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Abstract

The paper asks how the tools for the creation of an internal energy market may be made more effective. It reviews the principal legal instruments used to open up the markets in electricity and gas so far and draws some conclusions about their effectiveness. It makes some recommendations about the next steps which, in line with the new legislation's reporting requirements, will have to be proposed in 2005-2006. The structure of the paper is as follows:

- Part 1 sets the scene by summarising the latest internal market measures and the problems they were intended to address;
- Part 2 critically reviews the principal instruments used so far to achieve the internal energy market objective, noting the pros and cons of each. The review is limited to three sets of instruments used to achieve the internal market goal: legislation (directives and regulations), the application of competition law and 'soft law' instruments, such as guidelines annexed to regulations;
- Part 3 places these three sets of instruments in the context of the framework of co-ordinated regulation set up by the Member States and the European Commission for the electricity and gas sectors, and
- Part 4 considers how these instruments might be developed to make the internal market project more effective.

Keywords

Competition, law, regulation, energy, European Union, electricity, gas.

Introduction

Blackouts, rising prices for electricity and gas,[1] investment blockages and the emergence of government-sponsored 'national champions'—the results of more than 15 years of trying to open up EU energy markets to competition had by early 2005 fallen well short of expectations. As the Competition Commissioner noted a few months earlier, 'in most national markets, customer switching rates are modest, substantial barriers remain for new entrants, market structures are highly concentrated and, last but not least, a single European energy market has not been achieved'.[2]

Yet a package of new EU energy measures has recently entered into force, comprising two sweeping directives and a regulation on electricity reform,[3] all aimed at accelerating the pace at which an internal market in energy is established. This *should* have provided an unequivocal confirmation that the internal energy market process continues to drive forward according to a timetable that envisages full market opening by 2007. Instead, the early results of implementation have provoked a bout of hand-wringing and hurried debate among EU institutions on the adequacy of the package and indeed the progress of the Internal Energy Market programme itself.[4] Evidence accumulates that the market structure remains largely non-competitive, in spite of the repeated efforts at effective unbundling of previously integrated players and the creation of access conditions to networks. Concentrations of market power among the incumbent players are a particular source of concern as an obstacle to the development of competition.[5] In this context, DG Competition is carrying out a major review of the energy sector in 2005-06 as a first step towards pro-active enforcement of competition law in this area.

The current debate is sparked by a realisation that the latest European legislation—the acceleration package—will not be sufficient to bring about an internal market in energy. Indeed, all the evidence suggests that it remains a very long way off. This paper attempts to find out why and what can be done to change this. It reviews the various legal instruments that are available to promote competition in the EU energy market, and assesses how they might be used to close the gap between vision and reality. It argues that the existing regulatory networks may be used to mount a harmonised and forceful assault on the barriers to the creation of an internal market in energy. Although the focus is upon legal instruments, the paper is written with the non-lawyer in mind.

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1 Note however that much of the rise in prices has been triggered by a very large rise in oil prices and not by a failure of the competitive market.

2 Keynote speech at the European Commission's Energy Day seminar, 21 September 2004: 'Energy Liberalisation: Moving Towards Real Market Opening'. In January 2005 the Commission's *Annual Report on the Implementation of the Gas and Electricity Internal Market* stated that 'after five years of competition for electricity and over three years for gas, fewer than 50% have switched supplier in most Member States'. Commission of the European Communities, COM (2004) 863 final, 5.1.2005, p. 3.

3 Directive 2003/54/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in electricity and repealing Directive 96/92/EC, OJ L 176/37, 15.7.2003 (hereinafter 'E-Directive'). Directive 2003/55/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in natural gas and repealing Directive 98/30/EC, OJ L176/57, 15.7.2003 (hereinafter 'G-Directive'); Regulation (EC) No 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, OJ L 176/1, 15.7.2003 (E-Regulation). A separate Regulation for gas was adopted by the Council of the European Union in November 2004: Common Position adopted by the Council with a view to the adoption of a Regulation of the Parliament and of the Council on conditions for access to natural gas transmission networks, 12 November 2004, 11652/2/04 Rev 4 (G-Regulation).

4 For example, in the various papers delivered at the Energy Day seminar; see n. 2 above.

5 Commission of the European Communities, 2004. *Annual Report on the Implementation of the Gas and Electricity Internal Market*, COM (2004) 863 final, 5.1.2005, p. 6. See especially the Technical Annexes to this Report.

