THE INTERNAL ELECTRICITY MARKET

Chapter Three A

INTRODUCTION

The Commission introduced proposals for an internal energy market in two phases, and in both phases, the draft gas and electricity regulations were proposed in parallel. The Council, though, chose to separate out the proposals and, in each case, dealt with electricity first. The transit Directive, which was the first true internal electricity market regulation, was actually in force six months prior to the official start of the Single Market in 1992.

The Commission put forward its major proposal for liberalisation of the electricity (and gas) markets across Europe in 1992, under the cooperation procedure with Parliament. Following the entry into force of the Maastricht Treaty, however, the Directive required a legal codecision from the Council and the Parliament. Indeed, with the Council unable to accept the proposal, the Parliament played a critical role in guiding the Commission towards significant changes. Thereafter, it still took the Council a further three years to agree on the revised proposals.

Given the importance of the legislation, this chapter looks at the background to the negotiations and agreement in 1996, and goes into some detail concerning the Directive and its implementation.

This chapter also examines the Commission's attempts to apply competition law to the electricity sector. In general, where it has sought to force liberalisation - such as in the import/export monopoly cases - the Commission has failed; but where it has simply used its powers to ensure market agreements are not too restrictive, it has achieved more success.

THE ELECTRICITY MARKET DIRECTIVE - A MAJOR ACHIEVEMENT

The first measure directly aimed at the internal electricity market was the transit Directive, approved in October 1990 and in force since July 1991. Its main aim is to ensure that a grid operator in one Member States is not able to impede the trade of electricity between other Member States. It stipulates that the conditions of transit must be non-discriminatory and fair for all parties concerned. The Directive also contains an annex which lists the grid operators to whom the Directive applies, and this has been updated several times to account for changes in ownership and operation.

Specifically, the Directive requires transmission utilities to act without delay to:
- notify the Commission and national authorities of any request for transit in connection with contracts for a minimum of one year;
- open negotiations on the conditions of transit requested;
- inform the Commission and national authorities on the conclusion of a transit contract;
- inform the Commission and national authorities of the reasons for failure of negotiations to result in a contract in the 12 months following notification of a request.

The electricity transit Directive and its committee

In order to deal with transit conflicts, the Directive provided for a committee, consisting of 20 members - one representative from each Member States' operating grid, three independent experts, a member from the European association, and one Commission representative to chair the meetings. The idea of the committee was to propose conciliation compromises, at the request of negotiating parties, in the event of specific requests for transit. It was also supposed to examine the conditions of transit from a broad perspective and advise on further possibilities of cooperation on transit across the EU. It now meets about once a year and, in the light of a liberalised electricity market, may focus increasingly on issues such as tariff mechanisms and access conditions.

Original proposals for liberalisation considered overly ambitious

Draft proposals for common rules in the electricity and gas markets were presented by the Commission in February 1992. On electricity, they called for the abolition of exclusive rights regarding generation and the building of power lines; the unbundling of vertically integrated utilities; and the introduction of third party access (TPA) to the networks for large electricity customers above a certain threshold.

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The proposals were considered overly ambitious by a majority of Member States. Somewhat ironically, the UK, which was the strongest supporter by far of the Commission's proposals, presided over Council Conclusions in November 1992 which effectively blocked further progress on the basis of the Directive as it was then. (The gas Directive was put aside until agreement was reached on electricity - Chapter Three B). Moreover, the European Parliament produced a detailed Opinion rejecting some of the main aspects of the draft Directive, such as mandatory TPA, and suggesting alternative mechanisms and more harmonisation.

Parliament's call for negotiated third party access

In December 1993, the Commission responded to the Council's instructions and the Parliament's concerns with modified proposals for common rules in the electricity (and gas) markets. The key changes were the inclusion of negotiated TPA, the introduction of a tendering procedure as an alternative to the authorisation system for new transport and production facilities, and a greater emphasis on public service obligations and harmonised conditions.

Then, during the first half of 1994, the French said they could not even accept negotiated TPA and wanted to introduce a so-called Single Buyer (SB) to liberalise their system so as, particularly, to safeguard important public service obligations. This was a major departure from the text of the Directive, as proposed by the Commission after the Parliament's Opinion, but the Council, nevertheless, agreed to ask the Commission to carry out a study as to the feasibility of introducing such a system in parallel with TPA.

The year-long debate over the Single Buyer concept

The debate within the Council over the SB effectively straddled a whole year, running through the German Presidency in the second half of 1994 and the French Presidency in the first half of 1995. Both Presidencies were handicapped by national elections from making any compromises on the electricity market Directive. In France, the proposed legislation was considered by some as a charter for unemployment and therefore a highly sensitive issue at election time. In Germany, the political issue focused on the need for equivalent market liberalisation across both sides of the Franco-German border.

UK study against Single Buyer and French study against UK system

In an attempt to influence the Council's negotiations, independent studies from the UK and French camps were also published during this period. The UK's National Economic Research Associates concluded that, from both an economic and a legal point of view, the SB and TPA approaches were fundamentally incompatible. The French industrial policy consultant APIS took a different approach and tried to show that liberalisation in the UK was not as desirable as the UK had suggested. It found that overall average prices to the consumer in the UK were barely below what they were prior to liberalisation, that prices to domestic consumers had increased more quickly than inflation, and that the regulator was becoming increasingly involved in the operation of the business. APIS also pointed to erratic and inexplicable variations in day-to-day prices.

