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The Liberalization of the European Energy Sector from an Ownership Perspective

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Summary

The European energy market has undergone a large transformation in the last 20 years. It has gone from being a market strictly controlled by the Member States and dominated by state monopolies to being a privatized market under the rules of the market economy. This process has as its main aim to create a free and unified European energy market characterized by productive competition.

A number of secondary legislation acts has been adopted by the Council in order to apply Union Law to the area in an efficient way and to regulate the cooperation between the Member States. The most important acts are the Electricity Directive 2003/54/EC, the Gas Directive 2003/55/EC as well as the Electricity Regulation (EC) 1228/2003 and the Gas Regulation (EC) 1775/2005. The central task of these Directives is to promote actions on national level in to create an open sector without discrimination and to reduce risk of market dominance and predatory behaviour. The Regulations have been adopted in order to implement rules meant to promote the trade of energy between the Member States of the EU and to contribute to a unified energy market. They mainly aim at setting up frame provisions on conditions for cross border distribution and access to such infrastructure.

The rules on competition in the EC-treaty make up an important basis for the current work in the energy market. Article 86 EC on state controlled companies and Article 87 EC on state aid are of special interest when discussing the issues on the liberalization of state owned companies. State control over private companies is only illegal if it is exercised in a way that breaches any of the other competition rules of the treaty. Article 82 EC on abuse of dominating position is of special importance in this context. This Article serves to exclude principally all measures take by the state where it uses its position to set interfere with the conditions of the market. All measures construed as state aid under Article 87 EC are basically illegal. Such measures are only allowed when they can be justified under one of the exceptions in the article. These exceptions mainly consist in performing public service obligations, in which case the aid shall function as a compensation. The *raison d'être* of Article 86 and 87 EC is to restrain the involvement of the state in the market to an absolute minimum. This involvement may only occur in situations where it necessary to reach justified social or environmental goals that lie outside of what the free market can achieve and not go beyond what is necessary to reach these goals.

Even though the European energy production of today is mainly performed in the form of companies principally subjected to the terms of the free market, some obstacles still exists before the goal of a unified and liberalized energy market is achieved. The European energy sector is still divided in to national market that are often controlled by the former state

monopolies, thus lacking in real competition. This has led to insufficient new investments in infrastructure, especially concerning transmission systems between the Member States. The Commission has for these reasons proposed a new legislation package on this area. This shall provide stricter secondary legislation in the area by making the duties of the Member States in the process of deregulating national monopolies clearer. The new legislation is also meant to provide for a more efficient surveillance of the market. This seems to be a step in the right direction as the problems of the market to a large extent derives from the dominating of the former national monopolies. Those companies do often have interests in directly hindering the opening of the market in order to protect their dominating positions. Because these companies are to a large extent still owned by the Member States, they often have interests in protecting their national markets. What is primarily needed are more multi national actors that lift the focus to an international level in the energy sector. In order for the work of opening the sector to have a real result, a thorough reworking of regulations, surveillance and infrastructure is needed.

Sammanfattning

Under de senaste 20 åren har den europeiska energimarknaden genomgått stora förändringar. Sektorn har gått från att vara strikt kontrollerad av medlemsstaterna och dominerad av statliga monopol till att vara privatiserad och ställd under marknadsekonomiska villkor. Målet med denna process är att skapa en fri och gemensam Europeisk energimarknad kännetecknad av produktiv konkurrens.

För att på ett effektivt sätt omsätta unionsrätten på området och reglera samarbetet mellan medlemsstaterna och unionen har ett antal sekundärrättsliga akter antagits av rådet. De mest centrala är eldirektivet 2003/54/EG, gasdirektivet 2003/55/EG samt elförordningen (EG) 1228/2003 och gasförordningen (EG) 1775/2005. Direktiven har till främsta uppgift att skapa likvärdiga förutsättningar för producenterna på marknaden och minska riskerna för missbruk av dominerande marknadsställning. Det främsta verktyget för att uppnå dessa mål har varit uppdelningen av verksamheterna för energiproduktion och distribution hos de dominerande elbolagen. Förordningarna har antagits för att implementera regler som skall främja energihandeln mellan unionens medlemsstater och bidra enandet av den europeiska energimarknaden. De inriktar sig främst mot att reglera hur avgifter får tas ut vid energidistribution mellan unionens medlemsstater och villkor för tillträde till dessa distributionssystem.

De konkurrensrättsliga reglerna i EG-fördraget utgör en central en viktig primärrättslig bas för arbetet inom energimarknaden. Vid arbetet med att liberalisera statsägda företag är artikel 86 EG om offentliga företag och artikel 87 EG om statligt stöd av speciellt intresse. Statlig kontroll över företag strider endast mot fördragets regler om det utövas på ett sätt som strider mot dess konkurrensrättsliga föreskrifter. I detta sammanhang får artikel 82 EG mot missbruk av dominerande ställning en särskild betydelse. Denna medför att i stort sett alla åtgärder där staten utnyttjar sin särställning för att åsidosätta marknadens villkor är förbjudna. Alla statliga åtgärder som klassas som statligt stöd under artikel 87 EG är i princip förbjudna. Sådana åtgärder tillåts endast i de fall då de kan rättfärdigas under ett av de uttryckliga undantagen i artikeln. Dessa undantag består till största delen av offentliga statliga förpliktelser då statsstödet utgör vederlag för utförda tjänster. Målet med dessa artiklar samt kommissionen och EG-domstolens praxis i tolkningen har varit att minimera medlemsstaternas inblandning i den europeiska marknaden. Statliga ingrepp i marknaden skall endast ske i speciella fall motiverade av sociala skäl, där marknaden själv inte förmår uppnå målen.

Trots att den europeiska energiproduktionen drivs i form av privata bolag som principiellt är underkastade marknadens villkor återstår vissa hinder innan målet om en enad och fri elmarknad kan anses vara uppnått. Den europeiska energisektorn är fortfarande uppdelad i nationella marknader

som ofta är dominerade av de f.d. nationella monopolen och därför saknar verklig konkurrens. Detta har i sin tur lett till otillräckliga nyinvesteringar i infrastruktur, speciellt rörande energiöverföring mellan medlemsstaterna. Kommissionen mot bakgrund av detta lagt fram ett förslag till nya regleringar på området. Dessa skall skärpa föreskrifterna i sekundärrätten genom att tydliggöra medlemsstaternas förpliktelser i avregleringen av de nationella monopolen samt att skärpa övervakningen av energimarknaden på unionsnivå. Detta tycks vara ett steg i rätt riktning då problemen på marknaden till stor del består i de f.d. monopolens fortsatta dominans på marknaden. Dessa bolag har ofta intressen av att direkt motarbeta öppningen av marknaden för att kunna behålla sina dominerande positioner. Att dessa företag fortfarande till stor utsträckning ägs av medlemsstaterna gör att de har ett intresse av att skydda sina nationella marknader. Vad som framförallt behövs är fler internationella aktörer som lyfter upp fokuset på en internationell nivå i energisektorn. För att detta arbetet i sektorn skall få genomslag krävs dock en genomgripande omarbetning av regleringar, övervakning och infrastruktur.

Abbreviations

Commission of the European Communities	Commission
Council of European Energy Operators	CEER
European Communities	EC
European Competition Network	ECN
European Court of Justice	ECJ
European Transmission System Operators	ETSO
European Regulators for Electricity and Gas	ERGEG
European Union	EU
Single European Act	SEA
United States of America	USA

1 Introduction

The European states have for a long time, because its great importance, exercised control over the energy market. These measures have traditionally consisted in creating an energy market that has been characterized by a high degree of state control and domination of state monopolies. The EU has however had the goal to increase the cooperation between the Member States within this sector and ultimately to create a unified European energy market. This view on the sector was at an early stage supported by the European Court of Justice (ECJ) in the *Costa v E.N.E.L.* case, where the court confirmed that energy should be seen as a commodity and be subject to the competition rules in the EC-treaty.¹

1.1 Purpose

The purpose of this essay is to make a presentation on the current rules and regulations controlling the European energy market and the liberalization process. From this presentation I have aimed at making an analysis on how this legislation has had an impact on the energy sector and how they control and endorse the opening of the market. The principles of the EU concerning liberalization will be used as a foundation for the discussion on how they have been reached in reality. The essay will therefore be mainly agnostic to if this is the right way to go, but confine itself to discussing the progress.

1.2 Method and Material

When analyzing the liberalization energy market and the application of the EU-legislation I have worked in a traditional way by using literature and case law to estimate the situation. I have also relied on Commission reports to get a view on their reasoning and perceptions on issues in the sector. In order to get alternative and balancing opinion on the situation in the sector, I have used articles from magazines covering the interests of the actors within this field. When choosing case-law to include in this essay, I have made a selection of the judgments I have found most relevant in illustrating the attitude of the ECJ regarding state measures and the energy sector.

1.3 Delimitations

The focus this essay placed on the ownership perspective of the liberalization process and the role of the Member States. I have chosen to concentrate on issues arising from the process of implementing mechanisms

¹ Case 6/64, *Flaminio Costa v E.N.E.L.*

of a free market in a sector dominated by large, monopolistic, state owned actors. I have chosen not to concern myself with trust issues or other competition related topics that arises in this market when it is not motivated by a connection to the central topic.

This essay is limited to treating the markets of electricity and gas. When nothing else is stated, the term “energy sector” refers to these two markets only.

I have chosen to use the term of Europe when referring to the countries which today are connected to the common market.

In the discussion concerning the energy market a distinction is often made between transmission and distribution systems. Where the transmission systems signify the large high power networks used to transport the energy from the power plants to the different communities and the distribution systems mean the local networks used to bring the energy to the end users. I not go in to such detail that such a distinction is needed in this paper and will therefore treat them as one.

1.4 Disposition

The essay is basically divided into two parts. The first part describes the work in the EU to create an open energy market, as well as the issues and difficulties encountered. Chapter 2 is a quick walkthrough of the situation on the energy market out of a historical perspective, explaining the current situation. The chapter provides for a background to the current legislation in the field as well as a yardstick to which we can measure the success of the work so far. In this context, I will try to clarify what special factors that influence the energy sector and analyze their impact on the liberalization process. Chapter 3 explains the liberalization process itself and the goals of the Commission of the European Communities (the Commission).

The second part is a presentation and analysis of the legislation that controls the European market. This part starts with an overview of the central directives and regulations on the liberalization of the energy market. The following chapter contains a description of the role of the Commission and the authorities of the Member States in the work of supervising the market and developing the strategy for opening it up. The general provisions on state controlled companies and state aid in Article 86 and 87 EC is then analysed in the chapters six and seven. These two chapters are meant to be the main focus of the essay as these provisions make up the ground and frames of the work of the Commission in this field. The meaning of this disposition is to describe the specific conditions of the energy sector in the chapters two to five and then to connect this to an analysis of the underlying treaty provisions in the chapters six and seven. In the last chapter before the analysis I have chosen to include a description on the planned future

measures proposed by the Commission. This is meant to function as a compliment and as a starting point to my own analysis on the subject.

The last part of the essay contains a conclusion containing a description of my findings on the field as well as an analysis of the current legislation. It is begun with a presentation of my findings of the present status of the European energy sector. From this I have aimed at making a fuller summary of my findings regarding the legislation in the field. Although I wish to avoid repeating what has been written in the previous chapters it is my opinion appropriate with a comprehensive summary. In connection to this, I have tried to make an analysis of the legislation and in particular the connection between the treaty rules and the secondary legislation.

2 The European Energy Market

The essential role of the energy market in the EU has made it an important field for the work of the Council of the European Union (the Council) and the Commission. The aim of these measures have been to create a unified and competitive European energy market. This shall secure a sustainable and efficient energy sector that can supply the European market with energy in a secure manner to the best price possible.

In a communication from the Commission published in 2007 concerning the liberalization of the energy markets the following were emphasized as problematic fields²:

- Market concentration – The market is to a large extent still controlled by the pre-liberalization companies.
- Vertical foreclosure – A lack of effective unbundling makes vertical integration a continued problem in this market.
- Market integration – The European energy market is today segmented in many parallel market that lack integration with each other
- The regulatory environment – An effective authority and proper legislation is needed to ensure a working market
- Chronic lack of liquidity – Lack of liquidity remains an issue that halts investments in the infrastructures as well as stops new competitors from entering the market
- Lack of transparency – Market players as well as end users lack access to sufficient market information

The energy market in Europe has been highly regulated in the most Member States since the Second World War.³ A number of characteristics special to the energy sector can explain why the Member States have been so active in controlling this sector.

The supply of power is essential for the functioning of the society as a whole and has therefore been in the interest of the Member States for a long time. It has also been seen by the states as a strategic resource vital to the military capacity of the country. The fact that the energy market is naturally monopolistic because of high investment costs has also been seen a reason for the Member States to intervene in the sector. In order to avoid a situation with an energy market controlled by one private company without any competition, many countries have traditionally seen the intervention of the states as sole supplier of energy as the solution.⁴ Although the energy market today is opened for competition in all Member States, many issued relating to the policies of the Member States still exist.⁵

² Com (2006)851 Inquiry Pursuant to art. 17 of Regulation (EC) 1/2003, chapter 3

³ Cameron, Competition in Energy Markets, 2007, p. 12

⁴ Ibid.

⁵ Com (2008) 192 Progress in Creating the International Energy Market, p. 2

The Member States have traditionally seen it as their responsibility to ensure a reliable supply of energy in the country. Strict regulation has often been seen as a suitable tool for ensuring this goal, which have resulted in firmly controlled national markets. In order to secure the supply of energy to the whole society the states have often imposed obligations on the energy companies to ensure a reliable supply of electricity and gas to a certain price. The companies have in return been entrusted with exclusive rights and subsidies in order to be able to carry out these obligations.⁶ This system has limited the free market as the normal rules of the market have been put out of function. The energy companies have not been free to set their own prices and finance their business and new investments needed to achieve the best possible efficiency.⁷

These state controlled companies have generally had the responsibility for the entire supply chain. This solution is referred to as vertically integrated operations, meaning that both the power plants as well as the infrastructure for supplying the energy to the end user is under the control of the same company.⁸ The integrated supply companies have proven to be a problem in the creation of an open market because of a tendency to discriminate third parties wanting to get access to their energy transmission networks. This tendency to discriminate derives from a natural interest to further the associated producer.⁹ The European energy market is still to a great extent controlled by these companies with a very strong position on an isolated home market.¹⁰ Much work has been dedicated in the liberalization process to part the production function of the national energy companies from function of running the transmission nets. This is intended to remove the incitements for treating energy producers differently in giving them access to the transmission networks.

The Member States have for a long time had the policy of being self sufficient in electricity. This has had the effect that most national energy grids are well developed while the lack interconnection between them remains a problem.¹¹ Another consequence is that the Member States provides all the energy the national market consumes, and therefore have no need of importing any larger amounts of energy. Today the inter community trade is only about six to eight percent of the total electricity consumption.¹² A common energy market still does not exist in the EU as many of the Member States have proven reluctant to open up their national markets to competition in the privatization process. The integrated Transmission System Operators have also proven reluctant to increase cross border capacity as this can facilitate the entrance of competitors to the associated

⁶ Craig and De Búrca, EU-law, 2008, page 1080

⁷ Com (2006) 841 Prospects for the Internal Gas and Electricity Market, para. 7

⁸ Ibid.

⁹ Ibid, para. 6

¹⁰ Com (2006) 851 Inquiry Pursuant to art. 17 of Regulation (EC) 1/2003, para. 21

¹¹ Ibid , para. 21

¹² Cameron, Competition in Energy Markets, 2007, p. 24

energy producer on their national market.¹³ This causes an efficiency problem as there is currently an over production of electricity in the union, in order to ensure that all Member States have full capacity at all times. The fragmentation of the energy market also means that the energy sector loses synergy effects that a united European market would bring.

The European gas market is on the other hand highly dependant on import from third countries. About 40 percent of the gas being used in the EU today is imported from non-EU countries and one fifth of the gas produced in the EU is exported.¹⁴ Russia, Norway and Algeria are today the largest exporters of gas to the EU.

The infrastructure for trading gas is currently being built out to make inter European gas trade possible and some companies have expanded and are trading in multiple national markets. These advances are however limited and the gas trade mainly consist of transit agreement between major wholesalers. This makes it misleading to describe it as trade in the normal sense as it is not a question of competition on an open market.¹⁵

The supervision of the energy markets has also remained a problem in the European Union. Even though there are National Regulatory Authorities in all Member States with the task of controlling this sector the Commission has found that they have often been given insufficient powers to carry out their duties and that the real decision power has often remained with the ministry.¹⁶ The regulatory authorities shall on different occasions have been influenced by their respective governments to make decisions that go against the object of creating an internal market.¹⁷

Even though the sector as a whole can be described as generally monopolistic there are differences in the historical tradition of the European states. Monopolistic state controlled systems were built up in for example France where the markets are still dominated by the state owned giant EDF.¹⁸ France has however traditionally managed to keep consumer prices on energy low.¹⁹ The West German market has in contrast been dominated by privately owned companies.²⁰ The UK and the Nordic countries stand out as having managed to create highly liberalized energy markets. Some smaller Member State have made unsuccessful attempts to create a privatized national market without giving access to it to other Countries.²¹

¹³ Com (2007) 528 Proposal for Amending the Electricity Directive, para. 4

¹⁴ Leblond, Europe depicted as still a gas market “patchwork”, 2006

¹⁵ Ibid.

¹⁶ Cameron, Competition in Energy Markets, 2007, p. 96

¹⁷ Com (2006) 841 Prospects for the Internal Gas and Electricity Market, para. 8

¹⁸ Sec (2006) 1709 Implementation Report: Prospects for the Internal Gas and Electricity Market , p. 62

¹⁹ Percebois, Electricity Liberalization in the European Union: Balancing the Benefits and Risks, 2008, p. 2

²⁰ Cameron, Competition in Energy Markets, 2007, p. 13

²¹ Com (2006) 841 Prospects for the Internal Gas and Electricity Market, para. 8

The tradition of state controlled monopolies in the sector still has a strong impact on the European energy market and there still is a lack of meaningful competition in the electricity market of many Member States. The production as well as the distribution is still controlled by the previous state monopolies in these markets.²² The customers in these states often have no real choice in their electricity suppliers and the progress made in the gas sector is generally even smaller.²³

Electricity has the disadvantage of being very difficult or impossible to store in large quantities. This has the result that electricity always has to be generated “on demand” as a surplus cannot be generated in advance and stockpiled. This problem is enhanced by the fact that the demand of electricity fluctuates much over time. The usage is namely distinctly different at different points of the day as well as at different time of the year.²⁴ Hence, the operator must have a capacity to deliver the maximum load at a given time but at the same time an ability to adapt it to different demands. There are large costs involved in a situation when the operator fails to meet the demand or overloads the system. These costs impact the society at large as a blackout can have severe consequences on the trade and industry.²⁵ These issues can to some extent be solved by balancing the demand of the different individual markets against each other. That option is however not available to many of the European energy providers as their supply areas are bound to the national borders.²⁶

Unlike electricity gas can be stored in a number of ways. This makes the gas market more flexible as the system operators can balance out the usage in the system using the gas deposits. Being able to keep a storage also makes the systems less sensible to peaks in the consumer usage during the day as well as seasonal variations. The larger operators do however have a natural overtake here as they are able to balance out the usage between their customers where as the smaller are more sensible to fluctuations. The different qualities of gas is an important factor in this market because they cannot be mixed in the same system as opposed to electricity.²⁷ Safety is also a big issue when storing gas. The safety measures that must be taken to avoid incidents can often be time consuming and expensive compared to electricity.²⁸ Storage facilities are therefore only profitable on a large scale, giving yet another advantage to the large operators.

Another important factor when discussing the energy market is that the demand is not very price-elastic, at least not in short time usage. End-user demand for electricity and gas will therefore not vary much following the price changes in the market. This is due to the fact that the inter-

²² Com (2006) 851 Inquiry Pursuant to art. 17 of Regulation (EC) 1/2003, para. 20

²³ Ibid, para. 15

²⁴ Cameron, Competition in Energy Markets, 2007, p. 21

²⁵ Ibid, p. 22

²⁶ Com (2006) 851 Inquiry Pursuant to art. 17 of Regulation (EC) 1/2003, para. 36

²⁷ Cameron, Competition in Energy Markets, 2007, p. 26

²⁸ Ibid, p. 27

changeability between these energy sources and other commodities is next to non-existent making it a highly isolated market.²⁹ When the prices rise, the customers have small practical possibilities of changing to another energy source and only limited possibilities to lower their energy usage.