1. The State of Play

By 1 July 2004 Member States were required to implement two comprehensive Directives on Electricity and Gas (the 'E-Directive' and the 'G-Directive' respectively), aimed at accelerating the opening of these markets. They repeal two earlier Directives that attempted to lay the legal foundations for an internal energy market in significantly less robust terms. The Directives are supported by two detailed regulatory instruments that deal with cross-border issues.[6]

The principal achievements of the new legislation are the clear advocacy of regulated Third Party Access (TPA) and the regime on unbundling. The first is intended to promote network access to new market entrants more effectively than either the negotiated form of access or the weak form of regulatory access contained in the previous directives, while the second addresses the barriers to competition created by corporate structure. In both cases, practical success depends largely on institutional enforcement by National Regulatory Authorities (NRAs), which emerge with their policing powers considerably strengthened by these Directives. In contrast to the previous EU legislation, the NRAs are to have a minimum set of competences, with a particularly important role in the regulation of tariffs and access conditions. Moreover, they have an advisory role on implementation of the EU legislation and may take further steps (with the Commission) to deepen implementation through a newly established body called the European Regulators Group for Electricity and Gas (ERGEG).[7]

The Directives have two principal aims: firstly, to increase *quantitative* market opening and bring about full liberalisation (understood as 'market opening') by 2007; secondly, to enhance *qualitative* regulation and bring about more uniformity and co-ordination of national regulation. They introduce a number of new concepts on to the EU energy scene: enhanced consumer protection/universal service obligations for electricity; supplier of last resort; 'green' labelling and compliance programmes, and the idea that major new gas infrastructures such as interconnectors may be eligible for exemptions from pro-competitive measures.

Both the E-Directive and the G-Directive were to be implemented by all Member States no later than 1 July 2004. This is half the time given to Member States to transpose the preceding Directives on electricity and gas. By July 2004 there was to be freedom of choice of suppliers for non-household customers, and all customers are to enjoy this right no later than 1 July 2007. In practice, a number of Member States have already opened their markets entirely to competition, well in advance of the 2007 deadline. There is a possibility of derogations but these are tightly defined.

To ensure that the measures are effective, there are enhanced monitoring and reporting requirements for Member States and the Commission, covering, for example, import of electricity every three months where such imports come from third countries[8] and investment levels.

A separate instrument supplements the E-Directive, in the form of a regulation on conditions for network access in relation to cross-border electricity exchanges. It contains in an Annex a set of Guidelines on various aspects of congestion management. In particular, the Guidelines cover the management and allocation of available transfer capacity of interconnections between national systems. A further regulation is near the completion of its legislative stages and applies to the gas sector.[9] Such

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6 The E-Regulation and the G-Regulation, see n. 3.

7 2003/796/EC: Commission Decision of 11 November 2003 on establishing the European Regulators Group for Electricity and Gas, OJ L 296, 14 November 2003, pp. 34-35. For a detailed account of the provisions of the Directives and Regulations, see Peter D. Cameron, 2005, 'Completing the Internal Market in Energy: An Introduction to the New Directives to the New Legislation', in: Peter D Cameron, (ed.), *Legal Aspects of EU Energy Regulation: Implementing the New Directives on Electricity and Gas across Europe*. Oxford: Oxford University Press, Chapter 2, pp. 7-39.

8 E-Directive, Article 25.

9 See n. 3.

legal instruments are quite different from the framework directives used in electricity and gas, having direct effect in all the Member States and requiring no transposing legislation in the Member States to become effective. The Guidelines to the E-Directive may be added to or supplemented by other Guidelines on topics listed in the Regulation from time to time through a procedure (called 'comitology') that is much faster than a framework directive could ever be. The regulation instrument is also a more comfortable vehicle for the level of detail required in, say, the setting of principles for access charges to networks and the allocation of congested capacity. In the Annex to the draft G-Regulation there is also a set of Guidelines, covering third party access, principles for capacity allocation mechanisms, congestion management procedures and the definition of the technical information necessary for network users to gain effective access to the system, and related matters.

