*, 13 July 2000. One area in need of further coverage, as highlighted by the debate on renewables above (see the text at n. 55 *supra*) is the role of state aids law and policy in the electricity sector.

securing the functioning of the Internal Electricity Market. Unfortunately, the extent of guidance currently provided for the sector on the application of these rules is less than comprehensive. For many years, the energy sector was the 'forgotten man' of the enforcement of the Treaty rules[127] and only in more recent times has a clearer policy emerged in favour of subjecting the sector to the rules on competition and the single market. This was first signalled in the Commission's Working Document on the Internal Energy Market in 1988[128] and followed up by the enforcement actions in the *Energy Cases*,[129] which were commenced in parallel with the first attempt to pass the internal market Directive for electricity in 1992. This very short period of evolution of the competition rules places the sector in a somewhat more precarious position than most in the context of the latest reforms and proposed amendments to EC competition law.[130] These trends are worthy of brief discussion here.

(a) The new Verticals Regime[131]

This reform, which aims to reflect modern received economic wisdom on the impact of vertical agreements on competition, entered into force on 1 January 2000 and began to apply from 1 June 2000.[132] The basic idea of the new rules is that, subject to exception for certain types of clauses, vertical arrangements are in principle not a competition concern, *unless* the party that is in a position to impose them wields significant market power.[133] A detailed set of Commission Guidelines on the application of this 'Umbrella Block Exemption' has been published, which also covers the application of the competition rules to those agreements that do not fulfil the exemption conditions of the Regulation.[134] Under the amended Article 4(2) of Regulation 17/62, late notification of such vertical agreements no longer deprives them of a possible exemption from the date of their entry into force,[135] so even if the agreement is found to fall outside the exemption, the Commission will make no presumption of its illegality, will bear the burden of proving any infringement and can back-date any exemption granted.[136] When coupled with the possibility of severing certain undesirable clauses from the overall agreement under Article 5, the new Regulation provides much increased flexibility for undertakings and the Commission alike.

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[127] See Slot, P.J. 'Energy and Competition' 31 (1994) *C.M.L.Rev.* 511 for a useful account of the Commission's hesitant approach to applying the competition rules to the energy sector.
[128] COM(88)232, (1988), para 35.
[129] See n. 99, *supra*.
[130] Furthermore, the rapid pace of liberalisation in some countries, coupled with certain imbalances in market opening between different Member States, has led to a rash of merger activity over the past few years. Unfortunately, constraints of space here preclude any detailed consideration of the fast-moving case law in the merger field.
[131] For a detailed commentary on these provisions, see Whish, R. 'Regulation 2790/99, The Commission's new style block exemption for vertical agreements' 37 (2000) *C.M.L.Rev.* 887.
[132] Commission Regulation 2790/1999/EC of 22 December 1999 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices OJ 1999 L 336/21 (29 December 1999), Article 13.
[133] I.e. 'competition concerns can only arise if there is insufficient inter-brand competition, i.e. if there exists a certain degree of market power' (Communication from the Commission on the application of the Community competition rules to vertical restraints – Follow-up to the Green Paper on Vertical Restraints', Section III(1) 'Vertical restraints and market power').
[134] 'Commission Notice – Guidelines on Vertical Restraints' OJ 2000 C 291/1 (13 October 2000).
[135] As amended by Article 1 of Council Regulation 1216/1999/EC of 10 June 1999 (OJ 1999 L 148/5, 15 June 1999).
[136] See the Guidelines, n. 134, *supra*, paras 62-65.

Many agreements in the electricity sector will fall to be considered under this regime, as the relationships in question are commonly 'vertical' (in that each undertaking 'operates … at a different level of the production or distribution chain' as required by Article 2(1) of the Regulation). Hence, agreements between producers and distributors[137] are likely to be exempt from the application of Article 81(1) EC, provided that they do not involve any so-called 'hard-core restrictions', which generally refer to territorial protection clauses and attempts to impose retail price maintenance (Article 4). The presence of even one of these restrictions causes the whole agreement to lose the benefit of the exemption.[138] As the level of competition increases, it might be expected that more and more agreements would be able to take advantage of the exemption, creating a genuine 'safe harbour' in most cases in the electricity sector. However, this may be tempered by the intense merger activity in the sector; indeed, some difficulties might be experienced where two undertakings, both with an element of vertical integration,[139] seek to enter such agreements, as Article 2(4) makes it clear that the exemption is inapplicable to 'competing undertakings'. If such an agreement is to escape, it seems that Article 2(4)(b) must be satisfied: the exemption can apply if 'the supplier is a manufacturer and distributor of goods, while the buyer is a distributor not manufacturing goods competing with the contract goods'. The Guidelines state that this 'covers situations of dual distribution, i.e. the manufacturer of particular goods also acts as a distributor of the goods in competition with independent distributors of its goods'.[140] While this wording is perhaps not particularly helpful in explaining the position of electricity companies, it seems clear that much will depend upon the pre-existing structure of the industry in any given area and the way in which mergers and acquisitions have developed the situation on the market.