The gas companies are often involved in the oil business as well as the gas was usually found in association with oil. This has had the consequence the gas prices have generally been closer linked to the oil prices than the electricity prices.³⁰ The gas sector is however less exposed to free pricing than the oil sector.³¹

The energy markets are also special due to the fact that they are highly influenced by the different techniques available in the fields of transmission, distribution as well as transformation. Technical and financial specifications differ considerably because electricity can be produced using a variety of different techniques and different raw materials. In the gas market a large number of technical solutions are available as well, causing problems in the process of unifying the national energy grids. The large amount of techniques means that these technical solutions on the European market today must be combined in a well-functioning entity in order to get a common market in this field.³²

²⁹ Cameron, *Competition in Energy Markets*, 2007, p. 22

³⁰ Com (2006) 851 Inquiry Pursuant to art. 17 of Regulation (EC) 1/2003, para. 28

³¹ Cameron, *Competition in Energy Markets*, 2007, p. 25

³² Com (2006) 841 Prospects for the Internal Gas and Electricity Market, para. 7

3 Liberalization

3.1 Development of a Liberalized Market

The idea of cooperation in the energy markets has existed in Europe for a long time and the work for a common energy policy in the European Economic Communities (EEC) started as early as in the 1960's.³³ In 1964 the first formal steps within the area was taken in form Protocol of Agreement between the member states on energy problems and the Council took a policy decision on oil and gas the following year. The first guidelines of a European energy policy was published in 1968 by the Commission in a communication to the Council. In the following years the work of creating a common European energy market was unsuccessful and no remarkable progress was made until the late 1980's. The fall of the oil prices led the Member States to abandoning their agreed targets to achieve energy efficiency and common goals in 1986. Following the Single European Act (SEA) in 1987 establishing a common internal market by 1992 a turning point came in the work of creating a common European energy market.³⁴ The Commission took this as a green light for making an investigation of the European energy sector in the context of creating a single market. This involved a broad investigation and contributions were submitted by a large number of organizations in the field in the Member States.³⁵ The result was an inventory of the sector presenting the main priorities for removing the obstacles and creating a single market in this field.³⁶

The next big step was taken with the making of the directives on the fields of the electricity and gas markets. In 1996 the first directive on liberalizing the European energy market came.³⁷ These directives were replaced followed by the current directives on the field in 2003. Two Regulations have been adopted by the European Parliament and the Council, they are meant to compliment the Directives by serving to open up the market and improve competition in the field of cross border trade.³⁸

3.2 Aims of Liberalization

The EU has traditionally had a strong tendency to promote liberalization and privatization in all sectors of the market. State monopolies are seen as obstacles to the realization of the common market as they to a large extent

³³ Cameron, Competition in Energy Markets, 2007, p. 49

³⁴ Ibid, p. 51

³⁵ Ibid, p. 53

³⁶ Com (1988) 238 The Internal Energy Market

³⁷ Directive 96/92/EC on the electricity market and Directive 98/92/EC on the gas market

³⁸ Com (2007) 528 Proposal for Amending the Electricity Directive, para. 2

are incompatible with a competitive market economy. A high degree of scepticism can also be seen in the Commission's and the ECJ's view on state aid.

The three main goals of the European energy policy is to³⁹:

1. Create a competitive energy market
2. Secure security of supply
3. Fight against global warming

It is the paradigm of the Commission that a liberalized market with functioning competition leads to increased efficiency compared to a regulated market. Private competition in the energy market shall lead to better usage of resources and better targeting of investments possible which brings lower prices for the consumer.⁴⁰ The increased efficiency shall also leads to a strengthened security of energy supply.⁴¹ An increase in production efficiency shall also serve to make the European market less dependant on import of energy from external markets.⁴²

The efficiency of the sector can be increased by unifying the market that today is fragmented along the national borders to one and thereby eliminating double work and energy waste.⁴³ Deregulation of the market shall also lead to increased investments where needed. This mainly concerns the net connecting the European countries as a unified European energy sector would be a very attractive market to the energy companies. This in its turn is a strong incentive for new investments.⁴⁴

Through the mechanisms of the market the operators are induced to invest in innovation making them more effective and keeping their costs down. The operator who does not manage to keep up a competitive production will not be able to stay on the market. A functioning liberalized market will, due to competition, have lower prices than regulated one. It will however be likely to experience larger fluctuations, as the prices on the spot market can vary over the day where as the prices on a regulated market is set a few times a year by the authorities.⁴⁵

A deregulation of the market will serve to promote well run and effective undertakings while ineffective solutions will be forced out of the market due to the competition. On a regulated market it might be possible to maintain ineffective production techniques and outdated infrastructure due to market protection and subsidies. Such a market does in general tend to be less progressive and effective than a deregulated one. Price caps and similar

³⁹ Percebois, Electricity Liberalization in the European Union: Balancing the Benefits and Risks, 2008, p. 1

⁴⁰ Com(2006) 851 Inquiry Pursuant to art. 17 of Regulation (EC) 1/2003, para. 3

⁴¹ Com(2006) 841 Prospects for the Internal Gas and Electricity Market, para. 4

⁴² Com(2006) 851 Inquiry Pursuant to art. 17 of Regulation (EC) 1/2003, para. 9

⁴³ Com(2007) 528 Proposal for Amending the Electricity Directive, para. 2

⁴⁴ Com(2006) 841 Prospects for the Internal Gas and Electricity Market, para. 4

⁴⁵ Percebois, Electricity Liberalization in the European Union: Balancing the Benefits and Risks, 2008, p. 4

obstacles to the free price setting have also been shown to restrain the development of the market.⁴⁶ The restraint consist in the fact that as the companies do not have the freedom to set their prices as they see fit in order to fund new investments. Market deregulation can in fact lead to higher prices in some areas, if this is needed in order to finance investments and develop the market.⁴⁷ A functioning energy sector requires an open market with a lively competition as well as the possibility for the actors on that market to run their business in the way that is best from an economical perspective.

Another advantage of liberalizing the market is that it makes it easier to calculate the real production costs. This serves to direct the investments to where they are most needed. It also makes the payoffs of investments more visible, thus spurring the development of the energy market. In a regulated market unprofitable investments can be hard to keep track of because the cost are to a larger extent hidden and hard to calculate.⁴⁸

These advantages are however not written in stone. If the mechanisms of the market economy does not work in this sector, the result can be loss of efficiency as well as increased prices. The positive effects of the unbundling of vertically integrated companies might be cancelled by market abuse of horizontally integrated market giants.⁴⁹ In these cases the costs of unbundling the market might not be covered by increased efficiency. Even in a well functioning market the cost of producing and transferring energy can go up due to transaction costs and negotiation costs between the producers and the transmission companies as well as the charging of double marginalization. A loss of synergy effects as the vertically integrated companies are unbundled is also a plausible source of increased costs. The risk of foreign takeover on the national market is a factor that ha been used as an argument of privatization. This is, however not in itself bad for the sector, but is often used as a political argument. Contrary to this argument is the merging of the national markets one of the main objectives of the European energy policy.⁵⁰ The process of achieving full ownership unbundling is however problematic for many large European energy companies. They have in many cases made large investments in infrastructure and the demand on them to unbundle can bring radical and expensive shifts in the way the companies and markets works.⁵¹

The liberalization require measures to protect consumers as well as ensure that all citizens are included in the universal service of electricity. Special measures must also be taken to protect vulnerable customers. In the process of creating the common market consideration must also be taken to the

⁴⁶ Cameron, *Competition in Energy Markets*, 2007, p. 19

⁴⁷ Percebois, *Electricity Liberalization in the European Union: Balancing the Benefits and Risks*, 2008, p. 6

⁴⁸ *Unbundling in Europe – more to go*, 2007

⁴⁹ Pollitt, *The Arguments for and Against Ownership Unbundling of Energy Transmission Networks*, p. 706

⁵⁰ *Ibid*, p. 707

⁵¹ *Oil & Gas Journal*, EU proposes legislation to enforce utility unbundling

public service obligation that are tied to this central sector to the community.⁵² Efforts must be made to secure that the market opening is balanced in a way that prevents distortions from being created or reinforced.⁵³ Measures have also been taken in the form of community legislation to safeguard security of electricity supply in Directive 2005/89/EC. The Directive was adopted in order to remedy a lack of strategy in creating a safe supply of energy and set the frames of the work of the Member States.⁵⁴ It obligates the Member States to ensure that the electricity supply has a high level of security and continuity. The Member States shall cooperate to ensure that the infra structure meets the requirements also in cross-border supply.⁵⁵

The main problem when opening up the market to competition is the dominance of the vertically integrated companies that dominate the national markets. These are often former national monopolies that operates power generation as well as transmission systems. In the interest of cutting competition to their power generation business they can deny competitors access to their supply system, thus effectively locking them out from their national market. Lack of information is also a problem for companies wanting to establish themselves in a market dominated by a vertically integrated company. The company integrated with the supply system has a natural advantage as it can get more quickly to information about supply capabilities and demand than its competitors. Problems can also arise as the integrated transmission system operator is tempted to release sensitive information about competitors to the integrated supply company.⁵⁶ It is however not reasonable to expect that every energy supplier should build their own supply system and infra structure. Such a solution would seriously halter competition and would mean double work and waste of energy. The main solution to this problem is forced unbundling of the integrated energy companies which mean that the supply activity is separated from the production activity.

There are mainly two types of unbundling that are discussed by the Commission in this process:

1. Ownership unbundling:

In this solution the companies responsible of supply/generation are not allowed to own the transmission assets. The transmission systems shall be owned by a separate operator in order to ensure that access is allowed to all companies on non-discriminatory and commercial grounds. As the different functions are placed on different companies there would no longer be any conflict of interest for the separate operator in giving other energy suppliers

⁵² Directive 2003/54/EC of 26 June 2003 concerning common rules for the internal market in electricity [Hereinafter the Electricity Directive], rec. 26

⁵³ Com(2006) 841 Prospects for the Internal Gas and Electricity Market, para. 20

⁵⁴ Directive 2005/89/EC concerning measures to safeguard security of electricity supply and infrastructure investment, rec. 3

⁵⁵ Ibid, art. 3

⁵⁶ Com(2007) 528 Proposal for Amending the Electricity Directive, para. 4

access to the transmission system on a commercial basis. This is the preferred solution of the commission as there would be less need for regulation in order to prevent discrimination and market distortions.⁵⁷ This for of unbundling exists in a number of countries in Europe in the electricity market but is much rarer in gas.⁵⁸

2. Legal unbundling:

This solution requires a separation of function of supplying energy from the running of the transmission system. The company owning the transmission system may still be vertically integrated with the energy supplier as long as it is independent in terms of its legal form, organisation and decision making operation.⁵⁹ This system is today the preferred solution to certain Member States as it does not require a change of ownership in the assets. A drawback to this solution is that it requires supervision in order to control the independence of the system operator. In the view of the Commission this is a less favourable solution than the first one as more supervision is needed to guarantee independence. It is however still better than completely integrated companies.⁶⁰ The reason behind this solution that the system of ownership in the Member States is guarded in Article 295 EC. Thus, the EU has no legal possibility for forcing the Member States to sell of assets. In addition to these forms there are solutions that are not regarded by the Commission as real alternatives in the unbundling process. A variation of the legal unbundling is the *independent system operator* model. In this solution the operator of the network does not own the transmission assets but is in itself ownership unbundled from the rest of the system. The owner of the transmission system does however not need to be unbundled from the energy suppliers.⁶¹

Separation for accounting purposes makes up a third alternative. The principle is that the vertically integrated company has to maintain separate accounts for activities relating to the production of electricity/gas and the network activities. The idea is that this promotes transparency and facilitates surveillance in order to discover discrimination and cross subsidies. This is however a solution that is hard to maintain in practice without the two activities being run together or sensitive information leaking from the transmission branch to the production branch of the company about the competitors.⁶² This is no longer discussed as an independent solution by the Commission.⁶³

⁵⁷ Com(2006) 841 Prospects for the Internal Gas and Electricity Market, p. 11

⁵⁸ Pollitt, The Arguments for and Against Ownership Unbundling of Energy Transmission Networks, p. 704

⁵⁹ The Electricity Directive 2003/54/EC, arts. 10 and 15 and Directive 2003/55/EC of 26 June 2003 Concerning Rules for the Internal Market in Gas [herinafter the Gas Directive] , arts. 9 and 13

⁶⁰ Com(2006) 841 Prospects for the Internal Gas and Electricity Market, p. 12

⁶¹ Pollitt, The Arguments for and Against Ownership Unbundling of Energy Transmission Networks, p. 705

⁶² Cameron, Competition in Energy Markets, 2007, p. 33

⁶³ Com(2006) 841 Prospects for the Internal Gas and Electricity Market

Criticism has been raised claiming that the investigations made in the area are insufficient and that the measures taken by the EU in order to achieve unbundling are without any substantial ground. This is especially pointed at measures against private actors as they interfere with their private property rights.⁶⁴ Case studies within the field have however shown that liberalization have led to lower prices and higher efficiency in generation as well as in transmission of electricity and gas. The studies have not been very extensive within the gas sector as only few countries have implemented measures of liberalization within this field. The positive results of the studies are contained to the markets which have implemented the ownership unbundling solution. Where as the results of the markets that have implemented the less extensive solutions are unclear or in some cases even negative.⁶⁵ An investigation of the market was performed in 2005 by Ernst & Young confirmed the difficulty in getting exact results about this market. They found that competition have had an unquestionable good result in lowering electricity prices. These results were however only conclusive in the fully unbundled markets.⁶⁶ Liberalization could however not be linked to any increase in investments.⁶⁷ The Commission has however in their investigations found that the revenue reinvested in interconnection capacity is about twice as much for ownership unbundled networks as vertically integrated.⁶⁸

⁶⁴ Baarsma, Noij, Kostner and Van Der Weijden, *Divide and Rule*, 2006, p. 1793

⁶⁵ Pollitt, *The Arguments for and Against Ownership Unbundling of Energy Transmission Networks*, p. 710

⁶⁶ Ernst and Young, *The Case for Liberalization*, 2006, p. 49

⁶⁷ *Ibid*, p. 77

⁶⁸ Com (2008) 192 *Progress in Creating the International Energy Market*, pp. 3-4

4 Central Legislation

The central union legislation concerning the liberalization of the energy market are the Articles under title IV of the EC-treaty and the secondary legislation adopted in the field. A large number of decisions and guidelines have also been adopted by the Commission during the work in the sector.

Article 82 EC on abuse of dominating position is of interest as the previous monopolies tend to continue to have a dominating position after the deregulation of the market. Article 86 EC on the granting of special or exclusive rights is of obvious importance while discussing state hold companies holding exclusive rights (for example to provide energy and run transmission systems). Article 87 EC on the granting of state aid is also of interest as the energy companies are often subsidised while being obligated to provide public service obligations. The article 28 EC and the prohibition against quantitative import restrictions can also be of importance in the discussion concerning the effects of national measures on intra community trade. The function of these treaty rules will be further discussed in the chapters six and seven.

Certain secondary legislation has also been adopted by the Council in order to promote the development of a European energy market. These acts do not contain direct interpretations of the EC rules on the field. Instead they provide frame rules for the energy market that are meant to realize the rules on competition laid down in the treaty. The most central of these acts are the *Directive 2003/54/EC concerning common rules for the internal market in electricity* (the Electricity Directive) and *Directive 2003/55/EC concerning common rules for the internal market in gas* (the Gas Directive). These directives contain the objectives set for the liberalization of the energy markets of the Member States. The Council has also adopted two central regulations with provisions on cross border exchange of electricity and gas. These are *Regulation (EC) 1228/2003 of the European Parliament and of the Council of 26 June 2003 on conditions for access to the network for cross-border exchanges in electricity* (the Electricity Regulation) and *Regulation (EC) 1775/2005 of the European Parliament and of the Council of 28 September 2005 on conditions for access to the natural gas transmission networks* (the Gas Regulation). They were adopted in order to secure access to transmission nets in energy trade between the Member States.

4.1 The Directives

The directives serve to set up frames for the work within the EU to liberalize the market. They contain rules on the generation, transmission distribution

and supply on energy in order to achieve these goals.⁶⁹ The Gas and Electricity Directive both have the same aims and structure and I will present them in parallel while noting the key differences between them.

The Electricity Directive has the following main objectives:⁷⁰

- ensure a level playing field in generation
- reduce the risks of market dominance and predatory behaviour,
- ensuring non-discriminatory transmission and distribution tariffs,
- ensuring that the rights of small and vulnerable customers are protected
- ensuring that information on energy sources for electricity generation is disclosed,
- ensuring that reference to sources, where available, giving information on their environmental impact is disclosed.

The gas directive essentially has the same aims and goals but does not mention the two final objectives.⁷¹

The directives set up a number of public service obligations in order to guarantee a free market that meets the fundamental requirements of the European society.⁷² These requirements may relate to security, including security of supply, regularity, quality and price of supplies and environmental protection, including energy efficiency and climate protection. Within the scope of Article 86 EC the Member States may impose public service obligations on undertaking in the energy market in order to make sure that the ground requirements for all consumers are met. Three conditions are to be met for security of supply to be secured in the field of electricity: Adequate and reliable network infrastructure, satisfactory generation capacity and security of supply of the primary fuels. In the gas sector pipeline integrity and pressure must be maintained and adequate supplies must be available.⁷³

The electricity directive obligates the Member States to ensure that all consumers enjoy universal service.⁷⁴ This means that they have the right to be supplied with electricity of a specified quality within their territory at reasonable, easily and clearly comparable and transparent prices. In order to ensure of universal service, the Member States may appoint a supplier of last resort. This supplier may be a vertically integrated company, it will however still subject to the rules of Article 86 and 87 EC. The Gas Directive does however not contain these obligations. The right to enjoy universal service of electricity does not include a right to uniform tariffs irrespective of location. This means that the Electricity Directive allows for higher prices to be charged in remote areas as long as they fulfil the basic requirements of

⁶⁹ Electricity Directive 2003/54/EC, art. 1

⁷⁰ Ibid, rec. 2

⁷¹ Gas Directive 2003/55/EC, rec. 2

⁷² Electricity Directive 2003/54/EC, rec. 26 and Gas Directive 2003/55/EC, rec. 27

⁷³ Newbery, Problems of liberalising the electricity industry, 2002, p. 921

⁷⁴ The Electricity Directive 2003/54/EC, art. 3(3)

the directive.⁷⁵ A definition of reasonable prices does not exist in the directives; the rules of state aid would nevertheless apply when a Member State imposes a public service obligation on a supplier on the ground of price.⁷⁶

The Member State shall also impose an obligation on the distribution companies to connect customers to their grid in order to ensure global supply and avoid unjust discrimination. This is however not demanded in the gas directive. The Electricity Directive (only) also states that the Member State shall take appropriate measures to protect final customers, and in particular vulnerable customers, including measures to help them avoid disconnection.⁷⁷ In this context, the Directive also contain a possibility to take measures in order to protect final customers in remote areas. The Member States shall ensure that the eligible customer is in fact free to choose supplier.

Appropriate measures shall be implemented in order to achieve the objectives of social and economic cohesion, environmental protection, which may include energy efficiency/demand-side management measures and means to combat climate change, and security of supply.⁷⁸

All Member States are obliged to create competent bodies with the function of being regulatory authorities of the energy sector.⁷⁹ The function of these bodies will be further discussed in chapter five.

The Directives expressly state that the transmission system operators shall make sure that no discrimination occurs between those who seek access to their network.⁸⁰ The ECJ has in a case concerning the old Electricity Directive stated that this covers technical solutions as well as contractual agreements.⁸¹ This principle of non-discrimination also applies to access agreements that derive from legislative acts of the National Governments of the Member States.⁸² In order to ensure non discrimination in network access has unbundling of the network operators and energy suppliers been a central issue of the Directives. Even though the complete ownership unbundling is the preferred solution of the Commission, the directives only go as far as to demand unbundling through an independent system operator that still can be vertically integrated with an energy supplier.⁸³ In this case the Member States shall ensure that the transmission system operators has

⁷⁵ Hancher, EC State Aids, 2006, p. 287

⁷⁶ Ibid.