Implementation Issues

The adoption of the Directives and the E-Regulation has for the time being brought to an end the EU legislative agenda on internal market issues concerning electricity and gas (with the exception of the soon-to-be-adopted Regulation on gas). The ball has now been thrown into the court of the Member States. They have the task not only of transposing the above legislation into national law but also of adhering to the timetable for market opening that the Directives require. The structural and regulatory requirements of the Directives impose tasks upon them but also upon the NRAs, which have a clear responsibility to support the spirit and the letter of the new Directives. The Member States have a responsibility to make it possible for them to do so. Essentially, the first steps towards establishing a 'regulatory culture' have to be taken by the Member States, if they have not already done so.

On the face of it, initial reactions to this package have not been encouraging. Only two of the Member States had transposed the Directives into national law by the deadline of 1 July 2004 (the Netherlands and Slovenia).[10] By March 2005 no less than ten Member States (including Germany and Spain) had still failed to transpose one or both of the Directives. The Commission announced that it had sent warning letters to the Member States concerned and was considering action before the ECJ. A particular concern is the failure by Germany, whose full participation in the liberalisation process is of great importance for the completion of the Internal Market for gas, to make significant progress in establishing a regulated TPA regime. At the same time, it should be noted that many Member States have substantially implemented most of the measures in the acceleration package already, and have only minor adaptation requirements to make. It is quite wrong to interpret the delays in full transpositions by Member States as evidence of a widespread refusal to comply or as a 'go-slow' policy towards implementation of the Directives' requirements. The next stage is the more important one: the transposition measures taken by the Member States will be scrutinised by the Commission to ensure that the manner of implementation which they envisage is one that accords with the letter of the legislation. Experience so far suggests that the Commission will find grounds to raise questions about at least some of the national measures notified to it.

Two fairly distinct trends are at work. While one is encouraging, the other must be a source of some concern. Firstly, the processes of legal and institutional reform that are now at work in some Member States are more far-reaching than is strictly required by the Directives. In several Member States liberalisation is at an advanced stage and real efforts are being made to wrestle with the problems of making it work (Austria, the Netherlands and the United Kingdom, for example). In such cases, the response to the most recent EU legislation has been to introduce measures of adaptation and to review any exceptional or transitional measures that exist (for the gas industry in the Netherlands, for example). This vigorous approach on the part of some Member States creates a sense of déjà vu, since it was evident in the implementation of the first Electricity and Gas Directives in the late 1990s.

10 However, it should be noted that the existing legislation of many Member States already contained provisions which satisfied substantially the liberalisation requirements of the new Directives.

However, there is plenty of evidence of a second trend that is less congenial to the liberalisation process. This might—with some irony—be called 'adaptive implementation'. It arises when the Directives' aims seem to challenge some deep-seated feature of a particular Member State's approach to its energy sector. This feature or features could result from long-held policy priorities (France and its attachment to *service public*, or Germany with its historic preference for relying upon the market mechanism backed by competition law to bring about competition in the network industries). It can also arise from constraints based on geographical circumstances, the indigenous resource base leading to import dependence or policy choices on resource development that inhibit the pace at which competition can develop (variously, the Iberian Peninsula, Italy and Greece). The result is a form of implementation that is at best *minimalist* in character but at its worst risks a distortion of one or more of the Directives' liberalising goals.

For the Commission, it is the actions (and inactions) of the Member States that will now determine its future agenda. Its role as watchdog will be evident through the benchmarking reports and through its guardianship of the requirements of the Directives. Evidence of failure in the operation of the Directives once implemented and the emergence of new or underestimated problems will trigger the drafting of new proposals on its part. On the basis of the initial evidence, it seems only a matter of time before there will be Commission proposals for a further, third generation of EU Electricity and Gas Directives. Why might this be so? A brief review of some of the underlying economic trends might shed some light on this.

Market Trends in Competition[11]

There are some important differences between competition trends in the EU electricity and gas markets. From a competition point of view, neither is particularly satisfactory. In electricity there is a discernible trend toward competition, but in both generation and supply there is a high degree of concentration. There are only three or four Member States with six or more significant market participants (generation and supply respectively). In eight or nine Member States there are less than three. This market structure encourages suppliers to become more conservative and not to venture out of their traditional areas or to offer contracts based on stable long term prices. The market power of incumbents is such that any significant price increases are likely to be viewed with suspicion.

Progress has been made with respect to the establishment of principles of regulated TPA, separation of networks and a measure of integration, but the issue of market power remains a serious obstacle to the development of competition which has led to significant trading in electricity. Competitive markets have only developed in a few areas (the UK and the Nordic market) where there are several players.