In spring 1995, the Commission produced a working paper, based on a report from Cologne University's EWI, in which it stated that the French system was incompatible with TPA. However, it also laid down six conditions which, if met, could allow the SB to coexist with a negotiated TPA system. Under pressure from France supported by a few other sympathetic Member States, the SB concept was incorporated into the text of the draft Directive, with most of the conditions identified in the Commission report.

Final issues resolved under Spanish and Italian Presidencies

The general systems of access was only one difficult issue. By the June 1996 Energy Council, there was still a raft of others to be resolved. These included: the building and use of direct lines; the definition of independent producers and eligible consumers; the concrete conditions for accepting or rejecting authorisations for independent producers; how to deal with integrated companies in both systems, as regards production, transport and distribution, so as to avoid discrimination, cross-subsidisation and unfair competition; the detailed procedures as regards transitional periods; and, of course, the degree of market opening.

EFTA states' concern over use of Single Buyer

As if there were not sufficient difficulties within the Council, the EFTA members of the European Economic Area - Norway, Iceland and Liechtenstein - also expressed concern over the SB system, as they would be expected to take on the Directive after adoption by the EU. They argued that "a legal acceptance of this concept could distort the overall balance in the Directive". The EFTA group also said the new Directive should not distort the possibility of developing an effective and environmentally-sound Nordic market for electricity nor discriminate against electricity systems, such as those of Norway and Iceland, highly dependent on renewables.

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The Spanish Presidency, in the second half of 1995, managed to achieve agreement, at least in principle, on four of the main points:
- full management and accountancy unbundling for Single Buyers;
- organisation of tendering procedures (which are more restrictive than authorisations systems) by independent entities rather than electricity utilities;
- freedom to build and use direct lines for all eligible customers;
- freedom for eligible customers to contract with external and domestic suppliers via a triangular system involving the Single Buyer in a transparent, objective and non-discriminatory way.

However, it was not able to conclude a Common Position because of ongoing disagreements between France and Germany, despite their high-level bilateral talks. France continued to insist that it be allowed to exclude distributors from the terms of the Directive; the German Parliament, meanwhile, expressed very serious concern over the reciprocity issue.

Council agreement in June 1996

It was left to the Italian Presidency, in the first half of 1996, to tie up the final details. It focused on Article 19, which not only contained the detailed mechanism and thresholds for market opening, but also contained the controversial paragraph five on the avoidance of disequilibrium between markets. Agreement eluded the energy ministers at the scheduled Council of 7 May, but political agreement was finally achieved on 20 June, following an important bilateral between France and Germany on 5 June. The Common Position was formally adopted on 25 July and forwarded to the European Parliament for a second reading under the codecision procedure.

MEPs' decision to accept the Common Position

There was much speculation as to how MEPs might deal with the Directive. There was certainly a group of MEPs who argued that the fragility of a Council compromise was no reason not to use the EP's codecision powers. But Socialist MEP Claude Desama, the EP's rapporteur, put forward the argument that "Parliament cannot take the risk of killing off the Directive". The Council has little room for manoeuvre, he said, and "whatever strategy is proposed will inevitably have to take account of this, even in the case of amendments which appear relatively trivial".

Nevertheless, in the research/energy committee a number of smaller amendments were accepted and put forward to the plenary. The majority Socialist group, however, was not able to present a completely united front, and moreover the second largest group, the Christian Democrats, decided to oppose all attempts to adapt the Common Position. It was, therefore, approved by Parliament on 11 December 1996, and the Directive was formally adopted on 19 December.

Electricity Directive in force from February 1999

The text of the Directive laying down common rules for the internal market on electricity was then published on 30 January 1997, and came into force on 19 February. The Member States have until the same day in 1999 to transpose the Directive into national law, although Belgium, Ireland and Greece all negotiated a short transition period (one year, one year and two years respectively) because of "technical specifities of their electricity systems".

Since its adoption, the Commission has stressed that there are four important principles underlying the new Directive: that it is an initial step in terms of market opening to be followed by continual and progressive further steps; that subsidiarity is reflected in the way it allows for many different market mechanisms; that it ensures equivalence between Member States systems; and that it permits States to ensure public service obligations.

Summary of the electricity Directive's rules

The Directive contains a number of detailed provisions setting out the framework for implementation by Member States, but its main terms regarding competition for production, market access and unbundling can be briefly summarised.

The tender and authorisation procedures

With regard to generation, the Directive requires that the construction and operation of new production facilities be completely open to competition. Two alternative approaches are allowed, to reflect divergent policies with regard to security of electricity supplies:
a) the calculation of future electricity requirements by a central body and an open tender surveyed by an independent authority;
b) the use of a market mechanism to decide the level of capacity necessary to meet demand with an authorisation utilising objective qualitative and non-discriminatory criteria, stipulated by the Member State.

On access conditions, the Directive insists on each Member State opening up a certain percentage of its electricity market. This percentage (at the time of adoption thought likely to be around 23%)

depends on a detailed annual calculation, by the Commission, to be published before 1 November the previous year, of how much of the total market is taken by consumers consuming 40 GWh/yr or more (including autoproduction). One year later, (i.e. in February 2000 for 12 of the Member States), the percentage must be increased to a figure based on the total consumption by those consuming 20 GWh/yr; and, three years later, a further increase will take place based on a percentage calculated from those consuming 9 GWh/yr or more (thought likely to be around 33% of the market).