⁷⁷ Electricity Directive 2003/54/EC, art. 3(5)

⁷⁸ Electricity Directive 2003/54/EC, art. 3(7) and Gas Directive 2003/55/EC, art. 3(6)

⁷⁹ Electricity Directive 2003/54/EC, art. 23(1) and Gas Directive 2003/55/EC, art. 25(1)

⁸⁰ Electricity Directive 2003/54/EC, art. 9 and Gas Directive 2003/55/EC, art. 8

⁸¹ C-17/03 Vereniging voor Energie, Milieu en Water and Others v Directeur van de Dienst uitvoering en toezicht energie, paras. 43-45

⁸² Ibid, paras. 56-48 and Electricity Directive 2003/54/EC, art. 20 and Gas Directive 2003/55/EC, art. 18

⁸³ Electricity Directive 2003/54/EC, arts. 10(1) and 15 (1) and Gas Directive 2003/55/EC, arts. 9(1) and 13(1)

an independent management from the ownership integrated energy supplier. This shall ensure that the company is not discriminatory to other energy suppliers while operating the distribution system. All vertically integrated transmission system operator is obliged to give yearly reports on its work in order to ensure effective surveillance.⁸⁴

Ensuring a functioning and non-discriminatory market is the core of the European energy policy and these directives. Free access for the energy producers to the transmission systems has been deemed so important that the Commission has chosen a policy of regulated free access.⁸⁵ This can be put in contrast to the policy of negotiated access, which has been preferred by some states like Germany. (In the former, the conditions of access are laid down in legislation where as they are negotiated by the parties themselves in the latter.) The Member States have responsibility to make sure that third parties get access to the transmission network in a non-discriminatory way.⁸⁶ The free access to the transmission system and thereby the market can be said to be the main, or at least one of the ground plates of the entire work of the Commission when opening the energy sector to competition. In the gas sector this also includes access to storage facilities.⁸⁷ Refusal to a third party to use the transmission network may only occur when the transmission system operator lacks the sufficient capacity or when it would hinder it to perform its public service obligations.⁸⁸ The ECJ has stated that the Directive shall be interpreted in such a way that third parties wanting access to the transmission network shall have the possibility of choosing network in the extent that there is sufficient capacity.⁸⁹

An independent commission is in charge of ensuring that the prices for accessing the networks are set according to the “objective, clear and non-discriminatory” criteria. In order to ensure openness and predictability the prices shall be set according to the “use it or loose it rule” condition, meaning that unused network capacity shall be put back on the market.⁹⁰ This condition is implemented on the market in order to stop large energy producers from buying a lot of extra capacity in order to stop competitors from gaining access to the distribution system.

⁸⁴ Electricity Directive 2003/54/EC, art. 10(2) and 15(2) and Gas Directive 2003/55/EC, art. 9(2) and 13(2)

⁸⁵ Percebois, *Electricity Liberalization in the European Union: Balancing the Benefits and Risks*, 2008, p. 16

⁸⁶ Electricity Directive 2003/54/EC, art. 20 and Gas Directive 2003/55/EC, art. 18

⁸⁷ Gas Directive 2003/55/EC, art. 19

⁸⁸ Electricity Directive 2003/54/EC, art. 20(2) and Gas Directive 2003/55/EC, art. 21(2)

⁸⁹ C-239/07 *Sabatavskas v Seimas*, para. 1

⁹⁰ Percebois, *Electricity Liberalization in the European Union: Balancing the Benefits and Risks*, 2008, p. 17

4.2 The Energy Regulations

While the Energy Directives have the main aim of opening up the national markets and ensure a level playing field in a national context, the Energy Regulations have the objective of securing the integration of the national markets. This shall involve the establishment of a compensation mechanism for cross border flows and harmonized principles on cross border transmission charges.⁹¹

4.2.1 The Electricity Regulation

The Electricity Regulation basically consist of two parts. The first regulates the ways in which the transmission system operators are allowed to charge the users for the transmission of electricity over national borders within the EU. The second sets up provisions to combat congestions and prevent discrimination in such situations.

The Regulation establishes a system for compensation to transmission system operators for costs incurred as a result for hosting cross border trade. This compensation shall be paid by the operators of the national transmission systems. These costs shall be calculated on long run average costs of harbouring the cross border trade as well as costs of investments in infrastructure and extra capacity.⁹² These charges shall take the need for network security into account and reflect the actual cost incurred. They may however not be distance related and they may not be constructed in such a way that they discriminate against cross border trade.⁹³ Exceptions to these rules may be made if it is deemed as necessary in order to make interconnection investments possible where needed. In this case the costs of the investments may be laid directly on the market participants using the interconnection in question.⁹⁴ This is however dependant on the authorisation of the competent National Regulatory Authority. The National Regulatory Authorities shall notify the Commission of the decision under Article 88(3) EC in order to give them the opportunity of reviewing it.⁹⁵

The question on compensation has been a widely discussed topic in the process of building a cross European energy system. The main concern has been the different standpoints between the transit countries and the trading countries. The transit countries are the states centrally located in Europe, whose infrastructure is often used as passing through point when other countries are trading in energy. They generally have a high interest in getting full compensation for the usage of their transmission systems. The

⁹¹ Regulation (EC) 1228/2003, on conditions for access to the network for cross-border exchanges in electricity [hereinafter Electricity Regulation], art. 1

⁹² Ibid, art. 3

⁹³ Ibid, art. 4

⁹⁴ Ibid, art. 7

⁹⁵ Cameron, Competition in Energy Markets, 2007, p. 158

trading countries are on the other side interested in keeping the transmission costs down as they want to be able to trade as inexpensive as possible.⁹⁶

The second important field of this regulation is the management of congestion. Congestion is defined in the regulation as “the situation when an interconnection linking national transmission networks cannot accommodate all physical flow”.⁹⁷ The directive calls on the Member States to address these problems with non discriminatory market based solutions that shall preferably not be transaction based. The market participants are also obliged to inform the transmission system operators of the capacity they intend to use and unused capacity shall be reattributed to the market.⁹⁸ This is a central issue today as the inter community connections are under developed compared to the national power grids.

The regulation lays a responsibility on the National Regulatory Authorities to monitor the function of the cross border trade as well as the national supply systems.⁹⁹ The Commission shall adopt guidelines for the work of the Member States and National Regulatory Authorities as well as observing the market on a community level.¹⁰⁰

4.2.2 The Gas Regulation

The gas Regulation has a slightly different approach due to the different nature of this energy system. It is to a larger extent focused on providing minimum standards of the networks. This is a key point in order to build up a functioning intra community supply system on which a competitive market can be based.¹⁰¹ The primary goal of the regulation is non-discriminatory rules for access conditions to natural gas transmission systems. This includes harmonised principles for tariffs for access to the network, facilitating of party access and harmonised principles for capacity allocation and congestion management, the determination of transparency requirements, balancing rules and imbalance charges and facilitating capacity trading.¹⁰² That the price setting does not restrict cross border trade is also a vital issue.¹⁰³

The tariffs for accessing the transmission systems shall be controlled by the National Regulatory Authorities to ensure they:

- are based on actual costs,
- are set in a non discriminatory manner,

⁹⁶ Eberlein, *The Making of the European Energy Market*, 2008, p. 80

⁹⁷ Electricity Regulation (EC) 1228/2003, art. 2(2)(c)

⁹⁸ *Ibid.*, art. 6

⁹⁹ *Ibid.*, art. 9

¹⁰⁰ *Ibid.*, art. 8

¹⁰¹ Cameron, *Competition in Energy Markets*, 2007, p. 207

¹⁰² Regulation (EC) 1775/2005 of the European Parliament and of the Council of 28 September 2005 on conditions for access to the natural gas transmission networks [hereinafter Gas Regulation], art. 1

¹⁰³ *Ibid.*, art. 3

- take costs for system improvement into account,
- facilitate trade and competition
- and are transparent.

The transmission system operators are obliged to ensure that they offer services on a non discriminatory basis to all network users. This shall be ensured through use of either harmonized transportation contracts or a common network code approved by the National Regulatory Authority.¹⁰⁴ The terms in the harmonized transportation contracts must however not be the same for all transmission system operators unless in question of minimum requirements.¹⁰⁵ These operators shall take measures to allow capacity rights to be freely tradable in the open market and to facilitate such trade. This shall play an important part in creating liquidity in the market, thus making it more effective.¹⁰⁶

The maximum capacity of the transmission system shall at all times be made available to the market participants. The allocation of the capacity shall be done in an efficient and non discriminatory way. In the case that the congestion occurs on the transmission system, the allocation of the capacity shall be done in a non discriminatory way as well.¹⁰⁷

In order to ensure that the market participants get effective and non-discriminatory access to the gas networks the regulation states that they should be given sufficient information. This concerns information on the setting of tariffs as well as technical information necessary for the users to get effective network access. Information deemed by the Transmission System Operators as sensitive can be excluded from this requirement by the national authorities.¹⁰⁸

The Member States shall guarantee that the National Regulatory Authorities can ensure compliance with the Regulation and lay down an effective system of penalties for breaches. They are not hindered by the regulation to lay down more detailed rules on national level to ensure an effective market.¹⁰⁹

The regulation has an annex with guidelines on the implementation.¹¹⁰ Although referred to as guidelines they are in fact legally binding and enforceable.¹¹¹ This annex mainly contains provisions on the storage and organization of the supply system in order to ensure maximum efficiency.

¹⁰⁴ Gas Regulation (EC) 1775/2005, art. 4

¹⁰⁵ Ibid, rec. 10

¹⁰⁶ Ibid, art. 8

¹⁰⁷ Ibid, art. 5

¹⁰⁸ Ibid, art. 6

¹⁰⁹ Ibid, arts. 9 - 13

¹¹⁰ Ibid, art. 9

¹¹¹ Cameron, *Competition in Energy Markets*, 2007, p. 214

4.3 The Florence and Madrid Forums

The Florence and Madrid forums were developed to encourage input from the affected parties in the process of developing measures on community level. The concept was developed soon after the first gas and electricity directives in 1997-98 in order to discuss and monitor their implementation.¹¹² The forums meet roughly twice a year and consists of representatives of the market participants including Transmission System Operators, producers, consumers, network users, traders and exchangers. From the governmental side National Regulatory Authorities, Member States, and the Commission participates. In between the meetings of the Forums smaller workgroups are occupied with developing regulatory detail on specific issues. The key idea of the forum is to provide a platform for discussion between the parties of the sector and develop non binding best practice rules based on the best experiences in the sector. This shall make it possible to adopt guidelines and “regulation through cooperation” for the energy market. The end goal is to adopt common and effective solutions in the field. Because of the diversity of national solutions and unwillingness to accept Community actions, these forums were seen as necessary to reach this goal.¹¹³ If the Member States would adopt solutions completely independent the aim of creating a unified market could undermined by a lack of coordination.¹¹⁴

The forums have no law-making power and the participation is voluntary. They do however have had a high number of participants and the work has been valued by the National Regulatory Authorities. The work in the forums has however had a slow progress and the demand for unanimity has made it hard for them to reach decisions in many cases.¹¹⁵ Non the less are the Energy Directives a codification of standpoints taken by the forum of the respective area.¹¹⁶

During the work of these forums, different parties have formed organizations to represent them in the meetings. The transmission system operators of EU formed the Organization the European Transmission System Operators (ETSO) at the request of the Commission in 1999. It has firstly the function of representing the common interest of the transmission system operators in the work of the Florence Electricity Forum. The aim is to get common proposals from the transmission system operators in order to build a unified market. The ETSO also has the function of being a body for cooperation between the transmission system operators in the exchange of information and building a trans-European electricity net.¹¹⁷

¹¹² Cameron, *Competition in Energy Markets*, p. 103

¹¹³ Eberlein, *The Making of the European Energy Market*, 2008, p. 78

¹¹⁴ Cameron, *Competition in Energy Markets*, 2007, p. 102

¹¹⁵ *Ibid*, 2007, p. 111

¹¹⁶ Eberlein, *The Making of the European Energy Market*, 2008, Page 86

¹¹⁷ Cameron, *Competition in Energy Markets*, 2007, p. 103

5 The Surveillance of the Market

Even in a fully liberalized market an element of regulation and surveillance is needed in order to ensure that the market forces are playing freely and that they are fulfilling aims of creating a competitive and sustainable inter European energy market.¹¹⁸ The surveillance of the market in regard to state aid is performed by the Commission alone while the supervision of abuse of dominating position is performed jointly by the National Regulatory Authorities and the Commission.¹¹⁹

The surveillance of the competition on the energy market is performed mainly by the National Regulatory authorities within the framework of the EU. They are subject to the power of the Member States and may only act within the competences given to them by the national government.¹²⁰ The Commission performs a surveillance according to the competition rules in Article 81, 82 and 86 EC. It has the responsibility of ensuring that there is a functioning surveillance of the market as well as performing investigations in those cases where it is better suited to do so than the National Authorities. This mainly concerns multi national issues as well as measures taken by a Member State under Article 86 or 87 EC. The Commission also has the responsibility for ensuring that the Member States implement the legislation of the EU. It has the possibility of bringing an action before the ECJ according to Article 226 EC against the states that fail to implement union acts.

The National Regulatory Authorities are however responsible for enforcing the Commissions decisions against private subjects under national law.¹²¹ The frame rules for the responsibilities of the Commission and the cooperation between them and the National Authorities within the field are laid down in the Regulation (EC) 1/2003. It calls for them to act as one network in Europe in order to protect the competition and protect public interests.¹²² This network is called the *European Competition Network* (ECN).¹²³

Frame rules for the work of the National Regulatory Authorities have been laid down in the electricity and gas directives on community level. These require that all Member States set up a national authority with the aim of

¹¹⁸ Newbery, Problems of liberalising the electricity industry, 2002, p. 921

¹¹⁹ Hancher, EC State Aids, 2006, p. 710

¹²⁰ Cameron, Competition in Energy Markets, 2007, p. 97

¹²¹ Ibid, p. 429

¹²² http://ec.europa.eu/comm/competition/ecn/index_en.html, Regulation (EC) 1/2003 of 16 December 2003 on the implementation of the rules on competition laid down in arts. 81 and 82 of the Treaty [hereinafter ECN Regulation], rec. 15

¹²³ Commission Notice on cooperation within the Network of Competition Authorities 2004/C 101/03, para. 1

controlling the gas and electricity markets and invests them with the powers to perform these duties.¹²⁴ These bodies shall be wholly independent from the interests of the electricity industry and have the responsibility for ensuring non-discrimination, effective competition and the efficient functioning of the market.¹²⁵ It is also the responsibility of the Member States to ensure that these authorities can carry out their duties in an efficient and expeditious manner.¹²⁶

The national authorities shall supply annual reports on the current situation on the national energy market to the Commission. The directive also states that they shall have the responsibility of approving the methods used to establish terms and conditions for being connected to the national distribution networks.¹²⁷ These regulatory authorities shall also investigate complaints against transmission system operators concerning discrimination, network access, conditions for such access or other competition related issues. The authority shall make a decision within two months but they may in complicated issues be granted two extra months. Any party affected by the decision shall have a possibility of submitting a complaint for review.

The Member States are also obliged to set up efficient mechanisms in order to regulate and control the market and avoid abuse of dominant position predatory position in the field, in particular in the sense of art 82 EC. The national authorities shall send in reports to the Commission on market dominance and anti competitive behaviour concerning the electricity sector in the national field.¹²⁸ These measures must nevertheless respect the rules of the EC treaty as a whole. Italy implemented rules in 2001 that were meant to protect the national energy market from hostile investments by companies that were controlled by other States and that were held a dominant position in other national energy markets. These investors were namely stripped of their voting rights when their ownership in Italian energy companies exceeded 2 percent. This measure was challenged before the ECJ by the Commission. The ECJ found that these rules constituted a restriction of the free movement of capital contrary to Article 56 EC.¹²⁹ It also found that Italy could not show any grounds for justification in order to protect public interest under Article 58(1) EC.¹³⁰

Apart from surveying the market to prevent abuse, the National Regulatory Authorities are also responsible for monitoring issues concerning security of supply.¹³¹ The Member States also have a responsibility for ensuring that technical designs are used that ensure safety and long term security of

¹²⁴ Electricity Directive 2003/54/EC, arts. 4 and 23 and Gas Directive 2003/55/EC, arts. 5 and 25

¹²⁵ Electricity Directive 2003/54/EC, art. 23(1) and Gas Directive 2003/55/EC, art. 25(1)

¹²⁶ Electricity Directive 2003/54/EC, art. 23(7) and Gas Directive 2003/55/EC, art. 25(7)

¹²⁷ Electricity Directive 2003/54/EC, art. 23(2) and Gas Directive 2003/55/EC, art. 25(2)

¹²⁸ Electricity Directive 2003/54/EC, art. 23(9) and Gas Directive 2003/55/EC, art. 25(9)

¹²⁹ C-174/04, Commission v Italy, paras. 26 and 30

¹³⁰ Ibid, para. 35

¹³¹ Electricity Directive 2003/54/EC, art. 4 and Gas Directive 2003/55/EC, art. 5

supply as well as interoperability with other systems in order to integrate the market.¹³² In order to reach these goals the Member States shall set up authorization procedures to ensure that the Transmission System Operators comply with the objectives. The Directives also state that the Transmission System Operators have a direct responsibility to ensure that these aims are met.

The directives have left considerable room for interpretation by the Member States in organizing the National Authorities. Solutions where the most power is entrusted a government department or ministry thus leaving the Regulatory Authority unable to carry out its assignments in an efficient way has been adopted in an number of countries. The powers and competences of the National Regulatory Authorities have often been left narrow with the result that the inter-European cooperation between the national authorities is of little significance. The National Regulatory Authority can only work together in the extent that their Member States allows them to do so.¹³³ This has proven to be a shortcoming in the process of creating a unified market. The framework of the directives basically only sets conditions for the work within the national borders while the completion of the market requires a cross border system.¹³⁴ It has also proven a problem that the national authorities that are answering to the national governments are responsible for surveying markets where the same government is often a major actor.

The Commission has an important function in monitoring the over all development of the market on a European level. This includes an oversight of the progression of the work of the Member States in their work including the functioning of the National Regulatory Authorities. The Commission is also responsible for benchmarking the progress of the integrated and competitive European market in yearly rapports. It also has a big role in the development of new legislation within this field on a European level.¹³⁵ The Commission has the possibility of launching infringement procedures against the Member States who do not comply with the community legislation in the work of surveying the market. In 2007 the Commission had launched no less than 34 infringement procedures against 20 Member States.¹³⁶

The Commission continuously monitors the market in this field to ensure that structures threatening the free market are deconstructed. The today privately owned energy supplier E.ON has been the subject of antitrust investigations from the Commission. In order to try to settle an ongoing case against them E.ON has recently given suggestion to structural changes in which E.ON proposes to commit to selling its electricity transmission system network to an operator which would have no interest in the electricity generation and/or supply businesses and to commit to divest

¹³² Electricity Directive 2003/54/EC, rec. 22 and Gas Directive 2003/55/EC, rec. 23

¹³³ Cameron, Competition in Energy Markets, 2007, p. 97

¹³⁴ Ibid, p. 99

¹³⁵ Ibid.

¹³⁶ Com (2006) 841 Prospects for the Internal Gas and Electricity Market, p. 6

generation capacity to competitors. The Commission has not to date taken any decisive action but plans to give the proposal legal action through a decision after market-testing it.¹³⁷ As we see here issues concerning vertically integrated energy companies can be present in state owned as well as privately owned companies.