The gas market presents a different and even less satisfactory situation. The markets remain highly concentrated in the Member States, segmenting the European gas market. In eleven Member States the largest shipper has more than 90% of the wholesale gas market, and fifteen Member States there are fewer than six retail suppliers of gas. While there are more competitors in the supply market, these are often limited to a local area based on an existing distribution zone. In eleven Member States the percentage of available gas controlled by the largest company is greater than 80%. For the most part this follows from the heavy dependence on external supply areas and the resulting international approach to the gas business. The number of competitors in gas production is very limited. In contrast to electricity, the TPA regime for gas is not as well developed or as well regulated. It lacks coherence in the sense that it is not unusual for one aspect of TPA such as tariffs to be favourable but for another such as balancing charges or flexibility arrangements not to be. Another significant limit on the development of competition is the availability of capacity, since at certain points in the network there are long term capacity reservations. Progress so far has been most evident in those areas where there are a number of different sources of gas and where a programme of capacity release has been implemented.

11 This section is based on the Technical Annexes in the Annual Report on Implementation, see n. 5.

From the Commission's reports on the operation of the Internal Energy Market it is clear that there are many potential targets for actions against obstacles to competition. The challenge is less to identify such obstacles than to prioritise them and to do so in a way that recognises that some are more amenable to pressure from the available legal instruments than others.

2. The Instruments

What are the principal legal instruments that the EU has brought to bear to bring about an internal market in energy?

Legislation

For the past 15 years the principal legal driver of energy market reform in the EU has been the *framework directive*, an instrument also used to achieve internal market objectives in the telecommunications and other sectors. It has permitted the introduction of EU-wide common rules for both the electricity and gas sectors. It has facilitated a co-ordinated approach to the sector not thought possible by the application of other instruments such as anti-trust, merger control or by relying on possible ripple-effects from the liberalising policies of several market-oriented Member States. Sector legislation such as this has several justifications but a notable one is the view that *ex ante* regulation is essential for competition to flourish in the network-bound electricity and gas markets. Linked to this is the view that competition law alone, often wrongly characterised as comprising solely a set of *ex post* instruments, cannot achieve this. Instead, regulating for competition by providing a set of explicit common rules in a framework directive has been considered a prerequisite for energy market reform. Within the EU, with its objective of a single integrated market, another consideration is present: this approach to legislation, however slow, allows for a consensus-building exercise among the Member States that ensures that all of them sign up to the final legal measures, increasing their legitimacy and their likelihood of implementation. While other legislative options are available, such as different kinds of directives and decisions, and have been exercised in opening up the telecommunications markets, for example, these have not been thought appropriate to open up the energy markets. Historically, Member States have been most reluctant to cede control over their energy sectors. An approach to market reform that was not based upon a consensus-building approach would almost certainly lack Member State support. They would almost certainly suffer from a *carence democratique*.

The point concerning legitimacy is significant. In contrast to telecommunications, the rate of technical innovation in these industries is slow, even if information technology may be applied to the electricity and gas industries to their advantage. The impact of globalisation, or international competition, is minimal (although evident in the prices of primary fossil fuels). However, the *strategic* element is ever present and highly sensitive, whether defined in terms of continuity of energy supply or access to fossil fuels. These features have long contributed to weakening the force of arguments for energy market integration in the EU, especially among those Member States that are heavily dependent upon imports of gas and oil. They help to explain the strong influence of public service considerations in the electricity and to a lesser extent the gas industry of the EU. They help to make the energy sector a difficult participant in the internal market process.

If the framework Directive approach is limited in what it can achieve, what are the alternatives? In practice, there are two other sets of instruments that have been used to open up the electricity and gas markets in the EU. The principal alternative to sector legislation is the application of existing Treaty rules, and especially those on antitrust and merger control. The other option is the use of codes or guidelines, a form of 'soft law', most visible in the use of the Florence Electricity Regulatory Forum and the Madrid Gas Regulatory Forum to generate a consensus among stakeholders (especially industry) on very specific matters. It might be called 'the Third Way', although it has greater potential for legal enforceability than may at first appear. Each of these alternatives will now be examined.