Calculation of the degree of market opening

All consumers, buying 100 GWh/yr on a single site basis must be allowed to purchase electricity freely but, otherwise, Member States are free to specify their own "eligible customers" to reach the minimum percentage market opening, and may, if they wish, exclude distributors. However, where distributors supply eligible customers then they must be free to access the market for that share of supply.

Calculation of average share of electricity market opening

	Consumption (1,000 GWh)*		
	Of more than 40 GWh	**Total**	**%**
Aus	13.1	49.0	26.66
Bel	25.7	71.4	35.93
Den	2.9	32.4	8.97
Ger	125.0	463.0	27.0
Gre	7.2	36.3	19.73
Fin	28.8	67.3	42.81
Fra	100.6	384.2	26.18
Ire	1.7	15.8	10.44
Ita	60.1	246.0	24.41
Lux	2.4	5.0	48.72
Net	19.9	89.3	22.25
Por	5.5	29.5	18.6
Spa	37.7	154.7	24.34
Swe	41.7	134.3	31.05
UK	56.7	305.7	18.56
Total	**528.8**	**2,084.0**	**25.37**

* The consumption figures are rounded to one decimal place; the first column is the total electricity consumption by those consumers which use more than 40 GWh.

Source: Internal Commission paper

Choice of market access systems

Member States can choose between SB or TPA systems for opening their markets, and between regulated and negotiated TPA. Where regulated TPA applies, the Member State regulatory authority simply sets or approves fixed tariffs, to be applied within the vertically integrated company and to competitors alike. Such tariffs are to be published. In the case of negotiated TPA, the transmission tariffs are decided on the basis of free negotiation with the transmission system operator. The system operators are, however, obliged to publish, on a yearly basis, an indicative range of prices for use of the transmission and distribution systems.

The Directive also stipulates that vertically integrated companies must keep separate accounts for generation, transmission and distribution of electricity "with a view to avoiding discrimination, cross-subsidisation and distortion of competition". Unbundling of management is required where a vertically integrated company is also designated as a SB.

Provisions for derogations

There is some provision in the Directive for exceptions. A network operator, for example, can claim it has insufficient capacity to meet an access demand, although it must be able to justify its case. Moreover, a Member State can authorise a refusal of access on the basis of public service obligations, although these must be notified to the Commission. There is also a reciprocity clause which applies when different levels of market opening are implemented by two Member States and an eligible customer from one State that wants to contract electricity from a supplier in the other Member State does not have the status of an eligible customer in that other Member State.

The complex process of implementation

Following the Directive's entry into force, the Commission's priorities shifted from political to practical. The short-term task is to ensure the satisfactory transposition of the Directive into national law. To this end, DGXVII met regularly with all the Member States throughout 1997 and will continue to do so in 1998. For some countries where liberalisation is already a fact, such as the UK and Sweden, the task is simply to ensure compatibility between the provisions of EU and national law. But in other cases, such as Italy and France, DGXVII must monitor the detail of new legislation and structures being put into place for the first time.

For a broader exchange of views, DGXVII created a follow-up group consisting of Member State officials who are directly responsible for the transposition of the Directive. Moreover, it intends in the future to convene meetings of national regulators. The electricity industry group Eurelectric is also deeply involved in the process: at a seminar organised in March 1998, electricity representatives from all the Member States gave details on the state of the Directive's implementation in their own countries.

In November 1997, the Commission published, in the Official Journal, its first assessment of the degree of market opening. According to its calculations under Article 19, "the average Community share of electricity market opening, as effective in 1998, is 25.37%". A new calculation will be made each year. Because several Member States have already liberalised, or intend to liberalise, their markets to a much greater degree, the average market opening across the Community is likely to be significantly higher than that required by the Directive.

Commission to examine each request for support in detail

In a first report on the state of energy market liberalisation published in April 1998, the European Commission implied it was satisfied with progress so far and expected the timetable for transposition of the electricity Directive to be kept. In a short section on transition regimes, the Commission noted that 12 Member States (all but Italy, Finland and Sweden) had applied to use the Article 24 provision to provide time-limited support for (stranded) contracts which cannot be honoured after the Directive enters into force. The Commission said it may approve such support schemes but it would need to collect a lot of additional data in order to prepare a decision in each case. It noted, furthermore, that "a clear majority of Member States will in fact go beyond the minimum market opening provided in the Directive" Thus, even on the most conservative assumptions, it said, "it is evident that at least 60% of the EU's electricity demand will be liberalised by end 1999".

A first look at extra harmonisation requirements

Another of the short-term requirements of the Directive was for a Commission report on harmonisation requirements linked to the internal electricity market. The report, adopted in March 1998, said that harmonisation basically concerned two issues - energy taxation and environment considerations. There was no discussion on energy taxation, which is the subject of a separate proposal for a Directive (Chapter Three) but it focused instead on environmental matters, and, in particular, the use of schemes to support renewable energies.

A first look at harmonisation requirements

Such schemes must be analysed from two different points of view, the Commission argued. The first of these is state aid, and the report emphasised that they will all have to comply with the Commission's 1994 guidelines on state aid for environmental purposes. Secondly, they will have to be compatible with other EU law, and especially the electricity Directive.

The report went on to explain that the electricity Directive has only one explicit mechanism for the favourable treatment of renewables (Article 8-3 concerning the system operator), but that without accompanying measures its use is limited. Member States will need to utilise either the provisions for transition measures which are of limited duration, the Commission predicted, or the provisions for public service obligations (Article 3-2), and it signalled an intention to propose a Directive to provide a framework for renewables schemes (Chapter Four B).