5.1 European Cooperation Within the European Competition Network

The national focus of the National Regulatory Authorities and lack of competence of the Commission to perform direct supervision has left the cross border trade to a large extent unregulated. To remedy this the National Regulatory Authorities shall cooperate among each other and with the Commission in order to develop the internal market and creating a level playing field.¹³⁸ This cooperation is mainly exercised in the practical surveillance of the market within the ECN and in the work of developing the market where they participate in the forums and ERGEG. The rules for the cooperation is set up in the Regulation (EC) 1/2003 as well as the Commission Notice on cooperation within the Network of Competition Authorities (2004/C 101/03) and the Joint Statement of the Council and the Commission on the Functioning of the Network of Competition Authorities. The Member States have however shown a large unwillingness to the idea of forming a control institution on community level. This has its ground partly in the fact that the organization of the National Regulatory Authorities is highly different in the Member States but also in a protective tradition in this field. The problem is complicated by the fact that the accountability for energy supply lies on the Member States. This unwillingness to confer competence to the union has had the result that the European Competition Network has taken the form of a cooperation network without authorities of its own. Neither is it meant to harmonize the work procedures of the Member States.¹³⁹

The supervision of the market shall be performed in a decentralized manner in order to achieve maximum efficiency and the Member States are allowed to apply national legislation within the field of Article 82 EC under the condition that they also apply the provisions of the Article.¹⁴⁰ Article 82 EC contains the minimum rules and states that the national rules are not allowed to go against the objectives of the treaty rules. The Regulation also establishes the competences of the National Authorities and the Commission saying that the Commission shall have all the powers provided for in the

¹³⁷ MEMO/08/132 Commission welcomes E.ON proposals for structural remedies to increase competition in German electricity market

¹³⁸ Electricity Directive 2003/54/EC, art. 23(12) and Gas Directive 2003/55/EC, art. 25(12)

¹³⁹ Commission Notice on cooperation within the Network of Competition Authorities 2004/C 101/03, para. 2

¹⁴⁰ Ibid, art. 3, and Joint Statement of the Council and the Commission on the Functioning of the Network of Competition Authorities, para. 6

Regulation while the National Competition Authorities shall have the power to apply the Articles 81 and 82 EC in individual cases.¹⁴¹ The Commission shall have the ultimate but not sole responsibility for developing policies within the field and safeguarding efficiency and consistency.¹⁴²

The Commission shall be allowed to act on a complaint or on its own initiative in order to investigate breaches of community law. In order to bring infringements to an end it may take decisions on behavioural or structural remedies.¹⁴³ Structural remedies may only be imposed when there is no equally effective behavioural remedy or when such a behavioural remedy would be more burdensome. The Commission may make commitments made by an undertaking to meet certain concerns binding upon them through a decision.¹⁴⁴ The National Competition Authorities and the Commission are required to work in close cooperation with each other when carrying their surveillance duties and in exchanging information on infringements.¹⁴⁵ Any information released within this network shall be open to all network members.¹⁴⁶ Regulation (EC) 1/2003 gives the Articles 81 and 82 EC direct effect.¹⁴⁷ It is based on the principle that all Member States have full power to apply application of the Articles 81 and 82 EC and are responsible for an efficient division of work with respect to those cases where an investigation is deemed necessary. Each competition authority also remains fully independent and responsible for ensuring due process in the cases it deals with.¹⁴⁸

A case shall normally be handled by one competent authority only, where a single action is not possible the Member states shall coordinate their actions in order to secure maximum efficiency.¹⁴⁹ The cooperation between the Regulatory Authorities shall take place in the frames of the European Competition Network.¹⁵⁰ A time limit of three months shall be set up for allocation of information within the network after which the competent authority deemed best suited shall be appointed for handling the case.¹⁵¹ Which National Authority that is best placed to deal with the case shall be considered on the following grounds: the practice has effects on competition within its territory, the authority is able to effectively bring to an end the entire infringement and it can gather, possibly with the assistance of other

¹⁴¹ ECN Regulation (EC) 1/2003, arts. 4 and 5

¹⁴² Joint Statement of the Council and the Commission on the Functioning of the Network of Competition Authorities, para. 9

¹⁴³ ECN Regulation (EC) 1/2003, art. 7

¹⁴⁴ *Ibid.*, art. 9

¹⁴⁵ *Ibid.*, arts. 11(1) and 12(1)

¹⁴⁶ Joint Statement of the Council and the Commission on the Functioning of the Network of Competition Authorities 15435/02 ADD1, para. 10

¹⁴⁷ ECN Regulation (EC) 1/2003, art. 1(3)

¹⁴⁸ Cooperation within the Network of Competition Authorities 2004/C 101/03, paras. 4 -5

¹⁴⁹ Joint Statement of the Council and the Commission on the Functioning of the Network of Competition Authorities 15435/02 ADD1, paras. 16 and 18

¹⁵⁰ *Ibid.*, para. 2

¹⁵¹ *Ibid.*, para. 12 and 20

authorities, the evidence required to prove the infringement.¹⁵² In unusual circumstances the Commission may take over a case from the National Authorities.¹⁵³ The Commission shall be deemed best suited to deal with the case in cases where more than three Member States are involved.¹⁵⁴ It shall also be deemed to be best placed to deal with a case if it is closely linked to other Community provisions which may be exclusively or more effectively applied by the Commission, if the Community interest requires the adoption of a Commission decision on competition policy when a new issue arises or to ensure effective enforcement.¹⁵⁵ When the Commission has started a procedure against an undertaking the Member State cannot act against the same practice and is relieved of its duty to act.¹⁵⁶ In addition the National Courts may ask the Commission to assist them with information and opinions in proceedings.¹⁵⁷

The Commission may also on its own initiative undertake investigations on the situation of the competition within certain sectors of the Common Market. It may in these cases request that the undertakings or associations of undertakings concerned to supply the information necessary to make the investigation. The findings of the investigation may then be published in a report.¹⁵⁸ Such a report was published by the Commission on the electricity and gas market in 2007.¹⁵⁹ It contained a thorough review of the market and is used as a basis for the future strategy of the Commission in this field.

5.2 CEER and ERGEG

The Council of European Energy Operators (CEER) was formed in 2000 in order to represent the National Regulatory Authorities. It has a vital function of being an organization for cooperation and discussion between the National Regulatory Authorities.¹⁶⁰ Among its tasks is co-operation to achieve competition in the European markets, work for the development of regulations in electricity and gas, development of joint approaches with regard to transnational energy utilities and establishment of common policies. It has however not the function of being a supra national regulator but is merely a National Regulatory Authorities' discussion club, much like

¹⁵² Commission Notice on cooperation within the Network of Competition Authorities 2004/C 101/03, para. 8

¹⁵³ ECN Regulation 1/2003, art. 11(6)

¹⁵⁴ Joint Statement of the Council and the Commission on the Functioning of the Network of Competition Authorities 15435/02 ADD1, para. 19

¹⁵⁵ Commission Notice on cooperation within the Network of Competition Authorities 2004/C 101/03, para. 15

¹⁵⁶ *Ibid.*, para. 51

¹⁵⁷ ECN Regulation (EC) 1/2003, art. 15

¹⁵⁸ *Ibid.*, art. 17

¹⁵⁹ Inquiry pursuant to art. 17 of Regulation (EC) No 1/2003 into the European gas and electricity sectors

¹⁶⁰ Eberlein, *The Making of the European Energy Market*, 2008, p. 80

a counterpart to ETSO. It has no formal obligations towards the commission.¹⁶¹

The European Regulators' Group for Electricity and Gas (EREG) was founded on 11 November 2003 through the Commission Decision 2003/796/EC. It is a body consisting of National Regulatory Authorities of the 27 Member States with the aim of assisting the Commission in the work of completing the inner energy market.¹⁶² The group was established in order to facilitate consultation, cooperation and coordination between the National Regulatory Authorities of the different Member States and between the national authorities and the Commission.¹⁶³ Much of the work that was performed earlier in the forums, has now been taken over by the EREG. It has now gotten the leading role in the development of European guidelines together with the Commission. Unlike the forums EREG is closer involved in the process of liberalizing the market and somewhat has the status of an administrative body.¹⁶⁴ The EREG has also taken over much work from CEER that functions to a large extent as formalized forum with more regulatory teeth. The CEER does continue to function as an informal forum whose work to a large extent overlaps that of EREG.¹⁶⁵

5.3 The Legislative Competence of the Commission

If a Member State breaches the rules of the treaty the Commission has the possibility of bringing the matter before the ECJ according to Article 226(2) EC. In order to ensure a functioning inner market has the Commission the competence to make decisions, formulate recommendations or deliver opinions in this field according to Article 211 EC..

The Article 86 EC contains provisions on companies that are under public ownership or are granted special rights. Its third paragraph obligates the Commission to secure that the Member States does not maintain any measure that breaches the rules of the treaty. In order to fulfil this obligation the Commission is instructed to address appropriate directives or decisions to Member States. This is one of relatively few articles where such power is directly given to the commission.¹⁶⁶ The Commission has not used this competence in order to adopt any Directives directed specially to the market of gas or electricity.¹⁶⁷

¹⁶¹ Cameron, *Competition in Energy Markets*, 2007, p. 105

¹⁶² http://www.ceer-eu.org/portal/page/portal/EREG_HOME/EREG/ABOUT_EREG

¹⁶³ Com(2007) 528 Proposal for Amending the Electricity Directive, p. 9

¹⁶⁴ Cameron, *Competition in Energy Markets*, 2007, p. 111

¹⁶⁵ Eberlein, *The Making of the European Energy Market*, 2008, p. 86

¹⁶⁶ Cameron, *Competition in Energy Markets*, 2007, p. 466

¹⁶⁷ *Ibid*, p. 465

The procedure in article 86(3) EC differs itself from that in article 95 EC as the later involves a procedure with consultation of a wide range of parties where the Council is set to be the motor behind the measure. The Article 95 EC gives the Council a legal basis for adopting measures under Article 251 EC in order to further the inner market and combat obstacles to the free movement. In Article 86(3) EC the Commission has been entrusted more freedom to act on its own while the Article 95 EC involves an extensive consultation procedure.¹⁶⁸ The smaller consultation procedure and the lack of direct influence from the national governments means that the Member States have a smaller influence in the acts taken under Article 86(3) EC than under Article 95 EC. The Commission has used this power with moderation but the Member States have often challenged its competence to do so.¹⁶⁹

In the *Transparency Directive* case the Member States argued that the article only gave the Commission the power to deal with specific situation and was not suited for giving a general legislative power to the Commission. The ECJ rejected these claims stating that there were no warrant for constructing the term directive differently in article 86(3) EC than in article 249 EC. The power of the Council to adopt acts under article 89 EC does also not preclude the Commission to do so under article 86(3) EC.¹⁷⁰

In the *Telecommunications Directive* case France raised a complaint against a provision in the Directive that prohibited all exclusive rights within the telecommunications market. They claimed that such a prohibition would fall under article 226 EC as it was surveillance of abuse of the market. The ECJ held that this was not a question of a measure directed at a specific Member States but a general prohibition that falls under Article 86(3) EC.¹⁷¹ The plaintiffs also claimed that such a prohibition went outside of the scope of Article 86(3) EC. The ECJ found that the scope of Article 86(3) EC is determined by the scope of the rules which are to be ensured. Even if the existence of monopolies are presupposed in Article 86 EC the adoption of a directive prohibiting them does not go outside of the competence. The article may however not be used to adopt general measures against conducts falling under Article 81 and 82 EC.¹⁷²

¹⁶⁸ Cameron, *Competition in Energy Markets*, 2007, p. 467

¹⁶⁹ Craig and De Búrca, *EU-law*, 2008, p. 1081

¹⁷⁰ Case 188-190/80, *French Republic, Italian Republic and United Kingdom of Great Britain and Northern Ireland v Commission*, paras. 6 and 10

¹⁷¹ C-202/88, *French Republic v Commission*, paras. 17-18

¹⁷² *Ibid*, paras. 21-22

6 State Controlled Companies

The process of liberalizing state controlled companies is a central issue within the process of creating a single European energy market. The efforts made in the energy sector are one part of this greater process. The ideas behind the Directives and Regulations adopted are in line with a general trend in the recent years to favour a more confined role for the State in the market economy. There does however continue to be undertakings which either remain within public ownership or have a privileged status in the market place through special regulations or state aid.¹⁷³ The fundamental provisions on these measures taken by the Member States are laid down in the Articles 86 and 87 EC.

The energy markets can often consist of small, remote or for other reasons highly unprofitable markets. In order to ensure stable supply of energy, the Member States have often entrusted the public service obligations with special benefits or exclusive rights in order to compensate them for the losses. These compensations generally fall under the provision on state aid in article 86 EC. Another way for states to direct the actors of the market is to take direct control over the companies, such measures do also fall under this Article.

Article 157 EC is of interest in this context. It states that the Member States shall ensure that the conditions necessary for the competitiveness of the Community's industry exist. The article also expressly mentions the creation of open and competitive markets including encouraging an environment favourable to initiative and to the development of undertakings throughout the Community.

Article 16 EC states that the Community and the Member States shall take care that services of general economical interest operate on the basis of principles and conditions that which enable them to fulfil their missions. The Commission has expressed that these services are one of the pillars of the European society and that the fulfilment of them is fundamental to allow the citizens to enjoy their fundamental rights.¹⁷⁴ It is clear that the Community has the basic standing that it falls within the frames of the responsibility of the states to provide the citizens with some basic services when the market can not provide them.

According to article 295 EC the treaty shall not prejudice the rules in Member States governing the system of property ownership. The mere fact that certain economical activities are undertaken in the public sphere is not in itself contrary to the rules of the treaty. In the case of *Commission v Belgium*¹⁷⁵ the Belgian state had vested a "golden share" in the company

¹⁷³ Craig and De Búrca, EU-law, 2008, p. 1071

¹⁷⁴ Com (2004)374 White Paper on services of general interest, p. 4

¹⁷⁵ C-503/99 *Commission v Belgium*, para. 9

Société nationale de transport par canalisations which gave it the right to advance notice of any share transfer prior to the transfer, thereby enabling the Minister to prevent the transfer if it would impair national interests in the field of energy. The Belgian state did also have the right to declare any decision taken by the board of the company null and void if it was contrary to the energy policy of the company. The ECJ declared that Article 295 EC did not give the Member States the right to set up measures that infringed the freedom of capital in Article 56 EC in order to safeguard national interests. The free movement of capital, as a fundamental principle of the Treaty, may be restricted only by national rules which are justified by reasons referred to in Article 58 EC or by overriding requirements of the general interest that are applicable to all persons and undertakings pursuing an activity in the territory of the host Member State. Furthermore, in order to be justified, the national legislation must be suitable for securing the objective which it pursues and must not go beyond what is necessary in order to attain it.¹⁷⁶

These economic activities do however fall under the normal regulations on market distortions under Article 81 to 89 EC. It is as follows not the form but the effect on the market that determines if the state controlled company breaches the rules of the treaty.

Article 86

1. In the case of public undertakings and undertakings to which Member States grant special or exclusive rights, Member States shall neither enact nor maintain in force any measure contrary to the rules contained in this Treaty, in particular to those rules provided for in Article 12 and Articles 81 to 89.

2. Undertakings entrusted with the operation of services of general economic interest or having the character of a revenue-producing monopoly shall be subject to the rules contained in this Treaty, in particular to the rules on competition, in so far as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them. The development of trade must not be affected to such an extent as would be contrary to the interests of the Community.

*3. The Commission shall ensure the application of the provisions of this Article and shall, where necessary, address appropriate directives or decisions to Member States.*¹⁷⁷

Article 86 EC covers two types of undertakings¹⁷⁸:

- Public undertakings

¹⁷⁶ C-503/99 Commission v Belgium, paras. 36,44-45

¹⁷⁷ In the third paragraph of the article, legislative power is conferred to the Commission. This gives it the possibility to enact directives and decisions within the field of the article. This power is further discussed under the chapter “the Surveillance of the Market”.

¹⁷⁸ Craig and De Búrca, EU-law, 2008, p. 1122

- Undertakings which Member States have granted special benefits or exclusive rights

6.1 Subjected Companies

The term “public undertaking” in the context of Article 86 EC is not defined in the EC treaty. The ECJ did in the *Transparency Directive Case* apply the definition of public undertaking supplied in the transparency directive 80/723/EC to article 86 EC.¹⁷⁹ According to Article 2 of the Directive the term public undertaking means any undertaking in which the public authorities may exercise directly or indirectly a dominant position. Such an influence is to be presumed when the public authorities:

- Directly or indirectly hold the major part of the undertakings subscribed capital or
- Control the majority of the votes or
- Can appoint more than half the members of its administrative, managerial or supervisory body.

This definition is not conclusive but still has a big influence being approved by the ECJ.¹⁸⁰ In the *Mueller* case, the state had the power to nominate half the members of the management and supervisory board of a company. The ECJ stated that such a company holding certain privileges could fall inside of the Article 86 EC.¹⁸¹ An example within the energy sector of this is a national Electrical provider that has been privatized, but continues to hold some sort of monopoly position or privileges.

Even if an undertaking does not meet this definition it can still fall within Article 86(1) EC if it is granted special or exclusive rights. The basic rule is that if the state has relived a company partly or fully from the rules of normal competition, it must also bear the consequences.¹⁸²

The fact that an economic activity is performed by the state or by a company granted special or exclusive rights does not breach the article 86 EC *per se*. Provided that these rights are not exercised in a way that abuses its position or interfere with the free interplay of the market they do not by them self breach the treaty. For example is the largest energy provider in Sweden, Vattenfall, completely owned by the Swedish State.¹⁸³ Only when these rights are exercised in a way that breaches the provisions on market distortions in the Treaty on market abuse do they infringe on Article 86(1)

¹⁷⁹ Case 188-190/80 French Republic, Italian Republic and United Kingdom of Great Britain and Northern Ireland v Commission, para. 25

¹⁸⁰ Craig and De Búrca, EU-law, 2008, p. 1074

¹⁸¹ Case 10/71 Ministère public luxembourgeois v Madeleine Muller, Veuve J.P. Hein and others, para. 10

¹⁸² Craig and De Búrca, EU-law, 2008, p. 1074

¹⁸³ www.vattenfall.se/www/vf_se/vf_se/518304omxva/518334vxrxv/518574styre/518634bolag/index.jsp

EC. The ECJ has held that the Articles 28, 39 and 82 EC get direct effect when their application fall inside of Article 86(1) EC.¹⁸⁴

Some rights can however be seen to breach the Article 86(1) EC automatically, this is the case when they cannot avoid being abusive. In the *Höfner* case the German Federal Employment Office held an exclusive right to services of recruitment and placement of services for executive positions throughout Germany. The ECJ expressed that the granting of an exclusive right was not *per se* a breach of the treaty but the Member States only breach the treaty when the mere exercise of the granted rights is an abuse of dominant position under Article 82 EC.¹⁸⁵ In the current case the agency was clearly unable to fill the demand of the market and the monopoly was used to avoid competition, thus constituting an automatic abuse.¹⁸⁶ The ECJ sharpened its approach in the *Merci* case where a company held exclusive rights to load and unload ships entering the dock. These exclusive rights were deemed by the ECJ as breaching the Article 82(1) EC, they reasoned that the rights were contrary to the treaty when the company receiving them cannot avoid abusing its dominant position or when it *is induced to abuse it*.¹⁸⁷ This comes very close to deeming exclusive rights as abusive *per se*. It can be argued that this is a very narrow room, as most exclusive rights will be found to either automatically abuse a dominant position or induce such abuse. The stance of ECJ today is to hold all exclusive rights *prima facie* to infringe Article 81(1) EC. It seems that the only way which a Member States can get special or exclusive rights approved by the ECJ is to show that there are special justifications for them.¹⁸⁸ For example, to develop energy sources that have less impact on the environment.

6.2 Services of General Economical Interest

Companies entrusted with the operation of services of general economic interest fall under the second paragraph of Article 86 EC. This includes for example energy companies with the assignment of supplying certain unprofitable regions with energy. The paragraph consists of three parts with the following structure:

1. Companies entrusted with the operation of services of general economic interest fall under the rules of the treaty
2. They are however excepted from these rules in the extent that these would obstruct the performance of their duties

¹⁸⁴ Case 188-190/80 French Republic, Italian Republic and United Kingdom of Great Britain and Northern Ireland v Commission, para. 29

¹⁸⁵ C-41/90 Giuseppe Barassi v Commission, para. 29

¹⁸⁶ *Ibid*, para. 31

¹⁸⁷ C – 179/90 *Merci convenzionali porto di Genova SpA v Siderurgica Gabrielli SpA*, para. 19

¹⁸⁸ Craig and De Búrca, EU-law, 2008, p. 1079

3. This exception must not affect the development of trade to such an extent that it would be contrary to the interests of the Community

The ECJ has expressed that the category of companies “entrusted with operation of services of general interest” cannot be strictly defined but is subject to searching scrutiny. It is however not relevant if the undertaking is public or private so long as the operation has been assigned by a public authority. There are no demands on the form of this act but the state must have taken some definite steps to assign the service to the specific undertaking.¹⁸⁹ The ECJ has confirmed that measures designed to provide remote or sparsely populated areas with necessary infrastructure can constitute services of general economical interest.

For the exception in Article 86(2) EC to apply it must be shown that the application of the treaty rules obstructs the performance of the special obligation incumbent to the undertaking.¹⁹⁰ It is not necessary for the survival of the undertaking itself to be under threat. It is sufficient to show that the exclusive rights are necessary to enable the assigned undertaking to perform its operations under economically acceptable conditions. When arguing for an exception, the Member State does not have to show that there are no other measures available to enable the tasks to be performed under the same conditions.