At the outset, it should be noted, however, that these alternatives have been pursued *at the same time as* the framework directive approach, complementing it and indeed supporting it. They should not be thought of as alternatives in absolute or mutually exclusive terms. The use of competition law, in particular, is sometimes posited as an alternative to sector specific legislation, both by proponents of its vigorous application to the energy sector and by critics of its efficacy. Experience so far has shown that no such polar relationship exists in practice between the two sets of rules and forms of rule-making.

Application of Treaty Provisions

The Commission has a number of powers at its disposal that are of particular importance in the development of competition in electricity and gas markets. EC competition law empowers the Commission to tackle cartels and the abuse of a dominant position, to control mergers and to supervise state aid.

Over the past few years the Commission has exercised these powers and has scored many successes from its actions. These include interventions to promote network access (the Marathon case,[12] access to the UK-France and UK-Belgium interconnectors[13]), to remove obstacles to competition in supply (joint selling in gas involving the GFU[14] and DUC-DONG[15] cases, and territorial restrictions cases[16] (destination clauses), and anti-trust action in the field of long-term supply contracts.[17] Finally, there have been actions in a number of merger cases[18] and in cases concerning state aids.[19] In most of these diverse cases the Commission has sought to obtain assurances, remedies and settlements that contribute to the further development of the internal energy market by encouraging companies to adapt their behaviour on the market. Among the remedies accepted to take away the market power gained through the mergers are innovative measures such as the auctioning of temporary energy generating capacity, the reinforcement of cross-border transmission capacity, and measures to facilitate transmission access by de-bottlenecking transmission or interconnection. This approach was deemed appropriate to the circumstances of *transition* to a liberalised market in which market players had yet to adjust to the new environment. It may be noted that the majority of the anti-trust cases are ones that have been initiated by the Commission in the absence of complaints: in itself, a telling comment on the absence of new market entrants.

The adoption of new sector legislation in 2003-2004 has already triggered a review of the way that competition law is applied in the electricity and gas sectors. This is hardly surprising: the first set of liberalisation directives led to a thorough reappraisal of competition policy in the late 1990s. Until that time the Commission had taken very few actions to apply the competition rules in the electricity and gas sectors, except to remove the legal barriers to imports and exports in some Member States. Even the latter action can be seen as essentially supportive to the proposals for directives on electricity and gas in the early to mid 1990s.[20] Once these sector-specific directives were in place, the guiding thread in competition policy in this area was to apply the law in ways that *complemented* the liberalisation measures of the directives. This notion of complementary action co-existed with the idea that

12 Commission Press Releases IP/01/1641 of 23 November 2001; IP/03/547 of 16 April 2003; IP/03/1129 of 29 July 2003; IP/04/573 of 30 April 2004.

13 Commission Press Release IP/01/341 of 12 March 2001; IP/02/401 of 13 March 2002.

14 Commission Competition Report 2002, pp. 207-208.

15 Commission Press Release IP/03/566 of 24 August 2003.

16 Commission Press Release IP/03/1345 of 6 October 2003.

17 Commission Competition Report 2002, pp. 154-155.

18 Commission, Case M 1383 Exxon/Mobil; Case M 1673 Veba/Viag; Case M 2434 Group Villar Mir/EnBW/Hidroelectrica Del Cantabrico; Case M 2947 Verbund/Energie Allianz; Case M 1853 EDF/EnBW; Case M 2822 ENBW/ENI/GVS.

19 Commission Press Release IP/01/1077, 25 July 2001; Competition Report 2001, pp. 106-107; IP/03/1737, 16 December 2003.

20 P. Cameron, 1998. 'Towards an Internal Market in Energy—The Carrot and Stick Approach', *European Law Review*, 23, pp. 590-591.

competition policy has to be applied in a *dynamic* way to markets that are currently in transition to a single market.[21] Clearly, such a policy has to be adapted in the light of several factors: experience gained from applying the law and lessons learned from specific cases; changes in the content of the sector legislation, and the stage of the single market process. Moreover, the impact of these factors can be expected to differ according to the measures concerned.