In principle, even an agreement between a transmission system operator and a grid user is vertical; however, the market power criterion in Article 3 is likely to scupper any attempts by such system operators to rely upon the exemption. Almost inevitably, the operator will hold a market share far in excess of the 30% threshold. Various rules (see Article 9 and the accompanying Guidelines, paras 88-99) are provided for the definition of the relevant market and the calculation of the market share of the undertaking(s) thereon.

Finally, it should not be forgotten that the Block exemption cannot exempt the abusive conduct of undertakings with a dominant position on the market from the discipline of the Treaty's competition rules. Cases such as *Hoffmann-La Roche*[141] show that Articles 81 and 82 EC are capable of applying in one and the same situation, such as where a dominant undertaking requires its junior contractual partner(s) to respect or impose restrictive conditions. The recent development of the concept of 'collective dominance' has the potential to affect the electricity industry in this context, especially after the judgment of the Court of Justice in the long-running *Compagnie Maritime Belge* litigation.[142] There, on the question of the links between

[137] But not between producers/distributors and final consumers, as their position is not covered by the exemption under Article 2(1).
[138] See the Guidelines, n. 134, *supra*, paras 66-67.
[139] Complicated still further by the possibility (under Article 11) that the parties' 'connected undertakings' may provide a presence on a level that prevents reliance upon the exemption.
[140] See n. 134, *supra*, para 27.
[141] Case 85/76 *Hoffmann-La Roche A.G. v. Commission* [1978] E.C.R. 1139.
[142] Joined cases C-395 and 396/96 P *Compagnie Maritime Belge v. Commission* [2000] E.C.R. I-0000 (Judgment of 16 March 2000), concerning the practices of certain liner conferences in the shipping

two legally independent undertakings that were necessary to show that they formed, for economic purposes, 'a collective entity' on a particular market,[143] the Court held that an agreement containing appropriate terms could constitute that link. However, 'the existence of an agreement or of other links in law is not indispensable to a finding of collective dominant position; such a finding may be based on other connecting factors and would depend on an economic assessment and, in particular, on an assessment of the structure of the market in question'.[144] If this is sufficient to show dominance, then its abuse may be caught, even in the presence of a suitable block exemption under Article 81 EC. The case of *Tetra Pak Rausing S.A. v. Commission*[145] had suggested that any individual exemption granted under Article 81(3) by the Commission must, of necessity, also have considered any possible breach of Article 82, while block exemptions do not involve that individual assessment and so must be presumed to afford no such protection. Arguably, even this assessment of the effect of Article 81(3) EC is over-generous, as Article 82 EC is directly effective and can be relied upon in national courts; so, of course, can block exemption Regulations. Either way, as and when the Commission's overall modernisation proposals come into effect, the whole issue will land at the door of the national courts. This will only serve to underline the need for further guidance on the proper application of competition law to the sector and may underline the fears expressed by industry that too much flexibility in competition law enforcement may produce unacceptable legal uncertainty.[146] However, in those countries where there is an active and ongoing consideration of the relationship between the roles of sector-regulator (such as Ofgem in the United Kingdom) and the competition rules, there may be a greater fund of experience upon which to draw. Nevertheless, there is clearly great potential for an increase in references to the European judicature on such issues in the future.

(b) The Modernisation proposals[147]

Under a system of *ex ante* control, the burdens on the resources of the Commission as the regulatory authority were becoming increasingly unbearable. As the heart of the centralised system of control, the Commission had the monopoly over the grant of exemptions under Article 81(3) EC and all agreements had to be notified[148] to the Commission if they were to benefit from an individual exemption. This system had the merit of providing a good degree of uniformity in the interpretation and application of EC competition law, yet was becoming swamped by the increasing

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industry. The relevant sectoral block exemption (Regulation 4056/86/EEC on Maritime Transport, OJ 1986 L 378/4) expressly states that such exemptions do not provide any defence under Article 82 EC.