The Member State granting the special rights must however prove that the operation in question is of general economic interest and that the application of the treaty rules would obstruct its performance. In the case *Ahmed Saeed Flugreisen* the ECJ stated that Article 86 EC may be applied to carriers who are obliged by the public authorities, to operate on routes which are not commercially viable but which it is necessary to operate for reasons of the general interest.¹⁹¹ In the *Merci* case the court could see no such connection regarding the operation of a port facility and denied the application.¹⁹² The Court also argued, that a large number of alternative docs existed and that no obstacle to running these under normal market conditions had been proven. In the *British Telecom* case the ECJ rejected the argument of need for exemption from the treaty rules. It based its ruling on the fact that the claimant failed to establish that the application of the competition rules would hinder the company to carry out the tasks assigned to them.¹⁹³

The ECJ has accepted the use of exclusive rights in cases where companies are entrusted with a universal service obligation. This is the case where a company has the obligation to supply the whole market with a service, requiring them to perform tasks that are not in themselves profitable. Measures can then be taken to protect the market from competition in order

¹⁸⁹ Craig and De Búrca, EU-law, 2008, p. 1079

¹⁹⁰ C-157/94 Commission v the Netherlands, para. 32

¹⁹¹ C-88/86 Ahmed Saeed Flugreisen and Silver Line Reisebüro GmbH v Zentrale zur Bekämpfung unlauteren Wettbewerbs e.V, para. 55

¹⁹² C-179/90 Mercis convenzionali porto di Genova v Siderurgica Gabrielli, para. 27

¹⁹³ Case 41/83 Italy v Commission, para. 33

to prevent that competing firms “cream off” the profitable business without having any obligation to perform the unprofitable services. In the *Corbeau* case the ECJ accepted that some restrictions to the competition were necessary to enable the Belgian postal service to perform its universal service obligation. This shall however not serve to exclude all competition or go beyond what is necessary to allow the company to carry out the service under acceptable economical conditions. There could still be services which can be disconnected from the service obligation and where competition can be tolerated without threatening the economic stability needed for the holder of the right.¹⁹⁴ The case established the principle that the granting of exclusive rights are always contrary to the rules of the Common Market unless justified under Article 86(2) EC. In the *RTT* case special rights granted the Belgian telephone company RTT were challenged. The company held a monopolistic right to run the telephone network, which in itself, was not challenged by the ECJ. In connection to this monopoly it also had an auxiliary right to approve all equipment connected to the network. The ECJ stated that a Member State was in breach of Article 86 EC if it conferred additional rights to a company already in a dominant position if those rights could be separated and performed by a company on an adjacent market.¹⁹⁵ The Member States are not, as follows, free to include near lying services in a main-monopoly if these sub-rights are not in themselves justified.

The contested rights can also relate indirectly to the business of the receiving company. In a decision from 5. March 2008 the Commission found that quasi-exclusive rights to lignite (a type of coal) given by Greece to a state owned power-company constituted an infringement of the Articles 86 and 82 EC. Lignite is the cheapest source of fuel in Greece and more than 60 percent of all Greek electricity is produced in lignite-powered plants, making them by far the biggest source of power. Virtually all lignite deposits in Greece are owned by the state which in its turn grants exploitation rights to companies. The Greek energy company PPC has obtained 91 percent of these exploitation rights from the government. The Commission found that these rights constituted a breach against the Articles 86 and 82 EC as the uneven access to cheap fuel prevented other companies from competing on even terms. The Commission concluded that it is the responsibility of the Member State to identify concrete measures to end the infringement in the framework of its national energy policy.¹⁹⁶

The holding of a state monopoly in the energy market is as follows not in itself contrary to Article 86 EC. The treaty does however require that the monopoly is run in such a way that it does not constitute or induce abuse of dominant position or threatens the free movement in the Union. This means that all forms of exclusive import rights that discriminate against producers throughout the union are illegal.¹⁹⁷ Even if the exception applies the

¹⁹⁴ C-320/91 Criminal proceedings against Paul Corbeau, para. 21

¹⁹⁵ C-18/88 Régie des télégraphes et des téléphones v GB-Inno-BM SA, para. 17-21

¹⁹⁶ Decision of the Commission from 5 March 2008

¹⁹⁷ C-59/75 Pubblico Ministero v Flavia Manghera and others, para. 13

development of trade must not be affected to such an extent as would be contrary to the interests of the community. This provision has the effect of subjugation the exception to the interests of those of the Community in the relevant area.

In 1991 the Commission announced that it intended to take action on the basis of Articles 31 and 226 EC against several Member States as their national legislation provided for import and export monopolies on electricity and/or gas. These procedures were connected to the ongoing negotiations on the first electricity and gas directives. The Member States involved had been involved in discussions on the topic and expressed willingness to comply with the Commissions objections but no actions had been taken within the set time limit.¹⁹⁸

In the *Commission v the Netherlands* case the Commission contested the Dutch law prohibiting the supply of electricity provided by any other than the Dutch national electricity provider SEP as it breached Article 37 EC. The SEP had the task of coordinating all import of electricity to the Netherlands and no company could sell electricity on the Dutch market not imported through them. The Netherlands contested that it was a question of exclusive rights as it was possible for customers to buy electricity for their own use directly from other countries. The ECJ stated that it is not necessarily a requirement that the exclusive rights to import a given product relate to all imports: it is sufficient if those rights relate to a proportion such that they enable the monopoly to have an appreciable influence on imports for the Article 37(1) EC to be applicable.¹⁹⁹ It continued to state that it was clear that Article 37(1) EC applies to situations in which the national authorities are in a position to control, direct or appreciably influence trade between Member States through a body established for that purpose or a delegated monopoly. It was therefore clear that the exclusive right given to SEP was a state monopoly under Article 37(1) EC.²⁰⁰ The ECJ then went on to test if these rights did fall under the exception in Article 86(2) EC. They stated that for Article 86(2) EC to be applicable, it is sufficient that the application of those rules obstruct the performance, in law or in fact, of the special obligations incumbent upon that undertaking. It is not necessary that the survival of the undertaking itself be threatened.²⁰¹ The ECJ stated that the burden of proof for the Member State was to show that the body conferred the rights had a public service obligation and that the exclusive rights enabled it to perform them. The Member State did not have to show that no other possible measure could be taken but it was up to the Commission to show that the exclusive rights were excessive.²⁰² As the Commission had not with arguments connected to the current case proven that the exclusive right was excessive its application was dismissed by the ECJ. It had also failed to present arguments to that the market would be

¹⁹⁸ Cameron, *Competition in Energy Markets*, 2007 p. 478

¹⁹⁹ C-157/94 *Commission v the Netherlands*, para. 18

²⁰⁰ *Ibid*, para. 20

²⁰¹ *Ibid*, para. 43

²⁰² C-157/94 *Commission v Netherlands*, para. 62

distorted under article 86(3) EC and the application was dismissed in this part to by the ECJ. The Commission was harshly criticized by the ECJ in this case for not having provided enough information connected to the present circumstances to support its case but only having supplied legal argumentation with nothing to support it.²⁰³

In the linked case *Commission v Italy*, the Commission challenged a system in Italy where the import of electricity was dependant on a license granted by the Italian Minister of Public Works. The Italian company E.N.E.L. had been given the right to import a certain amount of electricity. The Commission saw this as an exclusive right conferred on the state and executed through E.N.E.L. that breached the Articles 28, 29 and 31 EC.²⁰⁴ The Italian government argued that the import and export of electricity should fall under services rather than goods because of the special nature of electricity. The ECJ rejected this argument and referred to earlier judgments as *Costa v. E.N.E.L.* declaring that electricity did fall under the definition of goods in Article 28 EC. It also found that the exclusive right granted E.N.E.L. were contrary to Article 31 EC as it consisted a obstacle to inter community trade.²⁰⁵ The ECJ then went on to control if the restrictions could be justified under Article 86(2) EC. It stated that the exception could only be applied when the performance of the service of general economical interest was dependant on the granting of the special rights in question. It is also vital that these special rights do not affect the development of the trade to such an extent that it would be contrary to the interests of the Community.²⁰⁶ The ECJ did however find that the Commission had not in its claim stated any grounds connected to the current case to motivate its opinion that the measures taken by Italy did not fall under Article 88(2) EC. The opinion of Italy that these measures were necessary to ensure that the public service obligation was performed must then be accepted and the application declined.²⁰⁷

The case *Commission v France* was connected both to the gas and electricity sectors where the French government had conferred monopolistic special rights upon EDF and GDF through concessions. The ECJ found that this exclusive rights were in breach of Article 31 EC as it was discriminating against the exporters in the rest of the Union.²⁰⁸ The french objection that this system of exclusive rights was similar to what existed in many other Member State was not accepted by the ECJ as a ground for declaring it valid in their case.²⁰⁹ France motivated the existence of their concession system with a public service obligation consisting in supplying the whole of France with electricity and the relevant markets with gas at a reasonable price. The ECJ stated that the Article 86(2) EC is an article that permits derogation

²⁰³ C- 157/94 *Commission v Netherlands*. 67

²⁰⁴ C -158/94 *Commission v Italy*, para. 11-12

²⁰⁵ *Ibid*, para. 17, 33

²⁰⁶ *Ibid*, para. 43

²⁰⁷ *Ibid*, para. 60

²⁰⁸ C-159/94 *Commission v France*, paras. 33-34

²⁰⁹ *Ibid*, para. 38

from treaty rules and must therefore be interpreted strictly. As held in previous case-law C-202/88, the Article 86(2) EC seeks to meet the Member States interest in using certain undertakings, as an instrument of economic or fiscal policy by allowing certain derogations from the treaty rules while safeguarding the Community's interest in ensuring compliance with the rules on competition and the preservation of the unity of the common market.²¹⁰ Uninterrupted supply of electricity throughout the territory is a task of general economic interest within the meaning of Article 86(2) ECT.²¹¹ So is ensuring the reliable and efficient operation of the national electricity supply in a socially responsible manner at costs which are as low as possible.²¹² The Court confirmed that for an undertaking to be regarded as entrusted with the operation of a service of general economic interest within the meaning of Article 86(2) ECT of the Treaty, it must have been so entrusted by an act of public authority.²¹³ The obligations must be linked to the service of general economic interest performed and designed to make a direct contribution to satisfying that interest. General obligation such as environmental policy cannot fall within these obligations.²¹⁴ The current measures by the French government served to combat illegitimate competition and "creaming off" which would hinder EDF and GDF from performing their duties. The ECJ held that it was shown that the public service obligations were acceptable and the measures suitable to serve these goals. The dismissed the application from the Commission as the like in the cases 157 and 158/94 had failed to provide ground for seeing them as inappropriate or excessive.

In the case *Commission v Spain* the Commission started a procedure against Spain according to the Article 226 EC. They pleaded that the Royal Decree of 1986 (BOE No 24 of 28 January 1985) that entrusted the company Redesa the function running the unified operation of the Spanish energy net constituted a statutory monopoly. The ECJ found that the unified operation involves coordination of the activities by which the various electricity-generating and distribution undertakings contribute to the country's electricity supply rather than concentration thereof in the hands of a single operator. The commission could not prove that the power entrusted Redesa went beyond coordinating the use and infringed the trade in a way contrary to the treaty. Their application was therefore dismissed.²¹⁵ In two actions brought against Spain in 2005 the ECJ found that the country had failed to implement both the Energy Directives.²¹⁶ The Directives should have been implemented on 1. July 2004.

The ECJ has safeguarded the free movement of goods by taking a consistent stance against obstacles to the free market but at the same time taken

²¹⁰ C-159/94 *Commission v France*, para. 55

²¹¹ *Ibid.*, para. 57

²¹² *Ibid.*, para. 59

²¹³ *Ibid.*, para. 65

²¹⁴ *Ibid.*, paras. 68-69

²¹⁵ C-160/94 *Commission v Spain*, para. 18

²¹⁶ C-357/05 *Commission v Spain* and C-358/05 *Commission v Spain*

consideration to the interests of the Member States in allowing them a reasonably large room to control the market in order to carry out public service obligations. The ECJ has also been clear in placing the burden of proof on the Commission regarding the question if the given rights are inappropriate or excessive for meeting the public service obligation.

6.3 Abuse of a Dominant Position

The rules on state controlled companies are closely linked to the provisions on abuse of dominant position in Article 82 EC. The fact that a public body holds the control of a company is in itself not contrary to Article 86 EC as long as the monopoly is carried out in such a way that none of the other rules of the treaty are broken. The fact that these companies often hold monopolies that are not natural but, are created through a distortion to the market is also factor that makes them liable to be abusive while exercising their obligations. Abuse of dominant position is an evident issue in markets where the state controls or gives certain companies special rights but it can also be a problem in fully privatized markets. This can be the case either when these markets are still dominated by the old monopolies or as in Germany, where market concentration has made monopolistic behaviour an issue.

Article 82 EC serves to control the market powers in reference to abuse of dominant position, whether this dominant position is held by one or a number of companies. The holding of a dominant position or exercising of these powers is not unlawful *per se*. Only when the position is exploited in a way that constitute *abuse* of the dominant position is the act unlawful. The article holds hold a list of examples of what constitute abuse:

- Directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions
- Limiting production, markets or technical development to the prejudice of consumers
- Applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage
- Making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

In order to establish if a company holds a dominant position must the relevant product market be established. The Commission established that the *relevant product market* shall be made up by all those products and/or services which are regarded as interchangeable or substitutable by the consumer, by reason of the products' characteristics, their prices and their intended use.²¹⁷ Both electricity and gas are products that makes up unique

²¹⁷ Commission Notice on the definition of relevant market for the purposes of Community competition law [1997] OJ 372/5, para. 7

markets. They are technically and functionally separated from other products and each other. Even though a household connected to both electricity and gas nets could to some extent exchange the services with each other this could only be done to some extent and often following technical adjustments.

Possessing a dominant position does aside from the product market also refer to a specific geographic market. Basically the relevant product market shall be made up of the whole European market when functioning good and there are a free exchange of goods, but so is often not the case. The Commission has defined the *relevant geographic market* as the area in which the undertakings concerned are involved in the supply and demand of products or services, in which the conditions of competition are sufficiently homogeneous and which can be distinguished from neighbouring areas because the conditions of competition are appreciably different in those area.²¹⁸

Having a dominant position in the meaning of Article 82 means partly being outside of the normal rules of competition because of the strong position. The ECJ did in the *United Brands* case form a legal test for determining if a company has a dominant position. A company has a dominant position if it has an economic strength on the market that allows it to prevent effective competition from being maintained on the market by having the power to behave to an appreciable extent independently of its competitors, customers and consumers.²¹⁹ Such a position does not preclude some competition as long as the company can act largely in disregard to it.²²⁰ It follows that the “dominating position” is not completely dependant on the market share of the company but rather the possibility of the company to act without taking consideration to the normal rules of the market due to its position as a dominating player. A market share closer to 50 percent has been seen by the court as being very large, hence indicating a dominant position.²²¹

Other factors relating to the relevant market can also be taken in to consideration when assessing if a company has a dominant position. An essential aspect here are barriers that makes it difficult for new competitors to enter the market. This is a present condition in the energy market as a high level of infrastructure and technical know-how is needed to enter the market. These barriers are even more evident in markets that suffer from a high level of vertical integration. Acting as a large player on a market with high barriers has been deemed by the ECJ as constituting dominant position.²²² This is a very clear characteristic of the energy market. Vertical

²¹⁸ Commission Notice on the definition of relevant market for the purposes of Community competition law [1997] OJ 372/5, para. 8

²¹⁹ Case 27/76 *United Brands Company and United Brands Continentaal BV v Commission*, para. 65

²²⁰ Case 85//76 *Hoffmann-La Roche & Co. AG v Commission*, para. 39

²²¹ C - 62/86 *AKZO Chemie BV v Commission*, para. 60

²²² Case 85//76 *Hoffmann-La Roche & Co. AG v Commission*, para. 48

integration in the energy market does also constitute barriers to competition as they serve to protect the integrated energy retailer from competition.

It is in this context important distinguish harmful obstacles to competition on the market from competitive strategy. It is not useful to punish companies for being successful in their field or adopting new technologies and strategies in order to get ahead of their competitors. A useful competition law shall allow the actors of the market to succeed and leave the market economy room to develop. The law shall only intervene when unjust winnings are made following abusive behaviour that is harmful to the market. There is also considerable disagreement on how the “abusive behaviour” should be measured.²²³ One school argues that the companies should be free to use the benefits of their position freely as this is the fruits of successful investments on their behalf. The ECJ has however taken the approach that a company, irrespective of the reasons for its dominant position, has special responsibility not to allow its conduct to impair genuine and undistorted competition on the common market.²²⁴ This means that a company in a dominating position must take special consideration of the effects of its action on the market and is consequently hindered to take certain actions.

Even though the Commission can undertake market investigations on its own initiative under Article 85 EC it has been criticized for taking to little pre active action to ensure a functioning market. According to Newberry the Commission tends to make a basic assumption that the competition is working well within the Common Market and only takes action when it gets an indication otherwise.²²⁵

²²³ Craig and De Búrca, EU-law, 2008, p. 1020

²²⁴ Case 322/81 NV Nederlandsche Banden Industrie Michelin v Commission, para. 57

²²⁵ Newberry, Problems of liberalising the electricity industry, 2002, p. 922

7 Public Service Obligations and State Aid

Member States often have interests in supporting the energy sector as well as promoting new investments. Such measures generally fall under Article 87 EC, which sets frames for such aid. The procedure for reviewing state aid is set out in Article 88 EC and provisions for making implementing regulations by the Council is made in Article 89 EC. Through the Regulation (EC) 994/98 the Commission has been given competence to review aid schemes. The Commission has traditionally had a strict attitude towards all forms of state aid especially in the period of market liberalization. In its guidance notes to the energy directives, the Commission notes that only services that cannot be provided by the market can even be considered being public service obligations.²²⁶ Two forms of aid have however generally been approved by the Community as they have seemed justified. The first is aid that is deemed to be necessary in order to counter-balance adverse effects of liberalization. The second is aid granted to support the development of renewable or environmental energy.²²⁷

The Article 87 EC consists of three parts:

1. paragraph one establishes that state aid is *prima facie* incompatible with the common market
2. paragraph two provides a list of exceptions with state aid that *will* (always) be deemed compatible with the common market
3. paragraph three provides a list of exceptions with state aid that *may* be deemed compatible with the common market

7.1 What Constitutes State Aid?

Article 87 EC

1. Save as otherwise provided in this Treaty, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the common market.

State aid is not directly defined in Article 87 EC but the ECJ and Commission have taken a broad view on the concept. The form of the aid is not defining but the essential point is that the aid must confer an advantage to the recipient. The aid may consist of positive benefits such as direct subsidies but also measures to lower the costs of the company such as tax

²²⁶ Hancher, EC State Aids, 2006, p. 287

²²⁷ Cameron, Competition in Energy Markets, 2007, p. 428

exemptions or lowered costs for public services. The deciding point is that the aid shall put the receiving party or parties in a better position compared to other competitors. For state support to be classifiable as state aid it must meet following criteria:

1. It must confer an advantage to the recipient
2. It must involve state recourses
3. It must distort or threaten to distort competition
4. It must have an actual or potential effect on trade between the Member States

7.1.1 Conferred Advantage

In order for a measure to be classified as state aid it must firstly have the effect of conferring a *selective benefit or advantage* to the recipient. General measures of economic policy, such as an interest reduction or tax cut, will not fall in to the category although it has positive effects on the industry.²²⁸ Non-sectoral national measures remains under the discretion of the national fiscal sovereignty while economical measures targeting a special sector or individual undertaking falls under the rules of state aid. In the *Adriana-Wien* case the ECJ found that a tax subsidy consisting in reimbursement of energy taxes given to the manufacturing industry to be state aid. They stated that such a measure targeting all the companies based in the national territory does not constitute state aid, but the fact that the manufacturing sector is selected is enough to qualify it.²²⁹ A measure may however constitute state aid even if it targets a whole range of industries such as export aid. This is an especially sensitive question within the EU as the common market in many cases clashes with the national markets. In those cases can the conflict between the fiscal sovereignty of the Member States and the rules of competition within the common market be evident. The energy sector is in many ways closely tied to the energy and environment policies of the single Member State and is for this reason highly exposed to this conflict.