In spite of the undoubted impact of the Commission's competition policy so far in electricity and gas, there are reasons for believing that the strategy developed in response to the first directives is no longer adequate. The second Directives and E-Regulation have set new targets to be met in the few years remaining until the internal market is scheduled to be completed. The modest results that the Commission has so far been seeking in its competition enforcement actions—entirely compatible with the modest aims of the first directives—can make only a very small contribution to meeting this timetable. Given the challenges facing the current timetable for completion of market opening in energy, and the more ambitious aims of the second directives and related instruments, it is hard to see how a continuation of such a cautious approach could be justified. The decision taken by the Commission in the Gas de Portugal case in December 2004 showed a new resolve and may herald a stricter approach to merger control.[22] This will be of small comfort however to those who argue that the long term damage has already been done by the mergers of firms in the larger Member States, and that the assurances and undertakings given by the merging companies have not always been honoured.

Coincidentally, the acceleration package has been adopted at a time when EU competition law has been in a sense 're-nationalised'. Considerable powers have been returned to the national competition authorities as a result of a modernisation of anti-trust rules. This has created a new potential for enforcement actions to be taken through the European Competition Network (ECN) comprising national authorities and the Commission.[23] This offers opportunities for synergies and a greater and perhaps more forceful impact than has been possible so far. Indeed, there are already instances of a pioneering anti-trust and merger enforcement by competition authorities in certain Member States such as Spain, the Netherlands and Denmark. Almost all of the competition authorities have dealt with cases involving mergers in electricity and gas, while a number of them have investigated presumed abusive behaviour by energy companies such as those involving long-term agreements, refusal to supply and access pricing issues. In this connection, it may also be noted that the Commission has made efforts to develop international networks of competition authorities to share experiences with competition bodies located outside the EU.[24]

In the light of the above developments, it is not surprising that energy has acquired a priority status both with the Commission competition authorities and with many, if not all, of the national competition bodies. Evidence of this lies in the choice of this sector for a wide-ranging review by the Commission in 2005-2006. Under Regulation 1/2003 the Commission has powers to conduct investigations in sectors where competition does not appear to be functioning as well as it might.[25] Given limited resources, the Commission has decided to focus on only two sectors during this period:

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21 M Albers, 2002. 'Energy Liberalisation and EC Competition Law', in: B. Hawk, (ed.), *International Antitrust Law and Policy*. New York: Fordham University School of Law, chapter 15, pp. 393-421.

22 Commission Press Release IP/04/1455: the incumbent electricity company, EDP, proposed to take over GDP jointly with ENI, an Italian energy company, strengthening EDP's dominant position in the wholesale and retail markets in Portugal and GDP's dominant position in the Portuguese gas market.

23 See the Commission's Notice on Guidelines on the application of Article 81(3), which establish an exemption from the provisions of Article 81(1). In general, on the subject of the EU competition network, see the comprehensive and authoritative collection of articles in, C. D. Ehlermann and I. Atanasiu, (eds.), 2005. *European Competition Law Annual 2002: Constructing the EU Network of Competition Authorities.* RSCAS European Competition Law Annual Series, vol. 7. Oxford and Portland, Oregon: Hart Publishing.

24 Competition Annual Report 2003.

25 Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in arts 81 and 82 of the Treaty OJ L 001, 04/01/2003, 1-25, especially Art 17.

energy and financial services, since both markets are central to the EU's overall competitiveness. The sector review process will involve consultations and eventually lead to proposals for solutions to obstacles to competition once these are identified. This may involve priorities for Commission case work or recommendations about both EU legislation and national legislation and the way they are applied. The conclusions may include recommendations for anti-trust actions or for other changes to the legal and regulatory environment. It is a process that will be carried out in close co-operation with the ECN and the NRAs. It is important to emphasise that in addition to analysing the operation of the electricity and gas sectors, the review will have a focussing function on proposals for improvements. Many options will be possible but few will be chosen.

'Soft Law' Mechanisms

The Regulations on electricity and gas (respectively, adopted and proposed in 2004) as part of the acceleration package of measures have included Guidelines on very specific matters in Annexes. These instruments rely heavily on input from the so-called Florence and Madrid Regulatory Forums on respectively, electricity and gas.[26] The Forum concept has been a means through which the principal sections of industry has been able to contribute to and shape the various soft law measures designed to facilitate action in specific areas in which action is considered essential to take the internal market process forward. It has been the means through which the regulatory authorities, the industry including TSOs, consumers and traders, and the relevant government departments, have met from time to time to discuss ways of deepening the implementation of the EU legislation. The concept has recently been expanded to permit the holding of regional mini-forums on electricity in various parts of the EU.