MINOR ACHIEVEMENTS THROUGH THE USE OF COMPETITION LAW

A landmark ruling by the Court of Justice in 1964 stated that electricity should be treated as "goods" and was therefore subject to the competition rules. However, it was not until the late 1980s, following the Council's decision to bring energy into the Single Market, that the Commission began a more serious attempt to use the Treaty competition rules to prise open some of the more obvious monopoly activities.

The Commission made a significant intervention in a deal between Electricite de France (EdF) and Pechiney to build a new aluminium plant. The deal depended on cheap rate electricity, but the Commission insisted on a 10% increase in the supply price for the last three years of the deal (1997-99). Subsequently, the Commission monitored other similar supply deals made by EdF but without needing to intervene.

Interventions in EdF related agreements

There were, though, two further EdF cases investigated by the Commission which resulted in adjustments. The first, in 1992, involved another European electricity giant, Italy's Enel. It related to the joint arrangements for fixing the purchase price for electricity from a small independent French generator, Societe Hydroelectrique de Grangeville (SHG), connected to Enel's grid but not to EdF's. The Commission's intervention ensured a better deal for SHG. Similarly, in 1993, a Commission investigation resulted in certain clauses - relating to exclusive transport, distribution and marketing rights - inserted into contracts with Coramine being adjusted so as not to infringe Treaty law.

On the other side of the Channel, the Commission was also deeply involved in monitoring the restructuring and privatisation of the UK electricity industry. Although the UK was clearly moving exactly in the direction of a liberalised electricity market, in line with Brussels policy,

there were a large number of new contractual and transitional arrangements which needed Commission approval. In particular, there were substantial subsidies to the nuclear industry (which the then Competition Commissioner Leon Brittan had considerable difficulty passing at Commission level), and favourable contracts for the coal industry that required justification under Treaty rules. The first and crucial Decision was made on 30 March 1990, on the eve of the vesting day of the old Central Electricity Generating Board. Over the next few years, a number of further Decisions were made concerning restructuring in Scotland and Northern Ireland.

Competition threats directly aimed at monopolies

These earlier cases, although significant in themselves, were not directly aimed at creating the internal energy market. Brittan did, though, threaten repeatedly in the early 1990s to introduce powerful Commission Directives, based on Article 90-3, which would oblige Member States to abolish or change national measures which interfered with competition. He had used such a method with some success in the telecommunications industry. However, with all the strategic implications of security of supply, and social consequences in terms of public service, such a measure was considered unacceptable by many Member States at the time, and, with the move towards subsidiarity and the departure of Jacques Delors, the idea of such a directly confrontational move vanished.

Nine infringement proceedings on import/export monopolies

Nevertheless, the Directorate-General for Competition (DGIV) did take some specific action. Infringement proceedings against nine Member States were opened in 1991 concerning their legal restraints on the import and export of electricity and gas. Although six of the Member States - Denmark, France, the Netherlands, Ireland, Italy and Spain - were unable or unwilling to answer the accusations, the Commission did not immediately bring the cases to the Court. On the one hand, the threat of Court action was used as a lever to encourage progress on the electricity Directive, but, on the other, the Commission was anxious to await the outcome of the so-called Almelo case.

This case was referred to the Court of Justice, not by the Commission, but by a Dutch Court which wanted to resolve an issue brought by local electricity distributors, led by Gemeente Almelo (and generally referred to as the Almelo case). In essence, the distributors had wanted, in the mid-1980s, to import electricity from Germany, but been thwarted by the exclusive import and export rights granted to the generators. A 1991 Commission investigation and Decision upheld the rights with regard to distribution customers but not for industrial customers. Almelo et al complained and the Dutch court referred the case.

Judgement in the Almelo case

In its April 1994 judgement, the Court of Justice found that, according to Articles 85 and 86, there had been restrictive practices imposed by the power generators and a disruption in trade. But the Court also ruled that Article 90-2 provided some protection from Articles 85 and 86 when a company operates a necessary general economic interest. Moreover, it acknowledged that the generators had some public service obligations in this case and confirmed that legal constraints should be taken into account in assessing the extent of the obligations. The Court did not, though, make any judgement on whether the obligations in this case necessitated the monopolistic behaviour. (Eventually, in 1996, the Dutch appeal court, taking the Court of Justice ruling as its base, found that the public service obligations presented by the generators were not sufficient grounds for imposing an import monopoly, and thus the generators had acted contrary to the Treaty's provisions.)

Five cases brought to Court over import/export monopolies

In June 1994, the Commission finally lodged five cases in the Court of Justice regarding national gas and electricity import and export monopolies (the one against Denmark was dropped as a result of last minute commitments to abolish the gas monopoly - Chapter Three B). The Commission argued that in each case the national rules created an effective monopoly in the relevant sector which was liable to restrict trade between the Member States and impede the free movement of goods as laid down in the Treaty. In addition, it said, they infringed Treaty rules which require all national monopolies of a commercial character, run on a direct or delegated basis, to be operated in such a way as to eliminate all discrimination between nationals of Member States.

The cases dragged on for three years. The UK intervened on the side of the Commission in each of the five cases and described how the markets operated in the UK without needing import and export monopolies to achieve security of supply while meeting public service obligations. France and Ireland intervened against the Commission on behalf of Italy, Spain and the Netherlands. France and Ireland also intervened in each others cases against the Commission. In mid-1996,

after the oral hearing stage, the Commission withdrew its case against Ireland, having been convinced that its legislation did not, in fact, prohibit imports.