The state is free to make normal economical investments, direct or through state held companies. These investments do not fall under the provisions of state aid. To determine if there is a question of investments or subsidies the ECJ did in the *Tubemuse* case take in to consideration if it was possible to find the invested capital on the private market.²³⁰ This principle is known as the *market economy investor principle* and was adopted by the Commission in 1984 to differentiate normal investments from state aid. According to this principle the investment is classified as state aid if the capital is contributed in circumstances that would not be acceptable to a private investor under normal market circumstances.²³¹ That is to say when the financial position of the receiving party is such, that a normal return on the investment cannot

²²⁸ Hancher, EC State Aids, 2006, p. 468

²²⁹ C-143/99 *Adria-Wien Pipeline GmbH and Wietersdorfer & Peggauer Zementwerke GmbH v Finanzlandesdirektion für Kärnten*, paras. 34-36

²³⁰ C-142/87 *Belgium v Commission*, para. 29

²³¹ Hancher, EC State Aids, 2006, p. 202

be expected in a reasonable time. Certain situations are excepted from being state aid that is:

- The fresh capital corresponds to new investments needs and to costs directly linked to them
- the industry receiving the capital does not suffer from structural overcapacity
- the enterprise's financial situation is sound

The Commission used the market economy investors principle in a decision against the state owned French energy company EDF in 2000.²³² This decision concerned the question if discount on electricity given to paper mills for the purpose of installing electrical infrared paper drying equipment constituted state aid. The discounts were given previous to the liberalization process and were given at a time when EDF had an overcapacity of energy production. The Commission found that a private investor would rather sell an additional unit of energy without covering the total costs than not sell at all in a situation of overcapacity and in the absence of competition. The Commission did therefore find that EDF's behaviour had to be considered to be justified on commercial grounds and did therefore not constitute state aid.

The Member States are free to give companies compensation for services performed without it being regarded as state aid under the conditions that this compensation represents normal market conditions. The ECJ established four conditions in the *Altmark* case that had to be met if the payment shall not be seen as state aid:²³³

- The recipient undertaking must actually have public service obligations to perform
- The basis for the compensation must be established in advance in an objective and transparent manner
- The compensation cannot exceed the costs of the company for performing the obligation and a reasonable profit
- If the company chosen to perform the obligation is not chosen through a public procurement procedure the cost of the company must be calculated on the costs of a typical well run company

7.1.2 Involvement of State Recourses

Secondly, only benefits granted direct or indirect through state recourses can be seen as state aid. Aid given indirect is often distributed through state hold companies. Mainly two types of aids are given through the energy companies. The first type is preferential tariffs designed to give certain consumers providing them with energy to a price lower than the market price, these are mainly financed through direct or cross subsidies. The

²³² Commission Decision of 11 April 2000, Commission declares that EDF rebates to firms in the paper industry do not constitute State aid

²³³ C-280/00, para. 89-93

second type is arrangements where the state controlled company sets guarantees to by a certain amount of energy from an energy provider or where energy is bought at a higher price than the market price.²³⁴ It is however not enough that a company giving preferential treatment is owned by the state for this measure to qualify as state aid. The ECJ found in the *Stardust Marine* case that the market investor principle should be applied on this cases to determine their compatibility with the market rules. Only if the special treatment cannot be justified out of a market perspective shall it be considered to constitute state aid.²³⁵

The state recourses can be granted by a regional as well as the central government of the country. In the *Intermills* case the ECJ mad clear that no distinction can be made between aid granted in the form of loans or aid granted in the form of holding acquired in the capital of an undertaking, both fall under prohibition in Article 87 EC. Recourses granted indirect does also include those granted trough a public or private state owned body.²³⁶

In the *Gasunie* case certain customers were charged specially advantageous tariffs by the gas company Gasunie. The ECJ first established that there is no necessity to draw any distinction between an aid given directly from the state and one distributed through a state controlled body. The company was incorporated under private law and owned to 50 percent by the Dutch government which also appointed half of the members of the supervisory board. The Minister of Economic Affairs also had the right of approval of the tariffs charged by Gasunie. The Court held that Gasunie did not have autonomy in setting the gas tariffs and the price cuts offered the customers were therefore to be seen as state aid.²³⁷ In the *Gemeente Almelo* case did the ECJ however find that a contract that held provisions that limited competition should not fall within state monopolies under Article 31 EC but under Article 81 EC.²³⁸ This contract was concluded between a company granted exclusive rights by the official authorities and a sub contractor. In one case the Commission was notified of an Austrian aid scheme where approximately 590 million Euros were paid in compensation for stranded costs related to projects tied to three power plants. Sums were to be paid out annually and would be financed by contribution made by regional network operators and other customers. The Commission raised questions to whether this system actually fell inside of scope of Article 87 EC as the aid did not appear to involve state resources. The state did however seem to have marginal control over the payment scheme. The Commission approved the payments under Article 87(3)(c) EC without this question having reached an answer.²³⁹ In a preliminary ruling on the Italian energy market the ECJ ruled on a extra tax laid on certain energy companies for access to the

²³⁴ Hancher, EC State Aids, 2006, p. 488

²³⁵ C-482/99 French Republic v Commission, paras. 52-56, 69-71

²³⁶ Case 323/82 SA Intermills v Commission, para. 31

²³⁷ Joined cases 67, 68 and 70/85 Lesieur Cotelle et Associés SA and others v Commission, paras. 35-37

²³⁸ C-393/92 Almelo and others v NV Energiebedrijf Ijsselmij, para. 31- 32, 39

²³⁹ Hancher, EC State Aids, 2006, p. 479

energy net. The tax was designed to counter balance some temporary advantages that had occurred with the implementation of the first Energy Directives. The ECJ found that in order for such a tax to constitute state aid it must be designed to finance an aid scheme. If it is a part of the general scheme of the system of charges and fills the said function without financing a conferred advantage it does not constitute state aid under Article 87 EC.²⁴⁰

7.1.3 Distortion of the Market

The Commission and ECJ have interpreted the third prerequisite that the aid shall distort or threaten to distort competition narrowly. Any grant of subsidy has the effect of putting the recipient in a more advantageous position and thereby distorts the market to the disadvantage of the competitors.²⁴¹ It is no defence for giving state aid that the aid is justified due to its aim to lower the costs of a sector of industry that has, in relative terms higher costs than other industrial sectors. This would mean that the subsidy electricity production in forms that are more expensive do fall under this rule. The argument that other countries give equal subsidies has also been declined by the ECJ.²⁴²

7.1.4 Effect on Inter State Trade

The fourth prerequisite that the subsidy shall have an effect on inter state trade is mostly relatively unproblematic as any aid strengthening the position of a company has been seen as affecting the trade. Neither the fact that there is question of a relatively small aid or a small local company has been seen by the ECJ as automatically precluding the possibility of effect on inter state trade. It is not necessary for the commission to show that the trade is affected, just that it might be affected.²⁴³ In a decision versus Scotland, the Commission noted that even though the geographical location of Scotland and physical constraints on the system made energy trade with the Community very unlikely, there was sufficient effects in inter community trade to apply the competition rules on them.²⁴⁴ The Commission did however rule out any effects on community trade in a later decision versus Ireland as there were no international interconnections from the country that made energy trade possible.²⁴⁵ The conclusion seems to be that effect on inter community trade can only be excluded when there is no conditions for such trade.

²⁴⁰ Joined cases C-128/03 and C-129/03 AEM SpA and AEM Torino SpA v Autorità per l'energia elettrica e per il gas and Others, paras. 46 and 50

²⁴¹ Hancher, EC State Aids, 2006, p. 471

²⁴² C-159/94 Ajinomoto Co. Inc. and The NutraSweet Company v Council, para. 132

²⁴³ Craig and De Búrca, EU-law, 2008, p. 1092

²⁴⁴ Commission Decision [1991] OJ 178/31, para. 31

²⁴⁵ Decision of the Commission [2002] OJ C222/2

State guarantees qualifies as a form of state aid as they serve to put the receiving company in a remarkably better position as illustrated by the EDF case. For many years the dominant electricity provider in France, *Électricité de France* (EDF), enjoyed a state guarantee which was unlimited in either amount or duration. This state guarantee had a positive impact on the company's credit rating as the chance of them becoming insolvent was close to zero. As a public enterprise it was not subject to the general law of bankruptcy and this together with the state guarantee enabled EDF to borrow money at very favourable terms. This is an obvious advantage over normal companies as EDF in reality got a interest discount through the guarantees set by the state. In the process of liberalization the state aid rules applied to the company and these guarantees made a competition limiting breach of those rules. The Commission began formal investigations against the company and in 2003 the French Government agreed to remove these guarantees until the end of 2004 and reform EDF into a limited company under corporate law.²⁴⁶ In the process of privatizing the EDF the ownership of the energy grid were restructured. This had the effect that reserves accumulated between 1987 and 1996 that were free of tax were no longer needed and could be allocated, giving EDF a strengthened position. The Commission declared this as unjustified state aid and instructed the French state to recover taxes (plus interests) in regard to these reserves in an amount of 1.2 billion Euro. This is the largest amount the Commission has ever required an individual company to pay back in state aid.²⁴⁷

7.2 Justification of State Aid

Measures classified as state aid can be deemed as compatible with the common market through some of the exceptions in Article 87 (2-3) EC. Article 87(2) EC lists three types of state aids that are *always* to be seen as compatible with the common market provided prerequisites are met. The Commission has no discretion in the application of the exception. Its only task is to make sure that the conditions for the exception are met.²⁴⁸

7.2.1 Aids Always Compatible With the Common Market

2. The following shall be compatible with the common market:

(a) aid having a social character, granted to individual consumers, provided that such aid is granted without discrimination related to the origin of the products concerned;

The conditions for the paragraph 2(a) to be applied, is that the aid:

²⁴⁶ Cameron, *Competition in Energy Markets*, 2007 p. 447

²⁴⁷ *Ibid* p. 448

²⁴⁸ Hancher, *EC State Aids*, 2006, p. 472

1. has a social character and is
2. granted to individual consumers,
3. if such aid is granted without discrimination related to the origin of the products concerned is compatible with the common market.

Article 87 EC does however only prohibit aid aimed at undertakings, it is therefore questionable to what extent aid granted to individual consumers would fall inside its scope.²⁴⁹ The fact that the aid must not confer a benefit to a company providing a service or product compared to its competitors limits the occasions when a state will be able to use this provision. Most state aid is directed exclusively to a particular firm within the Member State providing the desired service. To determine if the if his provision can be applied on a energy subsidy it must be ascertained that the customers receiving the aid can benefit from it regardless if the operator supplying energy is domestic or from another Member State. If the aid is dependant on the fact that the customers at one point or another use a domestic service it is seen as discriminatory, thus falling outside of the article.

(b) aid to make good the damage e caused by natural disasters or exceptional occurrences;

Article 87(2)(b) EC legitimates aid to make good the damage caused by natural disasters or exceptional occurrence. The aim of this article is reasonably clear and although the limits of what can consist a natural disaster is reasonably apparent the concept of the exceptional occurrence is vaguer. The scope of the article is narrow and it is only applicable to economic damage that originates directly from the disaster or exceptional occurrence.²⁵⁰ In assessing the damage caused, the Commission will also investigate to what extent the victims could have been expected to take action to lessen the economic impact of the occurrence.²⁵¹

(c) aid granted to the economy of certain areas of the Federal Republic of Germany affected by the division of Germany, in so far as such aid is required in order to compensate for the economic disadvantages caused by that division.

Article 87(2)(c) EC does however not allow for full compensation to the new German states for the disadvantages caused.²⁵²

The Article 87(3) EC contains aid that *may* be deemed to be compatible with the common market. As oppose to the exceptions in the former paragraph these are not automatically seen as justified. The ECJ has in the *Philip Morris* case confirmed that the Commission has a significant room of scrutiny when assessing the guidelines according to which aid shall be

²⁴⁹ Hancher, EC State Aids, 2006, p. 104

²⁵⁰ C-278/00 Greece v Commission, paras. 81-82

²⁵¹ Hancher, EC State Aids, 2006, p. 106

²⁵² Craig and De Búrca, EU-law, 2008, p. 1092

accepted under this paragraph.²⁵³ This principle was confirmed in the case *Belgium v Commission* where the ECJ stated that the Commission through Article 87(3) EC and the Regulation (EC) 994/98 has the power to lay down guidelines in social and economical issues for the granting of state aid. This competence may have the effect of a stricter regime than previously existed and may contain additional prerequisites.²⁵⁴

7.2.2 Aids under the Scrutiny of the Commission

3. The following may be considered to be compatible with the common market:

(a) aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment;

Article 87(3)(a) EC permits some aid to promote regional development in areas where the living standard is abnormally low or where there are problems with underemployment. The assessment to whether or not the living standard or employment is low enough to justify regional aid shall be made, not on a national, but on a community basis. As opposed to the cases in the second paragraph the Commission does have a discretion to the seriousness of the low living standard and the compatibility of the aid meant to cure it.²⁵⁵ The Commission has set up guidelines on regional aid under Article 87(3)(a) and (c) EC that are applied to every sector including the energy sector. The most recent sets of guidelines adopted in 2006 covers the period to the year 2013.²⁵⁶ It is now established practice by the Commission that this type of multi sectoral aid shall be granted on a basis of all firms in the region concerned and can not be used to restructure a single company or sector. A stance that has been approved by the Court of First Instance in the *HAMSA* case.²⁵⁷

(b) aid to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of a Member State;

According to article 87(3)(b) EC aids to promote projects of common European interest (such as improving energy efficiency) or to remedy a serious disturbance to the economy of a Member State. The first possibility has been used to develop a common standard for HD-tv. The ECJ has validated the Commissions view that such a project must be part of transnational European programme supported by a number of Member

²⁵³ Case 730/79 Philip Morris Holland BV v Commission, paras. 17-18

²⁵⁴ C-110/03 Jose Maria Sison v Council, paras. 71-73

²⁵⁵ Case 730/79 Philip Morris Holland BV v Commission, paras. 19, 24

²⁵⁶ Hancher, EC State Aids, 2006, p. 113

²⁵⁷ T-152/99 HAMSA v Commission, paras. 203-205

States or be a common action of a number of Member States to combat a common threat in order to qualify under Article 87(3)(b) EC.²⁵⁸

In order for a Member State to be allowed to give State aid to “remedy a serious disturbance in the economy”, the problem must affect the economy as a whole and not just a region.²⁵⁹ Aids to promote the execution of environmental of common European interest projects can be authorised under this provision as they will often have beneficial effects that go beyond the frontiers of the Member State concerned.²⁶⁰ In a decision concerning the emission trading scheme of the UK the Commission acknowledged that such a measure could in principle fall within the application of Article 87(3)(b) EC as a project of common European interest. It then went on to say that key elements of the British scheme did not reflect the one in the European, in particular because the former was not mandatory. The Commission therefore based its assessment on on regional aid under Article 87(3)(c) EC.

(c) aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest;

An important provision in the context of developing the market is in the Article 87(3)(c) EC that allows for aid to facilitate the development of certain economic activities or areas (sectoral and regional aid). The aid given must be a part of a well-defined regional policy of the Member State. These aids are connected to those given under Article 87(3)(a) EC as they may benefit disadvantaged but the demand on the regional problems are not as high under Article 87(3)(c) EC.²⁶¹ While sub paragraph (a) is linked to abnormally low incomes the paragraph (c) is linked to regional policies to remedy structural unemployment.²⁶²

The aid must be linked to an initial investment to promote or restructure the industry, in the *Glaverbel* case the ECJ confirmed that periodical maintenance could not be seen as economical development within Article 92(3)(c) EC.²⁶³ When tied to a regional reconstruction programme the aid given under this article cannot be aimed at just one activity or company, this functions much like the aid given under paragraph (a). Aid given to a single energy provider to locate a new energy plant in a specific region would not be compatible with Article 87(3)(a) or (c) EC as regional aid. It would however be possible to allow it under the article on other grounds for

²⁵⁸ Joined cases 62 and 72/87 *Exécutif régional wallon and SA Glaverbel v Commission*, para. 23

²⁵⁹ Craig and De Búrca, EU-law, 2008, p. 1095

²⁶⁰ Hancher, EC State Aids, 2006, p. 475

²⁶¹ Craig and De Búrca, EU-law, 2008, p. 1096

²⁶² Hancher, EC State Aids, 2006, p. 113

²⁶³ Joined cases 62 and 72/87 *Exécutif régional wallon and SA Glaverbel v Commission*, para. 31

example in the interests of environmental protection or energy security if done within the guidelines of the Commission.²⁶⁴

Aid for rescuing and restructuring companies in severe economical difficulties is an important topic within this field. Rescuing aid is meant as a short time help for rescuing companies from severe economic difficulties while restructuring aid is meant for a restructuring process. The Commission has formulated guidelines for giving rescue and restructuring aid. They require that rescue aid should:²⁶⁵

- Take the form of remunerated guarantees or loans
- Be limited to the amount to keep the enterprise in business
- Be restricted in duration
- Serve to ease a social crisis without negative effects on other Member States

The first two of these requirements often prove the most problematic and to restrict the rescue aid to guarantees and loans can often prove over simplistic. The Commissions guidelines on rescue and restructuring aid provide that the aid shall be restricted to a 12 months period except for in exceptional cases.²⁶⁶

Restructuring aid should:²⁶⁷

- Be a once-only grant in a ten year period (one time, last time principle)
- Be given in connection to a restructuring plan which ensures a return to viability in a foreseeable future
- Be limited to an absolute minimum and require own investments from private resources

The process of giving restructuring aid is complicated and often time consuming. Restructuring plans require complex plans financial and business plans which, if prepared by the beneficiary, should also be reviewed by the Member State with the assistance of external expertise. The Commission can also retain its own experts to review the plans during the procedure to approve the national measures.

An example of such aid in the energy sector is the restructuring of British Energy in 2004. This consisted of costs for restructuring ad well as payment of decommissioning costs and liabilities as well as liabilities connected to nuclear activities. The Commission was noticed about these liabilities under Article 88(3) EC and it approved aid to manage nuclear liabilities only. The Commission granted the aid but combined the decision with a nuber of conditions. It required annual rapports on the work as soon as specific thresholds were exceeded. The nuclear and non-nuclear generation had to be

²⁶⁴ Hancher, EC State Aids, 2006, p. 473

²⁶⁵ C-244/5 Bund Naturschutz in Bayern eV and Others v Freistaat Bayern, para. 31

²⁶⁶ Hancher, EC State Aids, 2006, p. 477

²⁶⁷ C-244/5 Bund Naturschutz in Bayern eV and Others v Freistaat Bayern, para. 32

separated in order to avoid cross subsidies. All aid had to be directed to the nuclear generation business. No increase in generation capacity was allowed for a six year period. The company was not allowed to offer electricity under the wholesale prices to its direct business for a period of six years.²⁶⁸ This shows that the Commission takes an active role in the over all organization of the restructuring in order to make sure that misuse of aid is avoided.

In a similar decision by the Commission, it granted aid from the British government for the decommissioning of nuclear power plants owned by *BFNL*. The authority responsible for the decommissioning (NDA) would take over the plants and run them until their final stop. The Government would guarantee that NDA was paid for their costs in the case that BFNL did not have enough assets. This aid was approved by invoking the polluter-pays principle as the money was to be used only to pay for the cleaning up of old power plants. The aid could constitute state aid in the case that the NDA run the plants for a extensive period. The Commission set up conditions for the aid, among others that the NDA should comply with pricing restrictions when selling the electricity and that future contracts concluded in respect to the power plants the will continue to run shall include all nuclear liabilities.²⁶⁹

The Commission has also granted states the right to adopt state aid in order to adopt environmental programmes under this article. In a decision in 2007 the Commission approved of a Danish programme to further the production of energy through methods with low CO₂ emissions. This aid was paid in the form of a compensation for the CO₂ tax; it was paid on a quarterly basis but was unlimited in time. Only high effective combined heat and power plants using either gas or waste as fuel were eligible for receiving this aid. All energy producers that met the efficiency criteria were able to receive the aid, thus making it non-discriminatory. The Commission deemed that the aid was in line with the environmental guidelines of the EU and deemed it compatible with the Article 87(3)(c) EC. They also stated that the payment of the aid must be administrated in such a way that discriminatory effect among the recipients is avoided.²⁷⁰

Aid can be justified in several ways in order to promote renewable energy. They include compensation for high investments costs, market mechanism and aid in line with rules on energy savings. The field of measures within this field that can be used to justify state aid is seemingly broad. The Member States can be issued to rework parts of their systems or find new solutions with the Commission.²⁷¹

²⁶⁸ Cameron, *Competition in Energy Markets*, 2007 p. 456

²⁶⁹ *Ibid*, p. 457

²⁷⁰ Commission Decision on 31 August 2007, p. 6

²⁷¹ Cameron, *Competition in Energy Markets*, 2007 p. 452

(d) aid to promote culture and heritage conservation where such aid does not affect trading conditions and competition in the Community to an extent that is contrary to the common interest;

Article 87(3)(d) EC provides that aid to promote culture and heritage may be admissible as long as it does not affect the trading conditions and competition in the Community in a way that is contrary to the common interest.