[143] *Compagnie Maritime Belge*, n. 142 *supra* para 36.

[144] *Compagnie Maritime Belge*, n. 142 *supra* paras 44-45.

[145] Case T-51/89 *Tetra Pak Rausing S.A. v. Commission* [1990] E.C.R. II-309, para 21ff. This assessment is echoed by Furse, M. *Competition Law of the UK &EC* (Blackstone Press, 2nd ed., 2000), 208.

[146] This is a bit of a 'better the devil you know' attitude, yet it does contain some justifiable concerns (see the discussion of the modernisation proposals in the text accompanying n. 147, *infra*).

[147] See 'Proposal for a Council Regulation on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty [etc.]' COM(2000)582 final (27 September 2000) (see Commission Press Release IP/00/1064 and OJ 2000 C 365/284 (19 December 2000)). This document is also available on the website of the Commission's Directorate General for Competition - see this address: http://www.europa.eu.int/comm/competition/antitrust/others/modernisation/comm_2000_582/en.pdf. It is intended to replace the current Regulation 17/62.

[148] Furthermore, notification usually granted immunity from fines and prevented legal challenges to an agreement's validity before national courts.

numbers of notifications received. In fact, very few notifications ever resulted in formal decisions: the comfort letter, a soft law measure of administrative convenience had become the norm, with a resulting reduction in legal certainty for the companies subject to the competition rules. In response to these developments, the Commission's White Paper proposed 'the abolition of the notification and exemption system and its replacement by a Council Regulation which would render the exemption rule of Article [81](3) directly applicable without prior decision by the Commission. Article [81] as a whole would be applied by the Commission, national competition authorities and national courts, as is already the case for Article [81](1) and [82].' The idea was to allow a more tightly focused Commission role in developing competition policy, concentrating on serious infringements and leading the evolution of the rules by means of Regulations and Notices. Furthermore, compliance costs for industry would be reduced and national courts and authorities would be encouraged to apply the competition rules more thoroughly and frequently.[149]

These suggestions have now been formulated in a formal proposal, which seeks to address some of the concerns of uniformity of application of competition law (thus preventing the so-called 're-nationalisation' of competition rules) and of legal certainty for the companies subject thereto. Under Article 1 of the proposed Regulation, Article 81(3) EC shall be directly applicable and no prior Commission administrative decision on compatibility therewith shall be required. The burden of proof under Article 81(3) is to fall on the party invoking the benefit of the exemption (Article 2 of the proposed Regulation). A number of other procedural codifications (e.g. the Commission's power to adopt interim measures (Article 8)) and reforms seek to enhance the Commission's enforcement powers to increase the effective application of the competition rules (e.g. ensuring the deterrent effect of fines and periodic penalty payments under Article 22 and 23). These measures seek to reinforce and intensify the level of *ex post* control exercised by the Commission and, as Hancher has commented,[150] the energy sector may have good reason to fear such developments as incumbents may increasingly find themselves subject to complaints by prospective new entrants and harsher Commission reactions to any conduct later found to be reprehensible.

The Commission proposes that, to maintain consistency in the application of the competition rules, a number of elements developed by the Court and Commission should be made explicit in the new Regulation. Thus, the obligation of co-operation between national courts and authorities (on the one hand) and the Commission (on the other) is recorded in Articles 15 and 16: 'every effort' shall be used 'to avoid any decision that conflicts with any decisions adopted by the Commission'. This is to be supplemented by provisions for formal co-operation between national authorities and the Commission in the running of certain types of individual case[151] (Article 11) and the Commission promises the development of a 'network' of national competition authorities, in which all apply the same law and policy when they enforce the EC competition rules. This is to be achieved under the auspices of Article 11 by means of

[149] 'Commission White Paper on Modernisation of the Rules implementing Articles 85 and 86 of the EC Treaty' (Commission Programme No. 99/027, 28 April 1999) OJ 1999 C 132/1, 12 May 1999, paras 12 and 13.