The judgements, when they came in October 1997, proved less consequential than some had hoped, at least when the cases were first lodged. Firstly, because the electricity Directive was already in place, and, secondly, because the Commission lost.

Judgements fail to shed light on internal energy market

In the case of Spain, the Commission insisted that a national law, giving responsibility for the operation of the national electricity network and for managing international electricity trade to the state company Rendesa, gave the State exclusive import and export rights, even though such rights were not explicitly mentioned. The Court, however, ruled that the Commission had failed to prove the existence of any statutory monopoly. Although Rendesa managed the electricity network, this did not mean that other undertakings could not have access to its international connection facilities. Consequently, the Court dismissed the Commission's action without ruling on the alleged infringements of the Treaty.

National provisions in Italy, France and the Netherlands do create monopolies

In the three remaining cases, concerning Italy, France and the Netherlands, the Court concluded that national provisions did indeed create national monopolies in the relevant areas, which would have a direct effect on the markets concerned and discriminate in favour of domestic operators. Consequently, they were contrary to Article 37 of the Treaty. Having established this point, the Court decided that there was no need to examine other alleged Treaty infringements, but went on to consider the arguments put forward by the Member States.

In each case, the States contended that, although the national monopolies were in breach of Treaty rules, they were justified under the Article 90-2 provisions allowing exemptions on the basis of services of general economic interest (as in the Almelo case). They also argued that attempts to change those systems could impede their functioning and the achievement of national energy policy objectives.

The Court noted, in its rulings, that the Commission had largely concentrated on general legal considerations, throughout its pursuit of the infringement procedures, without looking at the specific arguments in each case. In particular, the Commission had indicated that Article 90-2 was not applicable, suggesting that it only allowed Treaty rules to be breached if there was a risk that the financial viability of the company engaged in a public service was threatened. The Court, however, decided that such rules could be broken if they merely impeded the performance of the service in question, such as the uninterrupted supply to customers of electricity or gas at stable prices.

The Commission's failure to bring specific arguments

The question therefore, the Court said, was whether the national monopoly measures went beyond what was necessary in order to ensure a service in the general economic interest. The Court concluded that the Commission had failed to look at the specific conditions in each case, and that it (the Court) was in no position to give an opinion on the basis of available information. As the Commission had also failed to prove that the statutory monopolies affected trade to an extent contrary to the interests of the Community, the Court dismissed the Commission's actions and made it liable for costs.

Restricting electricity power purchase agreements

With the Council negotiations leading slowly towards a more liberal market, the Commission took care through the mid-1990s not to allow any new agreements with too restrictive an impact. In 1993, for example, it examined a project for the construction of the Pego power plant in Portugal but refused to sanction the proposed 28 year power purchase agreement (PPA). After negotiation, the PPA was restricted to a 15 year period with a "first option" system after that.

Long-term agreements for Portuguese power plants

In March 1995, the Commission received a further request, from the Turbogas consortium in Portugal, for negative clearance of a PPA for the supply of electricity from a combined cycle gas turbine power station to be built at Tapada do Outeiro. Turbogas requested a PPA with a 25 year duration from when the first of the three 330 MW units was commissioned: the Portuguese grid operator, REN, would purchase all the power generated by Tapada for the first 15 years, and enjoy a first right refusal for the subsequent 10 years. However, the Commission opposed the latter aspect and the parties agreed that the generator should be allowed to sell capacity and power freely to third parties after the 15 year period.

Similarly in Italy, Isab Energy, an independent operator, applied in September 1995 for a 20 year PPA with the state-owned electricity utility Enel, for a new 507 MW IGCC power plant it wished to build in Sicily. The Commission, however, restricted the deal to 15 years, but had no complaint about the 20 year limited restrictive agreements on oxygen and feedstock supply agreements which had also been notified.

Italian power supply agreements limited to 15 years

The Commission dealt with three other Italian projects for combined cycle cogeneration plants in an identical manner: the 352 MW Rosen project in Tuscany; the 276 MW Api Energia project in Marche, and the 550 MW Sarlux project in Sardinia. In each case, PPAs with Enel of 20 years were notified and restricted to 15 years by the Commission.

In making its decision to limit the contracts to 15 years, the Commission said it had taken account of "the present stage in the development of the internal market for electricity, of generation technology or primary energy sources having a favourable impact on the environment and of the proportion of demand covered by all the long-term contracts concluded by Enel with independent generators".

DGIV interventions in Belgium and Denmark

In Belgium, the Commission also intervened to limit the duration of supply contracts, but in different circumstances. During 1996, complaints were made concerning breaches of Treaty law by the major Belgian utility Electrabel with regard to the so-called third generation statutes. These statutes were to provide for exclusive 20-30 year supply contracts between Electrabel and the 17 municipal distributors (accounting for over 80% of electricity distribution in Belgium) which count Electrabel as a shareholder.

More freedom for municipal distributors in Belgium

Following a year-long investigation by the Commission, Electrabel and the association of the municipalities reached an agreement to allow, from 2006, the distribution companies to choose an alternative supplier for 25% of their baseload needs, after giving four years notice to Electrabel. From 2011, the distribution companies would be free to choose suppliers for 100% of their needs. From the same date, communes would also have the freedom to dissolve the distribution company and seek a new partner, although they will be obliged to provide Electrabel with full compensation. The Commission said this should lead to an opening of around 1,000 MW of baseload supply.