(e) such other categories of aid as may be specified by decision of the Council acting by a qualified majority on a proposal from the Commission.

This paragraph is a form of safety net allowing the Council to add other categories of aid to Article 87(3) EC when called for. The Council is only permitted to make additional exceptions from the basic prohibition against state aid under Article 87 EC. The application of state aid rules remain under the competence of the Commission. Nor is the Council empowered to declare specific aid compatible with the Common Market.²⁷² The Council does however have a possibility of intervening in the procedure on approving state aid through Article 88(2)(3-4) EC. It can in exceptional circumstances declare aid compatible with the common Market through a unanimous decision.

7.3 The Procedure on State Aid

Article 88 EC together with Regulation (EC) 659/1999 contains the rules on the supervision procedure of the Commission concerning state aid. State aid is in this context divided into new and existing state aid. The different types of aid have no definition in the EC treaty, but they have been defined in the Regulation (EC) 659/1999. It gives a list of what is to be classified as existing state aid:²⁷³

1. Aid that already existed before the entry into force of the treaty in the respective Member States
2. Aid that have been authorised by the Commission or by the Council following the appropriate process
3. Aid that is to be seen as having been authorised due to the failure of the Commission to act within the time limit set
4. Aid in regard to which is not recoverable because the time limit has expired
5. Aid that at the time it was put into effect it did not constitute an aid, and subsequently became an aid due to the evolution of the common market and without having been altered by the Member State. If certain measures become aid following the liberalisation of an

²⁷² Hancher, EC State Aids, 2006, p. 121

²⁷³ Regulation (EC) 659/1999 of 22 March 1999 laying down detailed rules for the application of art. 93 (now 88) of the EC Treaty [hereinafter Supervision Regulation], art. 1.b.

activity by Community law, such measures shall not be considered as existing aid after the date fixed for liberalisation.

New aid is defined in the Regulation as all other aid than existing aid as well as alterations to existing aid.²⁷⁴

It is clear that the EU has an interest of surveying existent aid, even in the case where the aid has previously been granted by the Commission or the Council. The Commission shall according to Article 88(1) EC keep all existing state aid under review. If the Commission finds that the existing aid can be incompatible with Article 87 EC due to the alterations made to it or the evolution of the Common Market, a procedure under Article 88(2) EC shall be started.

The Member States are under a duty to notify the Commission prior to granting new state aid according to Article 88(3) EC. The notification shall be made in advance in order to allow the Commission sufficient time to submit comments on the plans to grant or alter aid. The Member State must halt the implementation until the Commission has reached a decision authorizing the measure.²⁷⁵ The Commission shall when notified start an investigation to establish if the aid is compatible with the Common Market. This investigation is referred to as *preliminary examination* and is the first step in the procedure. It is meant to be a relatively short procedure in which the Commission shall make an assessment if the action of the state can have any consequences that breaches the rules of the market.²⁷⁶ It has a time limit of two months of giving a decision either to grant the measure or to start a procedure under Article 88(2) EC. If the commission fails to make any such decision within this time limit the Member State may proceed with the implementation of the measure.²⁷⁷ The Commission can reach a positive decision under Article 88(3) EC only when it is absolutely clear that the measure is compatible with the rules of the Common market and Article 87 EC. In the case that questions concerning the legality of the measure arises, then it shall proceed to the *formal investigation* under Article 88(2) EC.²⁷⁸

The formal investigation is a more extensive procedure than the preliminary examination and is meant to give the Commission an opportunity to make a fuller investigation of the facts. The time limit for this investigation is much longer than for the preliminary examination, here is boundary of 18 months set for the Commission.²⁷⁹ This procedure also applies to new aid schemes not granted under Article 88(1) EC as well as existing aids not given green light under Article 88(3) EC. The formal investigation is always step when the Commission makes a decision stating that a measure is unlawful state aid as a negative decision cannot be made in the first step. If the Commission

²⁷⁴ Supervision Regulation (EC) 659/1999, art. 1(c)

²⁷⁵ Ibid, art. 3

²⁷⁶ Case 84/82 Germany v Commission, para. 11

²⁷⁷ Supervision Regulation (EC) 659/1999, art. 4 (5-6)

²⁷⁸ Case 84/82 Germany v Commission, para. 13

²⁷⁹ Supervision Regulation (EC) 659/1999, arts. 4.5 and 7(6)

finds encounters issues on the legality of the measure under the preliminary procedure, a temporary prohibition is issued, which is then replaced by a permanent one, following the formal investigation. Existing state aids, which are deemed as incompatible with the Common Market, are unlawful from the date of the decision under the first paragraph. Other Member States as well as third parties that have interests that may be affected by the procedure may intervene in the formal investigation in order to give opinions on the aid. The third parties possibility of intervention are restricted to give opinions on the issue and they may not engage in an adversarial debate with the Commission.

If the Member State does not comply with the decision of the Commission after this procedure, the Commission or any interested state may according to the Articles 226 and 227 EC refer the issue to the ECJ.

The ECJ has held that the failure of a Member State to notify the Commission does not in itself make the aid unlawful.²⁸⁰ If the Commission holds information about illegal aid it is obliged to examine it without delay. It can in a case of suspected illegal aid request information from the Member State. In the case that the Member State does not provide the requested information, the Commission can require the information through a decision.²⁸¹ After giving the Member State opportunity to submit comments the Commission may then order it to suspend the aid until the Commission has taken a decision on its lawfulness (suspension injunction). The Commission may also make a recovery injunction, forcing the Member State to recover already paid aid. A recovery injunction may only be ordered if there is no doubt that there is a question of aid and there are an urgency to act as well as a risk for substantial and irreparable damage.²⁸² The Commission can also issue a recovery action requiring the Member State to recover the aid after the formal investigation if it finds that the aid is incompatible with the Common market.²⁸³

The main principle of the ECJ is that unlawful aid should always be recovered. The only exception to this rule is where it is absolutely impossible to recover the aid. The fact that the recovery is connected to difficulties is not a reason for failing to do so, even if the receiving company has to be wound up in the process.²⁸⁴

The Council has a possibility to decide, through an unanimous vote, that a measure taken by a Member State shall be regarded compatible with the Common market in derogation from the Articles 87 and 89 EC.

²⁸⁰ C-301/87 France v Commission, para. 3

²⁸¹ Supervision Regulation 659/1999/EC, art. 10

²⁸² Ibid, art. 11

²⁸³ Ibid, art. 14

²⁸⁴ Case 52/84 Commission v Belgium, para. 16

7.4 State Aid as an Import Restriction

The provisions on state aid are closely tied to the rules on quantitative import restrictions in Article 28 EC.

The ECJ has held a strict stance towards aid measures that can have the effect of setting up quantitative import restrictions under Article 28 EC. In *Commission v France* case the Commission had started proceedings against France concerning tax subsidies that was given to newspapers but only under the condition that they were printed in France. The ECJ held that even if these measures were a part of an aid scheme the Articles 87 and 89 EC, this fact cannot be used to frustrate the rules of the treaty on the free movement of goods or the repeal of discriminatory tax provisions. It stated that these provisions have the objective of ensuring the free movement of goods between the Member States under normal rules of competition.²⁸⁵ In the *Du Pont* case the ECJ ruled that legislation requiring an undertaking to buy 30 percent of its total supply from regional suppliers was contrary to Article 28 EC. It went on in confirming that Article 87 EC may in no case be used to set aside the rules of the Treaty on the free movement of goods. The fact that a national measure might be regarded as aid within the meaning of Article 87 EC is therefore not a sufficient reason to exempt it from the prohibition contained in Article 28 EC.²⁸⁶

National environmental policies often include aids or other form on interference in the market and may therefore risk breaching the European competition rules. In the *Preussen Elektra* case the German government had implemented rules on the distributors of electricity to buy locally produced electricity from renewable recourses at minimum prices that was higher than the actual market value of electricity.²⁸⁷ The Commission had at an earlier stage been noticed of at least the ground scheme of the system according to art 88(3) EC. The ECJ got an application from a German court on a preliminary decision to whether these rules breached Article 87 or 29 EC. The Court stated that the measures taken by the German government clearly distorted competition. Nevertheless, as there was not a question of state recourses involved the measures could not be classified as state aid under Article 87 EC. The measures did however qualify as quantitative import restrictions under Article 28 EC. They could however be justified under the general environmental policies of the EU which is one of its priority aims. Here the ECJ referred among other things to the electricity directive that states that the Member States are allowed to give priority to renewable recourses.²⁸⁸ The measures taken by Germany can therefore not automatically in breach of the treaty. As the goal was to promote renewable energy and this in itself is a central area of the EU as stated in Article 6 EC

²⁸⁵ Case 18/84 *Commission v France*, para. 13

²⁸⁶ C-21/88 *Du Pont de Nemours Italiana SpA v Unità sanitaria locale N° 2 di Carrara*, paras. 11 and 20

²⁸⁷ C-379/98 *Preussen Elektra AG v Schleswag AG*, para. 58

²⁸⁸ *Ibid*, paras. 69 -74, 81

as well as the energy directives, the measures are to be seen in the environmental policy work of the EU. The measures taken to promote renewable energy are therefore compatible with Article 28 EC.²⁸⁹ It appears in this context as that the free movement of goods can only be hindered when it is motivated by an area of interest under EC-law. Very little room is left for measures taken due to regional considerations where Community policies can be used in a freer way to balance interests. This can be explained that the Community interests are set up by the EU as a whole where regional policies threaten to distort competition due to lack of an overall view.

7.5 The Role of the National Courts

The Community courts alone have jurisdiction on the interpretation of the treaty and rulings on the validity of acts taken by the community institutions. National courts have no jurisdiction to rule on the compatibility of state aid with the Common Market.²⁹⁰ When a question concerning the interpretation of the Articles 87 and 88 EC arises before a national court they have the right to refer the question to the ECJ according to Article 237(2) EC. If such a question arises in a national court against whose decision there is no legal remedy, the court is obliged to bring the matter before the ECJ.²⁹¹

Assessment of the compatibility of state aid with Article 87 EC falls within the exclusive competence of the Commission. A national court may therefore not ask the ECJ to give a preliminary ruling on the compatibility of a given grant or grant scheme with the Common Market.²⁹² All questions on the legality of state aid shall be notified to the Commission under Article 88(3) EC. Commission decision can then be challenged before the European Courts under Article 230 EC.

The role of the national courts within the area of state aid is to preserve the right of individuals confronted with a breach by a Member State of the Article 88(3) EC. Although the national courts do not have competence to rule on the compatibility of state aid with the common market the ECJ has held that they have a responsibility to rule aid that has not been notified under Article 88(3) EC illegal.²⁹³ The third paragraph of the article has in this way been given direct effect. In their obligation to cooperate with the community, the national courts shall take measures against breaches of Article 88(3) EC until a final decision has been made by the Commission.

²⁸⁹ C-379/98 *Preussen Elektra AG v Schleswag AG*, paras. 72-81

²⁹⁰ Craig and De Búrca, *EU-law*, 2008, p. 1104

²⁹¹ art. 237(3) ECT

²⁹² Hancher, *EC State Aids*, 2006, p. 710

²⁹³ C-354/90 *Fédération Nationale du Commerce Extérieur des Produits Alimentaires and Syndicat National des Négociants et Transformateurs de Saumon v France*, paras. 10-11

Although the national courts have no jurisdiction to rule on state aid there is still a need for them to examine the nature of the measure. Only new aid falls under Article 88(3) EC and the court must therefore examine if the measure in question is new aid or existing aid. If they in this investigation find that it is a question of existing aid, no further action is possible by the national courts. Third parties who stand to suffer losses due to the grant of illegal aid can obtain an injunction from a national court in order to stop payment. This option is mainly directed at competitors to the receiver of the illegal aid. A national court can also order recovery of previously paid aid that has not been notified to the Commission. Such an order is made without a ruling on the compatibility of the aid with the common market.

Third parties who can prove that they have suffered damages because of an illegally granted aid may have an action against the Member State granting the aid. The national courts of have jurisdiction regarding such actions. In the case *SFEI v La Poste* the ECJ found that Article 88(3) EC does not impose any obligations on the recipient of the aid that allows for a third party suffering damages caused by illegal state aid to claim damages from the party receiving the aid. This does however not prejudice the possible application of national law to statue non-contractual liability in such cases.²⁹⁴ From this follows that the third party has a possibility to claim damages from the Member State giving the aid as well as the recipient in a national court, provided there is legal grounds in the in the national legislation.

The national courts can also enforce negative decisions taken by the Commission under Article 88(2) EC. In the *Capalongo v Maya* case the CFI stated that the Article 87 EC is meant to take effect in the legal systems of the Member States so that they may be invoked before national courts trough an act taken under Article 90 EC or a decision under Article 88(2) EC.²⁹⁵ The recovery of the aid shall take place in accordance with national procedural law. In this process the law must be applied in such a way that the recovery is made possible.²⁹⁶

²⁹⁴ C-39/94 *SFEI and others v La Poste and others*, paras. 73-75

²⁹⁵ Case 77/72 *Carmine Capolongo v Azienda Agricole Maya*, para. 6

²⁹⁶ Hancher, *EC State Aids*, 2006, p. 715

8 Proposed amendments by the Commission

An inquiry was initiated by the Commission in 2005 in order to investigate the progress in the liberalization process and find ways of mending shortcomings. Pursuant to the findings in this investigation the Commission has set out four key areas where work is to be intensified in order to achieve the goals of an open energy: (1) achieving effective unbundling of network and supply activities, (2) removing the regulatory gaps (in particular for cross border issues), (3) addressing market concentration and barriers to entry, and (4) increasing transparency in market operations.²⁹⁷ I will in this chapter go through the main schemes of the proposal for amendments to the current legislation. The main schemes within the electric and gas sector are alike, with some technical differences due to the nature of production and distribution. I will base the chapter on the legislation concerning the electricity market and note when there is a difference of importance in the gas market.

Following the finding of this enquiry and the discussions on how to develop the future European energy market, involving EGEG, the Member States and actors on the Market, the Commission declared on the 19 September 2007 that they would propose a row of amendments to the existing secondary legislation in what they call *the third energy package*. These new amendments shall make it possible to reach the Commissions goal of creating an open and unified market in 2009.²⁹⁸ The package contains amendments to Electricity Directive 2003/54/EC, Gas Directive 2003/55/EC, Electricity Regulation (EC) 1228/03 and Gas Regulation (EC) 1775/05.

The proposals for amendments to the existing law to achieve progress within a number of areas, connected to the shortcomings in the market described above. Firstly the proposal aims at ensuring a more effective unbundling of the energy companies in the Member States. The existing legislation requires that network operators shall be legally and functionally separated from supply and generation or production activities. Many Member States have complied with this requirement by creating different organizational structures within the same company. While the new directive makes it clear that the preferred option of the Commission is ownership unbundling it offers an alternative option for the Member States that choose not to go down this path. A Member State that chooses to go for this alternative option (the Independent System Operator model) must however provide guarantees that the Independent System Operator has full independence to take strategic decision and that it has same level of incentives to invest in new infrastructure that may benefit competitors as if

²⁹⁷ Com (2006) 851 Inquiry Pursuant to art. 17 of Regulation 1/2003 EC, para. 5

²⁹⁸ Memo/07/9, 10 January 2007

it was an independent company. This option can be said to constitute an exception the choice of complete unbundling that is allowed under the condition that the requirements set on the unbundled operator are not breached.²⁹⁹ This provision also applies to third parties that hold shares in an energy producing company as well as a transmission system operator.

In the present, all Member States are obliged to create National Regulatory Authorities to ensure a functioning market, especially to perform surveillance over the transmission system operators. As previously mentioned, these authorities have in numerous Member States not been given the necessary powers and competence to carry out their work in an efficient way. There has also been shortcomings in the possibility for some of the Authorities to participate in the work of the Community. The proposals of the energy package therefore aims to strengthen the powers of these authorities. The Member States shall also ensure that the Regulatory Authority can perform its running work independent without instructions from the government. While existing legislation only demands that the regulators shall be independent from the interest of the energy sector, the new proposal allows them a greater independence from the state as well. The proposal also states that these Authorities shall cooperate with other Member States as well as the Commission. More detailed and stronger rules concerning the competence of the National Regulatory Authorities and their possibilities to act have also been laid down in the proposal. They have been given the following duties:³⁰⁰

- monitoring compliance of transmission and distribution system operators with third party access rules, unbundling obligations, balancing mechanisms, congestion and interconnection management;
- reviewing the investment plans of the transmission system operators, and providing in its annual report an assessment of how far the transmission system operators' investment plans are consistent with the European-wide 10-year network development plan; monitoring network security and reliability, and reviewing network security and reliability rules;
- monitoring transparency obligations;
- monitoring the level of market opening and competition, and promoting effective competition, in cooperation with competition authorities; and
- ensuring that consumer protection measures are effective.

In addition, the proposal expressly specifies that the National Regulatory Authorities shall ensure that Independent System Operators operate in an independent manner from the associated energy producers/retailers. In order for them to be able to carry out these duties in an efficient manner, they shall perform field inspections to seize sufficient information.³⁰¹

²⁹⁹ Com 2007(528), Proposal for Amending the Electricity Directive, p. 30

³⁰⁰ Ibid, p. 36

³⁰¹ Ibid, p. 38

All actors on the market are obliged to provide the Authorities with sufficient information for them to carry out their surveillance duties. The companies in the market shall be under the obligation to keep record of data related to their operational decisions for five years, to ensure that allegations of market abuse can be controlled.³⁰²

In order to achieve a functioning surveillance body and to get a better perspective in the workings of the National Regulatory Authorities it has been proposed that ERGEG should be replaced with an agency with a wider field of work.³⁰³ This agency shall have the responsibility for coordinating and harmonizing the work of the National Regulatory Authorities.³⁰⁴ In regard to cross border issues the agency shall also be entrusted with individual decision powers on issues concerning infrastructure. This is a big difference from the ERGEG that has no competence to make binding decision. The agency shall also have an advisory role to the Commission on market regulation issues.³⁰⁵ As a second choice the Commission has also proposed a solution that confers additional surveillance powers to ERGEG.

Today there is a voluntary possibility of the Network System Operators to cooperate in order to improve cross border capacity through coordination and investments. The proposed amendments to the energy regulations aims at strengthening the cooperation in cross border issues making it mandatory in certain issues. This cooperation shall be organized through the European Network of Transmission System Operators for Electricity respectively Gas. The Agency of national regulators has the task of surveying this cooperation.³⁰⁶

The lack of transparency still remains a problem on the European energy market according to the Commission. In the current legislation there are requirements on transparency concerning the electricity sector but none in the gas sector. The rules on transparency will therefore be applied to the gas sector as well.³⁰⁷ An oversight of the legislation on the electricity sector will also be performed.³⁰⁸ The amendment to the Gas Regulation also contain strengthened provisions on the access to storage facilities. To ensure effective access to storage facilities four measures are proposed by the Commission: Make existing voluntary guidelines legally binding, establish functional unbundling of the storage system operators, enhance the powers of national regulatory authorities as well as require clarity on the regulatory regime applied storage facilities.³⁰⁹

³⁰² Com(2007)528, Proposal for Amending the Electricity Directive, p. 8

³⁰³ Ibid, p. 12

³⁰⁴ Com(2007)530, Establishing an Agency for the Cooperation of Energy Regulators, p. 10

³⁰⁵ Ibid, pp. 25 -26

³⁰⁶ Com (2007) 531, Proposal for Amending the Electricity Regulation, p. 26

³⁰⁷ Com (2007) 532, Proposal for Amending the Gas Regulation, p. 33

³⁰⁸ Ibid, p. 16

³⁰⁹ Com (2007) 532, Proposal for Amending the Gas Regulation, pp. 30 -33

The proposal also contains measures to ensure consumer freedom in selecting supplier. This shall be made in the form of binding guidelines that shall provide for better information to the consumer and ensure a true freedom to choose supplier. This propose has arisen from reports that many consumer today are tied up by long term contracts hindering them to change supplier and that the choice is many times complicated by complicated rules an a non transparent market.³¹⁰

³¹⁰ Com(2007) 528, Proposal for Amending the Electricity Directive, pp. 18

9 Conclusion

The situation on the European energy market today can be summarized in the following points:

1. The progress in this work of liberalizing the European energy market has been slow. A high degree market concentration to state owned companies as well as a fragmentation of the European market along the national borders is still characterising the market.
2. A conflict exists between the market liberal agenda of the EU and an unwillingness of some Member States to give up this control of the energy sector.
3. In the creation of the national markets, there was a strong tendency to building self-sufficient national energy solutions based on subsidies and measures designed to protect the state held companies. These structures still exist to a large extent in the European market and serve to halter market integration.
4. Even when the markets have been privatized, previous monopolies have often continued to hold a monopolistic position because of their existing strong position and the fact that they are often vertically integrated with the companies running the transmission systems.
5. High initial investment costs and discrimination by the integrated transmission system operators against new energy producers have halted the rise of a competitive market severely.
6. Protective policies of the integrated transmission system owners in order to protect the national market have halted the investments of the cross border connections between the Member States.
7. Inadequate powers and freedom to act of the National Regulatory Authorities has resulted in a inefficient surveillance regime in the energy market, especially concerning cross border issues.