[150] Hancher, L. 'Competition policy catches up with the energy sector' 139 (2000) *EU Energy Policy*, 13 July 2000

[151] The adoption of prohibition decisions, decisions accepting commitments and decisions withdrawing the benefit of a block exemption (Article 11(4) of the proposed Regulation).

the publication of a Notice, to 'foster the development of a common competition culture throughout the Community'.[152]

Furthermore, the publication of clearer Commission guidance on the application of the rules and policies is to be expected and the recent Verticals Block Exemption Regulation is perhaps a good indicator of the approach that the Commission will follow. If this preference for a more generalist approach signals a departure from the climate in which the Telecommunications Access Notice[153] was published then this does not augur well for legal certainty in the energy sector in the application of general competition law to its specific issues (such as long-term contracts and interconnector capacity, mentioned above). However, the continued development of policy in the specific sector of Telecommunications, evinced by the recent projects on 'Voice on the internet'[154] and access to the local loop,[155] as well as the current proposal for a consolidation of the competition rules applicable to the sector in a Directive,[156] suggests that such fears may be more speculation than reality. If the regulatory consultation process begun by the Florence Forum (and its Madrid counterpart for the natural gas industry) can be carried forward in this field as well, then the prospect of sector-specific guidelines for the electricity and gas sectors may be an attainable one. Indeed, the likely complaint from (some) Member States (if recent Council statements on speeding up the process are anything to go by) may well be that this sector-specific approach is not developing rapidly enough. Recent speeches by various officials in DG(Comp)[157] have endeavoured to highlight some of the relevant issues, which include the application of the state aids rules to 'stranded costs' and renewable energy, interconnector capacity, access to the grid, freedom of choice of supplier for consumers and the control of joint ventures and mergers. These initiatives will have to be pressed further and faster if the achievement of full market opening is not to come at the cost of a number of structural weaknesses that could dog the sector for the foreseeable future.[158]

*5(iii) Services in the general (economic) interest*[159]

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[152] Proposal for a Regulation, n. 147, *supra*, section 2.C.2

[153] Commission Notice on the Application of the Competition Rules to Access Agreements in the Telecommunications Sector – Framework, Relevant Markets and Principles', 31 March 1998 (OJ 1998 C 265/2, 22 August 1998).

[154] Commission Consultative Communication on the status of voice on the internet OJ 2000 C 1777/3.

[155] Commission Communication 'Unbundled Access to the Local loop - Enabling the competitive provision of a full range of electronic communication services including broadband multimedia and high-speed internet', COM(2000)237, 26 April 2000 (OJ 2000 C 72/55, 23 September 2000).

[156] Draft Competition Directive consolidating existing Directives on competition in the telecommunications markets, 12 July 2000 (see Commission Press Release IP/00/766 of the same date)

[157] See, for a selection of material in English, Albers, M. 'Views and Expectations of Competition – Developments in the EU Electricity Market', UNIPEDE/EURELECTRIC Workshop on the End of the Implementation Process of the Internal Electricity Market Directive, Brussels 24 and 25 March 1999 (see: http://www.europa.eu.int/comm/competition/speeches/text/sp1999_009_en.html; Tradacete, A. 'The Role of Competition Policy in the Liberalisation of EU Energy Markets', Brussels, April 2000 (see: http://www.europa.eu.int/comm/competition/speeches/text/sp2000_003_en.pdf; Schaub, A. 'Competition Policy and liberalisation of energy markets', European Utilities Circle 2000, Brussels, 23 November 2000 (see the following address on the DG(Comp) website for details: http://www.europa.eu.int/comm/competition/speeches/text/sp2000_023_en.pdf).

[158] An opinion reflected in the leaked Draft Communication, discussed above (n. 84, *supra*).

[159] This is a necessarily brief overview of some of the relevant issues concerning services in the general interest, focusing mainly on the likelihood of political or legislative action. There is also a wealth of case law on Article 86(1) and (2) EC (ex-Article 90 EC), discussed in contributions by (*inter alia*) Slot, P.J. (28 (1991) *C.M.L.Rev.* 964 and 35 (1998) *C.M.L.Rev.*1183), Edward, D. and Hoskins, M. ('Article

In 1996, the Commission adopted a Communication on 'Services of General Interest in Europe'.[160] This treated services of general interest as being 'at the heart of the European model of society'[161] and called for a specific reference to 'services of general interest' as one of the activities of the Community in Article 3 of the EC Treaty to be incorporated by the Amsterdam Intergovernmental Conference. The final text of Article 16 EC, however, may well have wider implications:

> 'Without prejudice to Articles 73, 86 and 87, and given the place occupied by services of general economic interest in the shared values of the Union as well as their role in promoting social and territorial cohesion, the Community and the Member States, each within their respective powers and within the scope of application of this Treaty, shall take care that such services operate on the basis of principles and conditions which enable them to fulfil their missions.'