The Commission said it had been concerned not to undermine the principles of security and regularity of supply which are of particular importance for the municipalities, and that the changes would benefit domestic consumers and SMEs connected to the networks of the municipal distribution companies.

Commission interventions in Denmark

It is worth noting one further case from the mid-1990s. The Danish government planned to introduce legislation designed to give utilities more freedom to utilise profits. The need for the change arose as a result of complaints concerning one utility, SEAS, which had run up debts on diverse projects and tried to recoup those debts by raising electricity prices to consumers. Following discussions with the Commission, Denmark's original approach to the legislation was abandoned and the government switched to dealing with each issue separately.

Thus, in December 1994, the Commission approved Danish legislation exclusively for SEAS, under Community guidelines on state aid for rescuing and restructuring firms in difficulty. Then, in April 1995, the Commission authorised general changes to the Danish law allowing utilities to earn a reasonable profit on production/supply activities and invest that profit as normal risk capital in other activities.

EU competition aspects of electricity mergers

With the liberalisation of the electricity markets starting to take hold across Europe, the Commission has needed to examine occasional electricity sector mergers. Several of these have involved Electricite de France (EdF). In June 1995, the Commission cleared the takeover of Italian electricity producer Ilva Servizi Energie by Edison, a subsidiary of Montedison, and EdF International. The Commission assessed that, although the Italian public monopoly for electricity, Enel, sourced electricity from foreign producers (including EdF) and independent Italian producers (including Edison), the operation would not lead to a coordination between the two parent companies. Edison's degree of flexibility in determining its behaviour towards Enel, it said, was very low. In Spring 1998, Brussels approved the acquisition by EdF of a stake in the Austrian electricity/gas utility Energie Steiermark, and a few weeks later, EdF notified a further move, this time towards the Swedish firm Graninge.

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In December 1997, the Commission authorised the acquisition by two German electricity companies (Bayernwerk, Energie Baden-Wurttemberg) and one Swiss (Nordost-schweizerische Kraftwerke) of a majority stake in the Swiss company Watt. The main assets of Watt were majority shareholdings in four companies active in the Swiss and southwest German electricity markets. The acquisition formed part of a general operation to split Elektrowatt into an industry part, taken over by Siemens (also approved by the Commission earlier that year), and an energy part.

Restructuring of gas and power firms in Belgium

Significant restructuring moves, involving both the gas supply and electricity industries, in Belgium and Germany have been notified to Brussels in recent years. In the mid-1990s, the Commission raised significant objections to a scheme by which Tractebel, a dominant player in the Belgian electricity market, would acquire the main gas supplier Distrigas. A revised scheme, notified in August 1994, was designed specifically to ensure full transparency in the area of gas supply to electricity generators. More or less at the same time, Tractebel also notified the Commission that it intended to purchase 50% of the stake held by SNI in Synatom, a company which managed the nuclear fuel cycle both upstream and downstream of Belgium's nuclear power plants. The model allowed the Belgian government to retain a golden share in defence of the public interest.

In its annual report at the time, the Commission said its examination of the two cases in Belgium - Tractebel/Distrigaz and Tractebel/Synatom - prompted a closer look at the concept of control as regards undertakings operating in regulated sectors. It also drew a distinction between the role of the state as shareholder and its role as public guarantor of the general interest. In fact, following the two concentrations, the Belgian state disposed of all the shares it held in Distrigaz and Synatom and retained only the prerogatives previously held as the public authority. The Commission took the view that the prerogatives were restricted to ensuring where necessary that the public interest was complied with, and did not constitute control within the meaning of the merger rules.

German concentrations referred back to Bonn

By contrast, in Germany, a complicated manoeuvre notified in 1996, involving concentrations between Thyssengas and RWE on the one hand, and Bayenwerk and Isarwerke on the other, was referred back to the Bundeskartellamt with a view to the application of German competition law. In both cases, the Commission said, the possible competition problems involved regional markets.

It is also worth noting that, in 1996, the Commission authorised the acquisition by GEC Alsthom of the worldwide power transmission and distribution equipment business of AEG. It emphasised that there had been significant restructuring in the sector because of technical harmonisation, the centralisation of manufacturing and "an improvement in the use of multiple and non-discriminating sourcing policies by customers" in line with the public procurement legislation. As a result, significant trade flows are now taking places between Member States, it said, and concluded that "the high market shares achieved by GEC Alsthom in some Member States could not give rise to serious concerns about effective competition".

Application of Treaty law by national authorities and courts

Apart from direct intervention by the Commission, there is an increasing tendency for national competition authorities and national courts to apply the terms of Treaty law.

Action taken by RWE to defend demarcation contracts

In 1993, the Bundeskartellamt (German cartel office) began an investigation into an exclusive supply contract between the utility RWE and the town of Kleve, near the Dutch border. RWE, however, referred the case to the European Commission and claimed the contract was legal under the Treaty's provisions for exemptions. The Commission opened an investigation which obliged the German cartel office to halt its own procedure. RWE argued there was a very important question over who would be responsible for the public supply obligation if it lost the exclusive right to supply, and that it was impossible to justify a system which allowed foreign suppliers to provide electricity for German towns, while German utilities had no access to French towns. However, before the Commission could decide on how to rule, the Kleve contract expired.