The Commission has taken the role as the driving force in the process of liberalizing the energy market. It has acted under the aim set up in Article 2 EC to create a unified market by setting up strategies as well as performing operative tasks under Title IV EC. It has carried out this work by taking direct actions against Member States under Article 226 EC as well as being a driving actor in the process of creating secondary legislation, much in accordance with Article 94 EC. A key part in this work has been to create cooperation in the Community stretching beyond the borders of the individual Member States. To manage this, the Commission has made direct contact through dialogs and given impulses to the creating of several organizations for this purpose, with CEER and ERGEG as the leading ones.

The authorities in each Member State remain primarily responsible for inspecting their national markets and ensuring free competition in the energy sector under the Articles 81-82 EC. Situations concerning cross border issues or where multiple national markets are involved fall under the competence of the Commission as they are generally better set to deal with these cases. The national authorities shall nevertheless cooperate among each other in cross border issues through the European Competition Network. This cooperation mostly concerns exchange of information but they are also primarily responsible for dealing with trans-national issues concerning less than three Member States.

The Commission also has the main responsibility for investigating cases directly tied to the actions taken by the state, such as the granting of special rights or state aid in the Articles 86-88 EC. In this context, the national courts have certain obligations to make sure that the procedural rules in the EC-Treaty are respected. This may consist in making injunctions on non-notified aid in order to avoid irreparable damage against competitors of the receiving party. They do however not have any competence to rule on the material aspects of community law. After a final decision has been made by the Commission or the ECJ they also have a responsibility of taking the necessary measures to ensure enforcement in the Member State.

In order to secure the work for an open energy market and implement the rules of competition in the EC-Treaty, the Council has adopted a number of acts in the field. The most central are the Electricity Directive 2003/54/EC, the Gas Directive 2003/55/EC, the Electricity Regulation (EC) 1228/2003 and gas regulations (EC) 1775/2005. The main goals in the directives are to promote a functioning market by setting up frame rules for the Member States in the liberalization of energy companies and in the organization of market surveillance in order to secure an open and non-discriminatory market. All transmission system operators are obliged to give all prospectors access to their systems on a non-discriminatory basis. The splitting of the generation industry from the transmission industry has been deemed an important task in order to secure access for all power generation companies to the transmission networks without discrimination. This process is referred to as unbundling. As the national systems of property are protected in Article 295 EC, the Council does not have the possibility of imposing complete system ownership unbundling upon the Member States. Instead, the Directives are limited to stipulating a separation of function in regard to energy production and the running of the transmission systems, while both structures can still be owned by the same person. The directives obligate the Member States to ensure a certain level of service to the end consumers as well as taking measures to protect vulnerable customers.

The Regulations mainly concern the promotion of cross border trade in the EU. They deal with the issue of compensation to the system operators in cross border trade. The main goal is to ensure balanced tariffs that do not discriminate against cross border trade compared to usage of the national

system but still gives reasonable compensation to the system operators for investing in such infrastructure. They statute that the cost shall be calculated on a long run average of harbouring cross border trade, they may also not be distance related. Exceptions to these rules may however be made if deemed needed to make new investments possible. A second important aim of the Regulations is to ensure non-discrimination in the access to the cross border transmission systems. This is meant to ensure that energy producers are allowed access to the distribution system on equal basis in the case that there is insufficient capacity.

The Directives and Regulations on the field amount to an extensive body of legislation on the field. This has resulted in a switch from a state controlled market to a regulated market in order to ensure competition. It appears that the privatization process has not taken away the need for regulation but merely replaced administrative law with competition law. The main primary legislation concerning state intervention on the market are laid down in the Articles 86 and 87 EC. The first Article covers both public undertakings and when a state has granted an undertaking special or exclusive rights. Public undertaking does in this context mean undertakings directly or indirectly controlled by the state. Such influence is presumed when the state hold more than half the capital or votes of the company or when they can appoint more than half the managerial or supervisory body. Many member states still hold a large part of the shares in privatized energy companies, Vattenfall as an example. Such influence can also occur though national regulation on state influence in the sector or though other constellations of control like the government holding a decisive “golden share”. Companies granted special rights do also fall inside of the provisions of this article. The ECJ does seem to have made a practice where it has taken the power to make an over all assessment on the influence of the state, and the apply the provisions if deemed necessary. The control or grant of exclusive rights are however not *per se* illegal under the Article. It merely states that such behaviour is subjugated to the competition rules in the Treaty; a breach of this article is in other words dependant on the breaking of a second provision on the free market. The golden rule is: if a state has taken influence in a company or relived it from normal competition rules through the granting of special rights, it must also bear the consequences. This means that there is no obstacle in the Article to the state holding a company as an investor, as long as it is under normal market rules. The borders of what constitutes normal market rules have however been set narrowly.

In most cases, there is however a special motive for the state to be directly involved in the market in such a way. The whole reason for the creation of a public undertaking is often to allow the state to carry out political measures through them. In other words, to make sure that the conditions of the market are not the sole factor on which the actions of the company are grounded. The fact that an economic activity of the state is carried out by a company does also not breach the Article *per se*. It is possible for the state to have a company on the market with a special assignment as long as it plays by the market rules. Therefore, if a country has a normal energy company put

under normal competition rules, but instructed to provide all customers with energy to the lowest possible price, this is in principle in order. Such companies do however tend to be accompanied by exclusive rights in order to allow them to carry out these assignments without running the risk of being put out of business by more profitable privately owned companies. This does however tend to be a breach of the competition rules. Rights given a company are seen as we have seen, viewed as abusive by the ECJ, if the receiving company can not avoid to abuse its dominant position or even if they are (only) induced to abuse it. A monopoly or an exclusive right to provide services to an area, motivated by the reason that they could not survive under the normal market rules is a clear case of such automatic abuse. Even if the receiving company did not make use of the special right immediately it could have the consequence of making it act in a certain way not based on economical profitability knowing that it had this back up the right would still be a breach because it induced abuse.

Such measures can however fall under the exception in Article 86(2) EC if they are deemed to qualify as service of general economical interest. There is no general definition of such services, but they are judged individually under searching scrutiny. Uninterrupted supply of energy to all consumers in the national territory has however been confirmed by the ECJ as such a service in the case C-159/94. The Energy Directives do also recognise the obligation for the Member States to provide certain public services such as securing supply of energy to the whole market and upholding environmental protection. This serves to give guidance to the room for state measures in the energy sector. Environmental protection plans should also fall into this group. In general it is reasonable to assume that the areas taken up under Article 87 (2-3) EC give an indication of what is accepted. As mentioned earlier it is enough that the application of treaty rules would obstruct the performance of the service, for it to be a valid ground for a granting of a special right. It is then reasonable to apply a sort of market economy investor principle to the issue; would it be a reasonable deal for a normal company to take the deal? The ECJ has also indicated that the special right cannot go beyond what is reasonable as a compensation for carrying out the service. It is however the burden of the Commission to show that a conferred right is excessive if it is challenge before the ECJ. The conditions of the market economy is in other words the norm even when areas are exempted from the normal rules of competition. This is a clearly different approach compared to the regulated market where such services were performed under conditions that resemble those of a plan-economy.

When the government uses a state owned company to interfere in the market, this is likely to constitute a breach of Article 82 EC on abuse of dominating position. Many of the former state monopolies still hold a massive piece of the home market going well over the 40-50 percent set by the ECJ as a presumption for dominating position. Both gas and electricity also constitute unique product markets. This has the consequence that many of these actors fall inside of the scope of article 82 EC. A problem in the field of market surveillance is that it is mainly performed by national

authorities. These authorities are under the control of the owners of the largest actors in the market, which halts their possibilities to perform their duties severely. This issue also connects to the need for unbundling of the energy market. When the already dominating actor on the market also controls the distribution system they gain a very powerful position. The ECJ has held that companies with such a dominant position must take special consideration to the effect of its conduct on the market and not take actions that can impair a genuine and undistorted competition on the common market. This principle is not having much effect on the energy market today. If it is to have any real effect it must also be applied in the energy policies of the Member States. It can only be established that there is a lack of real competition in the energy markets today and that further measures must be taken to ensure a functioning market, especially on Member State level. Even though mergers are not inside the frames of this paper, it can be noted that the aim of fighting predatory behaviour among large energy producers must be combined with the aim of creating international market actors.

The rules on special rights are connected to those on state aid although the latter has a broader field of applicability. State aid is often used in order to control the actions of the receiver in a direction preferred by the state and encourages the market to take decisions that are not economically sound out of an investor perspective. This practice also serves to distort the mechanisms of the market by allowing unprofitable companies to remain in business. Liberalizing and unbundling state held companies and stopping unjust state aid under has therefore been two of the main objectives in the creation of an open and competitive energy market.

State aid encloses a variety of measures whose key point is that they confer an advantage to the recipient. The ECJ has also found that support must involve state resources and have a potential effect on the market to be classified as state aid under Article 87 EC. These measures can consist of direct funding, loans, directed tax cuts or guarantees that serves to lower the cost of the recipient. An interesting point concerning the last one is that it is classified as an aid from the point issued although it only is a potential use of state resources. Energy companies can be involved in state aid both in the role of givers and as recipients. When preferential treatment is given by a state control energy company to one of its customers, the market economy investor principle is applied on this measure. If no objective reason for the special treatment can be found out of a strictly economical perspective, it is presumed that the measure that it is a case of state aid. Such measures can be deemed to constitute a case of abuse of dominating position under Article 82 EC if the state controlled company in question holds a large portion of the market. As we can see here, the measures taken by a state held company will always be under the scrutiny of the Commission and ultimately the ECJ, in order to impose the rules of the market on it, even when it is not naturally bound by them. There would be less need for such a control on a completely privatized market as it would be rational for most companies to act according to investor principles. Maintaining state control over the sector under a regime of liberalization is for these reasons tied to more work

both on national and union level. Both these areas are presented in the secondary legislation as important work areas in order to develop a functioning and sustainable energy sector.

The requirement that the aid shall distort or threaten to distort with the common market has been broadly interpreted by the ECJ. Only when it is no practical way the aid could interfere with the market, no matter how big or small it is does it fall outside of this provision. This means that practically all aid given comes under the scrutiny of the Commission and the ECJ.

Not all actions of the state on the market is however automatically seen as state aid. Firstly, the state is allowed to give companies contracted to perform certain services for the state reasonable compensation. Such payments are however placed under certain conditions in order to secure that the compensation is in line with normal market compensation. Secondly, it is allowed to make normal investments on the market. The objectives of these rules all have the aim at getting the Member States to act according to investor principles when interacting with the market, directly as well as through a state controlled company.

Economical transactions of the state relating to the market may only occur under the exceptions given in Article 87 (2-3) EC. These mainly concern social aid, limited emergency aid to companies and regional aid. The general grounds for exception to the prohibition against state aid are divided in to two groups. The first group, in Article 87(2) EC consist of aids that are always to be seen as compatible with the common market if they meet the prerequisites of the Article. Concerning the second group of aids in Article 87(3) EC, the Commission has a room of scrutiny in, giving them green light.

Aid of social character given to individual consumers under Article 87(2)(a) provided it does not have any discriminatory character related to the origin of the products involved. This is a case of a strictly social measure. A general tax subsidy directed at the energy consumers or a national aid to them in order to lessen the costs energy consumption would fall under this scheme. Subsidies aimed at one or all of the energy providers would not as is not granted directly to the consumers and probably would be running the risk of being discriminatory. It is however questionable if this is at all a question of state aid as it excludes all aid directed at the market.

The second type of aid in which the Commission has a room of scrutiny in assessing their suitability in respect to the aim and compatibility to the market. Article 87(3)(a) refers to regional aid given to promote regions with abnormally low living standard. These regions are today to a large extent found in the new Member States. Article 87(3)(c) is similar but while (a) is linked to low incomes, (c) is linked regional policies to remedy structural unemployment. Aid aimed at reconstructing companies in economical difficulties can be granted under this paragraph but is subjected to strict requirements. It must be tied to a specific reconstructing plan approved by

the Commission, be limited to an absolute minimum and be a one time only occurrence as well as being limited in time. This type of aid has a large application in the energy sector as it allows for energy companies to receive aid in order to reconstruct or decommission unprofitable or outdated technology in order to turn their business profitable. Strict conditions have been set up by the commission when granting this type of aid from leaking and being used subsidy other areas than the necessary reforms. These types of aid can only be granted when the company cannot itself finance the necessary measures. Another important type of aid under this paragraph is aid aimed at promoting environmental programmes. This can be to build energy plants fuelled by renewable energy sources or measures to lower the CO₂ emissions from existing plants. The Commission has a more generous approach when granting this types of aid, provided it is done within the environmental policy of the EU.

Aid to can also be granted under Article 87(3)(c) in order to remedy a serious disturbance in the economy of a Member State. In order for a disturbance to fall under this paragraph, it must affect the economy of a country as a whole. The paragraph also allows for aid to be given in order to promote the execution of projects of common European interest. These projects must be a part of a common European programme or supported by a number of Member States in order to qualify for this exception. It is not enough that one Member States claims that its internal measures have a positive effect on many other states. Measures that can qualify under this Article for example the investment in cross border connection in order to promote trans-national energy trade within the European energy policy. Aid to promote the execution of environmental plans involving multiple Member States can also be granted here.

State aid can often have discriminatory effects do often have effect of a quantitative import restriction under Article 28 EC. If the aid is distributed among a set number of recipients in a way that serves to lower their production costs, this will constitute a disadvantage to other companies competing with them as they will have to carry their whole production costs themselves. The ECJ has stated that, just because a measure can be defined as an aid under Article 87 EC, does not exempt it from being subjected to Article 28 EC. This means that an aid with such alleged effects can be tried under both these provisions separately. Certain reasons have however been found to be grounds for exempting the measure from both these rules. Environmental protection can be used as a ground for exemption both under Article 87(3) EC and to Article 28 EC (according to Article 30 EC). Environmental protection is also mentioned in the policy work of the EU as well as under the principles of the EC under Article 6 EC. It seems that strong grounds are needed for such a wide exemption to be granted. It is however still important that these aid schemes do not involve arbitrary discrimination.

The granting of state aid is a two-step procedure performed by the Commission in accordance with Article 88 EC. In the first step the

Commission conducts a preliminary examination under either Article 88(1) or 88(3) EC of the given aid. If the Commission cannot deem the measure compatible with the treaty rules it must go on to the second step in paragraph 2 to make a final decision. The Article 88(1) EC gives the Commission the competence to conduct an investigation of existing aids on its own initiative. All Member States are according to Article 88(3) EC under the obligation to notice the Commission of new aids in sufficient time for them to submit their comments before the entry into force. The aid is not automatically illegal if they fail to notify the Commission but they run the risk of having to recover all given aid. It is the principle of the ECJ that all given aid shall be recovered if found illegal. This requirement to recover illegal aid is practically unconditional, even if it has the effect of making the recipient go bankrupt. The Commission also has the option of making a suspension injunction for the remainder of the procedure in order to stop payment until the final decision is made. As previously described, the national courts also have an important role in this procedure in protecting the interest of third parties concerning aid not notified. The Commission has a central role in the politics of the Member States in regard to the market because of its role as a surveillance authority in the field of state measures. Most measures that in some way connects to the market and involves state assets can theoretically fall under the rules on state aid. This means that the Member States are obliged to notify the Commission of every such measure, under the threat of at a later point getting a negative decision followed by an order to recover the given aid.

The liberalization process has until today had a big breakthrough in the European energy sector. The sector as a whole have been subjugated to the principles of the free market in the EC-Treaty. This has been a journey from a highly regulated market dominated by state monopolies and government regulation to a market with an increasing number of actors and economic competition. The greatest issue today, is to go from a European energy market consisting of parallel monopolies on the different national markets, to one unified market with many multi national actors. In order to realize this goal, the dominant position of the national giants must be broken.

The situation of the national companies is influenced both by the treaty rules and the secondary legislation. This mainly concerns abuse of dominating position under Article 82 EC and anti trust measures under Article 81 EC. Today, the Commission is doing a lot of work in the field of surveying mergers in the sector. Still, by taking a more aggressive stance under Article 86 EC in conjunction with Article 82 EC, the Commission may be able to attack misuse of vertically integrated companies. The problem seems to be that the situation on the market is not as much a series of infringements as a permanently bad investment climate. The treaty provisions on state measures and competition are very blunt instruments to attack this type of problem with. It is also hard to derive the general situation on the market from the acts of a major player if no specific violation can be found. It is after all not a breach of the treaty to have state owned companies. Instead the provisions found in the Directives can be more useful as they aim at

opening the market by changing the current situation. A more forceful implementation is however needed for a decisive effect. Instead of attacking single acts of violation they are meant to diffuse the situation once and for all by unbundling the problematic structures. This has however not been entirely successful, mostly because the EU lacks the competence to force such economic reforms upon the Member States. They have been confined to offer a less extensive form unbundling than the complete ownership unbundling. This in combination with haltering implementation has resulted in a situation where the previous problems still exist.

The triple role of the Member States as owner of the power grids, owner of large energy producers and surveillance authority has resulted in a conflict of interest. The National Regulatory Authorities have not gotten the powers and independence from the state needed to carry out a surveillance of the national market, including the nationally owned companies, in an efficient way. In this part it is questionable if the Member States have carried out their duties in enforcing the union legislation. In the new legislation package the Member State are obliged to guarantee full independence to the Regulatory Authorities. This should improve the surveillance regime on national level but a strengthening of the international cooperation is also needed to ensure coverage of the whole market. The lack of a competent body with a union perspective that can enforce the aims of the directives directly upon the market players is still a vital shortcoming. The Commission has recognised this problem and proposed for such an authority to be created, the cooperation of the Member States is however needed for the realization of such an organization.

It is also a vital task for the Commission and the Member states to stimulate investments in the necessary infrastructure to build a working inter European energy grid. This work is mostly to be done through cooperation with the Member States and the enforcement of the secondary legislation in the field. This is a field where state aid can be a useful tool in order to spur investments that would otherwise not have been made. In order to form an interest in building such structures the focus must be lifted from a national to a community level in the energy sector. The forming of multi national companies and trans national investments does in this case go hand in hand. A powerful solution to the above given problem would be to sell out the state owned companies in pieces to private investors. This would create multi national investors as well as decreasing the interest of the Member States to protect their national companies. There is however no way under the current competition rules to force such a measure from the Member States. In contrary, Article 295 EC guarantees the ownership of the Member States.

To conclude the legal situation today it can be said that the treaty rules and the applicable juries prudence prohibits direct measures by the Member States that threatens to distort the Common Market. Most involvement by the Member States in the market is strongly discouraged, but with certain exceptions for areas where the national governments are deemed to have

special obligations to fulfil. Because of the vital role of the energy sector it is likely that the exceptions can be applied to many measures taken by the national governments in this market. The problems in the liberalization process today are caused by structural problems in the energy market and shortcomings in the implementation of the directives and regulation issued rather than flagrant breaches of the treaty rules. The question therefore lies on a political level where a disconnection between the national governments and the private market is needed as well as a strengthened cooperation on community level. This can partly be achieved through the strengthening of the secondary legislation but a dialogue on Union level in order to find a way of getting the Member States to comply with the Union objectives in this sector is still the most important step to be taken.

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