At the Lisbon European Council, the Member States considered

> 'it essential that, in the framework of the internal market and of a knowledge-based economy, full account is taken of the Treaty provisions relating to services of general economic interest, and to the undertakings entrusted with operating such services. It asks the Commission to update its 1996 communication based on the Treaty'.[162]

As a result of this prompting, the Commission has now drawn up a new Communication on the subject, in the light of more recent experience in this field, providing guidance on the Community law rules on competition and the internal market as well as developing the European framework for such services.[163]

The Council has welcomed the new Communication,[164] supporting in particular the references to the role of Member States under Article 86(2) EC in determining the tasks, operation and financing of such services, subject to the Commission's scrutiny of the proportionality of such measures. However, the Council did suggest a clarification of the operation of the State aid rules in relation to the funding of such tasks, especially where such funding is provided to offset the extra costs incurred in providing such services.

There is one initiative upon which the Commission and the Council seem firmly agreed: the need to conduct an exercise to monitor public service *standards* (concerning, for example, service quality, accessibility and fair and transparent pricing).[165] Under Directive 96/92/EC, the Member States are already under an

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90, Deregulation and EC Law', 32 (1995) *C.M.L.Rev.* 157), Edward, D., 'Article 90 EC Treaty and the Dergulation, Liberalisation and Privatisation of Public Enterprises and Public Monopolies', Report for the Series 'Europe before the Intergovernmental Conference 1996', (Bonn: Zentrum für Europäisches Wirtschaftsrecht, 18 December 1995), Publication No. 60 and Hancher, L. (16 (1998) *Journal of Energy and Natural Resources Law* 42), and summarised in a very helpful manner in Ross, M. (25 (2000) E.L.Rev. 22).

[160] OJ 1996 C 281/3.

[161] Commission Communication of 1996, n. 160 *supra* para 1.

[162] Presidency Conclusions, Lisbon European Council, 24 March 2000, para 19.

[163] European Commission Communication 'Services of General Interest in Europe' OJ 2001 C 17/4 (21 January 2001).

[164] Council on Internal Market, Consumers and Tourism, Brussels 30 November 2000 (Press release 13663/00).

[165] As the Commission notes in Annex I to the Communication, not only are many licences made subject to certain conditions on service standards, but such levels of performance are another are in which companies compete: hence, intense competition can lead to significant improvements in standards of service, above the levels set by regulators. As yet, no Member State has sought a

obligation to notify any public service *obligations* to the Commission and such obligations must be 'clearly defined, transparent, non-discriminatory and verifiable'.[166] The Commission is particularly keen to require Member States to notify it of all measures taken, so that a report could be drawn up on a regular basis: then, the Commission could (where appropriate) issue recommendations on best practice in ensuring high public service standards.[167] While the Council seemed more cautious about the appropriate level for such actions, there is clear agreement upon the need to maintain the extensive consultation practice that has developed in this general area in recent years.[168]

The precise future impact of the Article 16 EC is difficult to predict. Ross's evaluation seems a sensible one:[169] its wording seems to leave intact the case law developed under Article 86(2), while (more fundamentally) upgrading services of general economic interest into 'positive horizontal policy-shaping considerations for both Member States and Community institutions'. The 'shared Union values' and the promotion of 'social and territorial cohesion' reflect the attitude taken in the Commission's original Communication and, in the updated version, there is a clear Commission drive to promote a 'European perspective on general interest services for the benefit of citizens',[170] to the point of recognising that 'a core common concept of such general interest may be necessary to sustain allegiance to the Union'.[171] This movement towards making explicit a link between such services and European citizenship was presaged by Ross,[172] but this lies beyond the scope of this paper. Suffice it to say here that the maintenance of a number of public service values will prove a question of considerable difficulty in a liberalised electricity market, as competition intensifies and companies are less willing and/or able to provide services that do not turn a (sufficient) profit for their shareholders.[173] In its leaked Draft Communication, this is one area where the Commission does provide a specific proposal: the right for householders to be connected to the grid and be supplied on reasonable conditions 'must be viewed as an underlying objective of the internal market'. It is difficult to see how this could have been stated so clearly (in the absence of specific legislation) until the advent of Article 16 EC.