Then, in June 1995, the German cartel office announced it would investigate another exclusive long-term contract between RWE and, this time, Nordhorn, also near the Dutch border, over the use of the town's distribution grid, which, it said, was illegal under Article 85-1 of the EU Treaty. RWE followed the course it had taken with the Kleve case and referred it to the European Commission, in October 1995, asking for an exemption to the competition rules also based on Treaty law. This time, though, the European Commission declined to open an investigation and allowed the German cartel office to rule first. A ruling came, prohibiting the licensing agreement, in early 1996.

This ruling led to two actions in the Court of Justice. The first stemmed from an appeal brought by RWE and Nordhorn to the Berlin Court, which referred the case to Luxembourg. The second, in the Court of First Instance, was brought in August 1996 by RWE which claimed that the Commission, when asked for a negative clearance, had failed to act, under Article 175.

EFTA Surveillance Authority energy cases

Swedish producers obliged to dismantle purchasing pool

Developments towards an internal electricity market stretch beyond the EU's borders and take in the European Economic Area, thus including Norway, Iceland and Liechtenstein. The EFTA Surveillance Authority is charged with dealing with competition cases arising within the EEA. One such case came to a head in early 1995. Since the 1970s, Swedish electricity producers had coordinated their electricity sales to, and purchases from, Norway through an organisation known as KSN. The arrangement was notified to the Authority prior to the 30 June 1994 deadline imposed for the European Economic Area.

The Authority found that cooperation within KSN breached European Economic Area competition rules, especially with regard to elements of price fixing and coordination of behaviour of the major Swedish operators on the Norwegian market. The Authority noted that because the Norwegian power market was deregulated and open for competition, the behaviour of KSN, which was functioning with only short-term aims, could jeopardise its proper functioning.

Later in 1994, the Authority warned the producers it intended to take a negative decision in the case. Consequently, the Swedish producers decided to dismantle KSN and, when it notified the Authority in early 1995, it said the short-term exchanges of electricity between the two countries would, in future, take place independently, by the companies concerned.

ASSESSMENT

The internal electricity market Directive is the single most important piece of Community energy legislation ever completed. For five years, between 1992 and 1996, this one dossier dominated the Energy Council's workload and remained the Commission's number one priority. Even by EU standards, five years is a long time for negotiations over one law, but there are good reasons why it took so long.

Need for Commission to draft adequate legislation

In the first place, the Commission's initial proposals were too radical. In the early 1990s, only a very few Member States had really begun a serious restructuring and liberalisation of their electricity sectors, while most, although intrigued by developments in the UK, were still dominated by monopolistic thinking. In retrospect, it seems clear that, prior to presenting its proposals, the Commission spent too little time analysing the technical complexities of opening up the industry to competition, and that it ignored potential political hurdles in the Member States.

There is an argument that suggests it was necessary to place a bomb under the industry with a slow-burning fuse to get things moving. But this is flawed reasoning. As a result of the Commission's too hasty proposals, the Parliament and the Council were left with the job of constantly drafting and redrafting (albeit with the Commission as an adviser) the Directive. It is the responsibility of the Commission to draft adequate legislation in the first place, not to put forward proposals, the consequences of which have not been studied or thought through sufficiently. Although the departure of Jacques Delors left the Commission a place with less vision and drive, a more considered and practical approach to future legislation was ushered in with the Jacques Santer Presidency, one more in keeping with the principle of subsidiarity.

It took the Council a year to realise it could take the original draft Directive no further, and then another year for the Parliament to adopt its Opinion, on the basis of which the Commission was able to revise its proposal. Only then, with the real prospect of a Directive in view, did the political fears start to emerge from the Member States, and especially France, in terms of practical objections. It was never clear, for example, whether France introduced the idea of the Single Buyer primarily to subvert and/or delay the negotiations, or whether there was a genuine belief that the Single Buyer model could be a useful addition to the liberalisation process across Europe. Thereafter, the details for a final deal took some time to work out, and, ultimately, waited on France and Germany to reach a mutual understanding.

Having played a significant part in the early stages of the Directive under the cooperation procedure, the European Parliament might reasonably have been expected to make use of its codecision powers to ensure some of its concerns, expressed on first reading, were taken up in the final Directive. One of these concerns was to ensure that end consumers would profit from the

liberalised market by including distributors as eligible customers. However, after much opposition from the Commission, the Council chose to allow Member States to decide for themselves whether they wanted to include distributors.

EP justification for leaving distributors out of electricity Directive

Socialist MEP Claude Desama, the EP's rapporteur, and a previous chairman of the research/energy committee, might have chosen to take a stand on the eligibility of distributors. Indeed, Desama asked in his report: "*Why should distributors, who manage the distribution systems from which captive customers are supplied, not also be able to enjoy the real or supposed benefits of competition?*" But Desama answered his own question: "*Whilst some countries oppose the idea, they do so not to prevent small consumers benefiting from changes which such eligibility might bring, but simply because in many cases, distribution systems are the stable elements of demand. Electricity companies have developed investment policies for which the write-off periods are 10, 15 or even 20 years. They fear that they will lose not only their industrial customers but also the bedrock of captive demand.*" This may have been a cop-out by Desama and the Parliament, but the reality was quite simple: there were not enough MEPs willing to take a stand on the issue and, even if they had, the Council would not have altered its stance.

The final adoption of the Directive, in December 1996, must be seen as a significant achievement for the Union; and despite the reluctance of the Member States to transfer sovereignty on energy issues, this was a giant leap. The new law does leave the Member States in control of their markets, but it is interesting to note how involved the Commission will be in the regulatory aspects of the new market. It is worth listing the different aspects of the Directive for which the Commission has responsibilities.