The agreements reached through the Forum process have seemed to justify the term 'regulation by co-operation'.[27] Instructions are given to the parties at each meeting to report on specific matters for the next meeting and a linkage has also been established between this process and the implementation of the sector Directives. In this voluntary process, expectations are raised about future actions, and their response is scheduled to be reviewed at the following meeting. Meetings have been held roughly twice a year although recently the frequency has declined. The leadership of the Forum has been shared between the Commission and the Council of European Energy Regulators (CEER).

The limitations of the Forum process have proved to be considerable. They have shown themselves in different ways in electricity and gas. In the electricity sector, an impasse was reached in discussions on congestion management guidelines at the Eleventh Electricity Forum in September 2004. These were supposed to be incorporated into the Electricity Regulation but instead are only being applied provisionally in the absence of an agreement in the Forum. As a way out of the deadlock, the discussion shifted to a series of regional meetings called mini-forums, involving regulators and TSOs. This may lead to adoption of a revised set of guidelines but probably not before 2006. This is not the first time that an impasse has been reached in the Electricity Forum.[28] In the gas sector, the reluctance of the industry to make adaptations to the climate created by the very modest provisions of the first gas directive drew attention to the absence of teeth in the Forum process. In 2004-2005, there have been similar difficulties in making progress with the establishment of guidelines on access to gas storage facilities. There are other shortcomings—apart from its lack of teeth—in the Forum process as an alternative to legislation. Most importantly, it is slow, with consensus being built up gradually among the various participants. With the key deadlines for completion of the internal market approaching, it

26 For a detailed assessment of the Florence Electricity Regulatory Forum see, Burkhard Eberlein, 2005. 'Regulation by Co-operation: the 'Third Way' in Making Rules for the Internal Energy Market', in: Peter D. Cameron, (ed.), *Legal Aspects of EU Energy Regulation: Implementing the New Directives on Electricity and Gas across Europe*. Oxford: Oxford University Press, chapter 4, pp. 59-88.

27 J. Vasconcelos, 2001. 'Co-operation between Energy Regulators in the European Union', in: C. Henry, M. Matheu and A. Jeunemaitre, (eds.), *Regulation of Network Utilities*. Oxford: Oxford University Press, pp. 284-289.

28 See Conclusions from the Florence Regulatory Forum meetings, 2002: www.europa.eu.int

could be argued that progress at such a slow rate is no longer appropriate. However, if the electricity or gas industry and/or other parties do not agree with a proposal, there is always the threat that legislation may be introduced to resolve the deadlock. If they do agree, there is the possibility—perhaps now the probability—that the resulting codes of practice or guidelines will be given legislative form by incorporation in an Annex to the E- or G-Regulation in any case to 'consolidate' the regime and to harmonise with existing legislation.

The specific outcomes of the Forum processes are now becoming a part of the law applicable to the electricity and gas industries. The potential of 'soft law' measures such as Guidelines, annexed to Regulations, should not be underestimated. They are binding on the persons to whom they are addressed (in the case of the E-Reg Guidelines, this category is the TSOs), who have an obligation to implement them. Their interpretation may not be uniform across the EU, which could throw up obstacles to the internal market, but this is more likely to arise when the Regulations are drafted in general terms. In the case of the G-Regulation, in which the drafting of the Guidelines is very specific, it is unlikely that many problems of interpretation will arise: after all, the Guidelines are based upon the second version of Guidelines for Good TPA Practice agreed by the Madrid Gas Forum. If the TSO's were to insist on differing interpretations of the Guidelines, the Commission could, using the Comitology procedure, amend the text of those Guidelines which contains the disputed interpretation so that the obligations which the Commission wishes to impose on the TSO's are created. Under Article 8(1) of the E-Regulation, the Commission's has the power to amend Guidelines, enabling it to compel TSO's to comply with the texts of Guidelines which are determined by the Commission, following the comitology procedure. In other words, the Guidelines do not *in the last resort* rely for their effectiveness on the willingness to co-operate by the parties most affected. In that sense, they are not 'soft law' in the sense of being difficult or impossible to enforce, and they do not rely entirely on the co-operation of the parties most affected for their implementation. It may be noted that the wording in the draft G-Regulation is drawn more tightly over the issue of making further guidelines by this procedure.