Finally, in an Annex to the new Communication, the Commission discusses the 'State of Play for Individual Sectors' with regard to general interest services.[174] In

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derogation (under Article 3(2)) from the requirements of Directive 96/92/EC on the ground that no less restrictive way of achieving a public service objective could be found, which suggests that this improvement in standards is sustainable at least in the short to medium term.

[166] Article 3(2) of Directive 96/92/EC.

[167] 'Details of forthcoming proposals for full opening of the Internal Energy Market' No. 90 *EC Inform-Energy* – February 2001, at 9; and see the new Communication (n. 163, *supra*), paras 62-63.

[168] See the Commission's latest Communication (n. 163, *supra*), para 59 for examples from the postal and telecommunications sectors.

[169] Ross, M. 'Article 16 E.C. and services of general interest: from derogation to obligation?' 25 (2000) E.L.Rev. 22, 33-34.

[170] Communication of 21 January 2001, n. 163 *supra*, para 57.

[171] Commission Communication of 21 January 2001, n. 163 *supra*, para 64, citing the reference in Article 36 of the Draft Charter of Fundamental Rights to access to services of general economic interest, *viz*: 'The Union recognises and respects access to services of general economic interest as provided for in national laws and practices, in accordance with the Treaty establishing the European Community, in order to promote the territorial and social cohesion of the Union.'

[172] Ross, M., *supra* n. 169, at 34-38.

[173] See the admirably clear discussion by Patterson, W. 'Can Public Service survive the market? Issues for Liberalised Electricity', Royal Institute of International Affairs Briefing Paper, New Series, No. 4 (July 1999).

[174] Annex I to the Communication of 21 January (n. 163, *supra*).

the Energy section, the security and reliability of the network is emphasised (having retained its monopoly character in most countries – indeed, in Span and The Netherlands, there are reports that the transmission network is being brought (back) into public ownership). The possibility for Member States to take action to protect the security of supplies is highlighted (such as specifying the fuel type for new generation) and the need to protect the less powerful consumers is underlined (both in the right to a grid connection and in special provisions to prevent disconnection, using minimum licence conditions). The tenor of and examples in the Communication with regard to the energy sector both suggest that increased activity on the European level is to be expected in the near future. A review of regulatory reform and service standards in the gas and electricity industries is firmly on the Commission's Work Programme for 2001[175] and in the Communication on Services of General Interest, the Commission states that this is currently being prepared.[176] In conjunction with the forthcoming reform proposals for the achievement of a fully open, internal market, these developments could prove highly significant for suppliers and customers alike.

## 6. Conclusions

This paper has attempted to provide an overview of the major developments and issues arising from the fast-moving liberalisation process in the Community electricity sector, while delving into some of the controversies uncovered in more detail. The political will to achieve the goals of liberalisation, market opening and increased competition is growing even now among Member States. This has the effect of driving forward the rate of proposals at the European level. Nevertheless, difficult cross-cutting interests and policies illustrated within and between certain Member States are regularly illustrated by negotiating behaviour on the European level. The role of the Trade Unions in the French liberalisation process is a difficult and unpredictable one, which also relates to the future possible role of Electricité de France.[177] Furthermore, plans such as that of the Portuguese government for states to retain a 'golden share' on the privatisation of electric utilities, even if only a minority stake is retained, are coming under increasing scrutiny at the European level.[178] In both cases, there is a clear policy tension on the national level between recognising the benefits of liberalisation and fearing for its consequences without retaining certain types of national regulation.

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[175] 'Commission Work Programme for 2001' No. 90 – *EC Inform-Energy*, February 2001, 7, which combines COM/01/28 (31 January 2001) with the leaked internal paper discussed above (n. 84, *supra*).

[176] OJ 2001 C 17/4, para 59 (in the footnotes).

[177] See Jones, T. 'Dark days for electricity sector dim hopes of French volte-face', *European Voice* 1-7 February 2001, 21, which records the unions' intense pressure on the socialist government to resist the drive towards liberalisation, using the Californian crisis as an indicator of what can go wrong in an insufficiently regulated market (even though it seems clear that the conditions for the Californian situation are not present in the European, or the French, market). The article 'Electricité de France – A giant awakes' (*The Economist*, 4 November 2000, 119) suggests that the EdF management are currently talking a good liberalisation game, while handicapped in this by the domestic political situation, but points out that EdF still benefits greatly from its incumbent status. This suggests a tension even within the French sector itself about the future role for their industry within any European electricity market.