The Commission's long list of responsibilities

- States must notify the Commission of any public service obligations they wish to impose on undertakings operating in the electricity sector (Article 3);
- States must notify the Commission of any refusals to grant authorisations for new generating capacity (Article 5);
- States must notify the Commission (under the terms of a 1983 Directive on standards) of the technical rules establishing minimum design and operational requirements for the connection to the system of installations, circuits, direct lines etc. (Article 7);
- States must notify the Commission on an annual basis of the measures they are taking to ensure an opening of the market; the Commission will publish the average Community share and threshold for market opening each year (Article 19);
- States must notify to the Commission every year the criteria for the definition of eligible customers (and this to be published in the Official Journal). The Commission may request modifications to these criteria if the Member State creates obstacles to the correct application of the Directive (and, if not complied with, can follow through with further powers) (Article 19);
- under the reciprocity provisions, the Commission may, in certain circumstances, force a supply contract to be executed between parties in different Member States. The Commission will evaluate the working of the reciprocity arrangements and report on any relevant imbalances in the electricity markets (Article 19);
- States must notify the Commission of any measures taken in the event of an energy crisis - the Commission can amend or abolish them (Article 23);
- the Commission is to decide on individual transitional regimes because of obligations made prior to the Directive's entry into force, or because of the nature of their small isolated systems. Measures to be published in the Official Journal (Article 24);
- the Commission is to publish a report, and any necessary proposals, on harmonisation requirements, not linked to the provisions of the Directive (Article 25);
- the Commission is to review the working of the Directive and make proposals for further opening of the market to be effective after the nine year period.

These responsibilities may not yet add up to classifying the Commission as a real EU-wide regulator, but as pressure builds from producers and consumers for a level playing field, the Member States may need to centralise regulatory powers further. For example, the Commission has already identified the need to harmonise conditions of public support for renewables and the importance of the provisions on public service obligations, and has promised a Directive. Any new legislation will also need monitoring and regulating. Moreover, it is still very early days.

So early indeed that, in March 1998 with less than a year to go, some Member States had still not decided how they would meet the terms of the Directive. The Commission remains satisfied that transposition is proceeding well in all Member States, bearing in mind the extra year(s) allowed for three States. But French officials, for example, presented a consultation document to the March 1998 Eurelectric meeting that contains so many unanswered questions it is difficult to imagine that France

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will meet the February 1999 deadline. It is also apparent from the French consultation document, in particular, but also from the detail of the work under way in most of the Member States, just how technically complex and far reaching are the necessary changes required by the Directive.

Some States still undecided on how to transpose the Directive

Although the Commission started the internal energy market legislative process rather clumsily in the early 1990s, latterly it redeemed itself by its patience and persistence and its willingness to make compromises where necessary. On paper, a 25% opening of the market may not look like much of an achievement after five years of negotiations, but as the Commission, the industry and the governments themselves now fully realise, the liberalisation ball is rolling and will almost certainly move faster in most places than required by the Directive.

Electricity Directive choices

	Access system	Generation system
Austria	Reg. TPA/SB	Auth.
Belgium	No decision	No decision
Denmark	Neg. TPA	Auth.
Finland	Reg. TPA	Auth.
France	No decision	No decision
Germany	Neg. TPA/SB	Auth.
Greece	No decision	No decision
Ireland	TPA?	Auth.?
Italy	No decision	No decision
Luxembourg	Reg. TPA/SB?	Tend./Auth
Netherlands	Reg. TPA	Auth.
Portugal	Reg. TPA	Tend./Auth.
Spain	Reg. TPA	Auth.
Sweden	Reg. TPA	Auth.
UK	Reg. TPA	Auth.

NB: The information in this table is summarised from the Commission's Communication with some additional information from papers given at a Eurelectric seminar.

Source: COM/98/212

By contrast, the Commission's sometimes highly publicised efforts to use competition policy to trim monopoly power in the energy sector have proved largely inconsequential. A Commission warning in the early 1990s that it would utilise Article 90-3 Commission Directives to break open the energy markets proved no more than hot air. The Commission then threatened legal proceedings against national monopolies controlling the import/export of gas and electricity. It prevaricated over these cases for years, five of which it eventually took to the Court of Justice. They were the most important legal cases in the energy sector ever brought to the Court. Half way through the lengthy procedures, the Commission withdrew one of the cases; then it lost the other four.

The Court accepted that monopolies did exist in three of the countries, but it judged that the Commission had not put forward specific enough cases as to why the monopolies were illegal. The Commission's competition services, which had trumpeted these cases for years, remained rather quiet after the judgements. However, a few months later, in early 1998, two officials published an article in which they claimed the Court may have taken its "unusual" stance and made its "relatively severe" analysis so as not to interfere with the legislative process on the electricity and gas Directives. They argued also that the Court's judgement did not rule out further actions, so long as they were more specifically guided and contained information on how any desired liberalisation should be carried out.

This is surely the point, for it is not the job of the Court to make policy. Until agreement on the electricity Directive, there were no Community orientations on the shape of a liberalised energy market. Court judgements against monopolies in other sectors were never going to be translated to the energy sector, because of its special nature. Whether because of security of supply concerns, or public supply obligations, the special nature of the energy sector has been a fact of the Community's political history right up until the present day. The Court had already shown its reluctance to make any judgements over the balance between liberalisation and public obligations in the Almelo case, and its judgements on the four import/export cases should have been no surprise to legal experts.