[178] See 'European Commission – Lisbon protects EDP with golden share' 141 (2000) *EU Energy Policy*, 29 September 2000. The Court of Justice in Case C-58/99 *Commission v. Italy* (judgment of 23 May 2000) has ruled that a similar golden share held by the Italian state in Eni infringed the Community rules on the free movement of capital and was thus illegal.

These difficulties will no doubt be to the fore in the inevitable forthcoming negotiations on the next round of proposals from the Commission and may lead to a fuller consideration of perhaps the key general issue: what is the breadth and depth of regulation *at the European level* envisaged for the electricity (or indeed energy) sector? Should there be ever more extensive, sector-specific rules to cope with the difficulties of co-ordinating an ongoing liberalisation process, or should greater reliance be placed upon competition law mechanisms? In its Second Harmonisation Report,[179] the Commission opened the debate on this issue in the context of the regulation of transmission system operators, suggesting that specific regulation (beyond competition law) was necessary and proposing either some regulatory forum co-ordinated by the Commission, or a European level regulatory instrument, run by the Commission or some new 'European Regulator'. This general impression can only have been underlined by the Commission's experiences with the Florence Forum and by industry workshops over the past year,[180] so, in the light of the forthcoming proposals for the sector, the Member States will have much to ponder.

The encouragement of desirable objectives (such as the promotion of renewables, infrastructure investment, greater recourse to local generation, Combined Heat and Power (or cogeneration), etc.) may run into conflict with much of the presentation of the liberalisation issue. Most sales talk in favour of market opening has been couched in terms of its ability to secure lower prices and better services, yet this may not encourage energy saving practices and will continue to threaten the environment and make achieving the Kyoto targets ever more difficult.[181] That these environmental goals form only one (albeit very important) part of the policy mix is made clear by the recent Green Paper on the security of energy supply[182] and this issue overlaps with another more general question concerning public service and the market. Reaching the right balance of often conflicting policy objectives in a flexible and responsive manner will be the key to (perceptions of) the success of the liberalisation project on the European level. In all of this, the role of the courts in the liberalisation process, both on a national and the European level must not be forgotten. Reforms of competition law and the apparently increasing use of legal instruments to achieve certain policy goals will, at times, place the courts in unenviable positions in the interpretation of the applicable regimes. Much as with the *Cassis de Dijon* case law,[183] the pronouncements of the Court of Justice could yet have a profound impact upon the regulatory responses to the problems raised by competition law and the internal market for the electricity sector, as perhaps illustrated by the environmental protection cases discussed above.

In the light of this complex combination of interests, policies and legal analyses, the progress of electricity (and, indeed, natural gas) liberalisation in the

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[179] 'Second Report to the Council and the European Parliament on the Harmonisation Requirements: Directive 96/92 concerning the internal market for electricity', (SEC 1999/470) – 16 April 1999, section III on Regulation of the Electricity network at the European level.

[180] See, for example, the position paper presented by the European Energy Millennium Forum (EEMF) at a conference in Brussels on 27 June 2000, attended by the Commission (reported in 'Is the EU ready for a European energy regulator?' 139 (2000) *EU Energy Policy*, 13 July 2000).

[181] See, generally, Patterson, W. *Transforming Electricity: The Coming Generation of Change* (RIIA/Earthscan, 1999).

[182] Commission Green Paper 'Towards a European strategy for the security of energy supply' COM(2000)769, Brussels, 29 November 2000 (available on the DG(TREN) website at the following address: http://www.europa.eu.int/comm/energy_transport/library/livre-vert/livre-vert-en.pdf).

[183] Case 120/78 *Rewe-Zentrale A.G. v. Bundesmonopolverwaltung für Branntwein* [1979] E.C.R. 649 ('*Cassis de Dijon*').

European Union in 2001 and beyond is a rich subject for study and worthy of the closest attention from government, industry, academics and the public alike. Many details still remain to be worked out and the interaction between the various interested parties will continue to provoke a wide range of responses as the process unfolds. The old attitude towards electricity ('taken for granted … at least until the bill arrives') has already changed beyond recognition and this process must continue to develop in the twenty-first century. For now, the open question is: what role should the European Union play in securing this development? This paper has tried to summarise the areas where an answer may be nearer than we might think.