The establishment of the ERGEG in 2003 inevitably raised a question about the continued need for the Forum process. Historically, the Forum process was extremely useful and constituted an important initiative of the Commission immediately after the first liberalisation directives. However, it might be thought to have peaked in terms of its importance in the process of developing 'soft law' instruments as a result of the establishment of the ERGEG, which will work with the Commission and consult with industry and other parties according to a clear set of rules. The decline in the number of meetings of both of the Forums in the past couple of years (and subtle shifts in their operating procedures) might also suggest that their relevance has been undermined by this further development of the NRAs' network and perhaps at a later stage by the procedures for the making of soft law under the E- and G-Regulations. The above analysis of the Guidelines annexed to the E-Regulation adopted in 2004 suggests however a fairly positive interpretation of the instruments agreed upon through the Forum processes so far. Indeed, a harmonious and constructive interplay between the ERGEG and the Forum processes seems to be envisaged by the consultation procedures adopted by the ERGEG itself.[29] That said, the trend for the ERGEG to take the leading role in discussions on matters that are destined to produce Guidelines has already been evident in the debate on the draft gas storage guidelines in 2004-2005.

3. The Opportunity—A Regulatory Culture Begins to Emerge

If one were asked to identify a single factor responsible for shaping the current EU regulatory framework for the electricity and gas industries, it is the determination of the Member States to resist the emergence of a single European energy regulatory authority. The heterogeneity of NRAs and the creation of regulatory associations with important co-ordinating roles is the result of this resounding '*non*' to the idea of a single federal-style regulatory body. The entire construction that is currently being developed

29 www.ergeg.org

gives the lie to any suggestion that a single energy regulator might emerge in the EU in the foreseeable future. That said, the Member States have now—with the implementation of the acceleration package—a strong interest in encouraging cohesion and co-ordination among the diverse regulatory bodies that make up the complex EU regulatory structure. They include not only NRAs and national competition authorities but also administrative and quasi-judicial bodies as well as environmental authorities. Questions about competence have to take into account the very different stages of maturity of the various bodies with regulatory authority and their relations with their 'host' government departments.

The instrument of the framework directive has been used to encourage the spread of NRAs in the electricity and gas sectors of EU Member States and to ensure a minimum set of competences for them. Since the Directives expressly require a co-ordination of NRA activity inter se and between NRAs and competition bodies, it may be said that they aim to establish, albeit implicitly, nothing less than a 'regulatory culture' in the EU energy sector. A summary of many of the sweeping changes which the Directives have introduced is contained in Annex A of this paper. These changes serve to underpin the emerging EU regulatory architecture.

While the first Directives approached the establishment of a co-ordinated EU regulatory framework in a way that was both hesitant and imprecise, the second Directives more than compensate for this unpromising start by setting out minimum requirements for the functions and competences of sector regulatory bodies charged by the Member States with supervising the electricity and gas sectors. Their independence from the electricity and gas industries has also to be guaranteed.[30] More than this, they require the NRAs to co-ordinate with each other and to liaise with the Commission from time to time. While Member States have discretion at many points about how exactly they meet the requirements, the outcome is likely to be a very different, more pervasive and significantly less politicized regulatory environment in the near future—if the Member States permit such a loosening of State control.

In each Member State there now exists a 'holy trinity' of enforcement agencies, comprising a lead ministry, a sector regulatory agency and a competition authority (sometimes a competition court). The differences in development of their relationships *inter se* and the relative independence of the new bodies from political control may vary considerably from one Member State to another. Indeed, there is no requirement to limit the number of sector regulatory agencies to one; more may be established if the Member State considers it appropriate for reasons of regional policy, for example. In some cases, administrative instruments such as guidelines and concordat-style agreements have been developed in the Member States to avoid duplication of effort between the respective authorities and to minimise conflicts over competences. In other cases, however, the relationships within government appear to be at an early stage of development. For example, in two very different regimes, Germany and Greece, the regulatory authority is in need of considerable development vis-à-vis the Member State ministries to comply with the minimum conditions of powers and independence that are required by the Directives. Yet, in spite of the foregoing, the sector regulator has, in a number of cases, already had sufficient roots for the proper exercise of his regulatory powers and as a result of its published decisions, a distinct body of jurisprudence has begun to build up (Austria, Italy and Spain are examples, in addition to the Netherlands and the UK).

Finally, the role of the courts in reviewing exercises of regulatory authority should not be neglected. In some Member States (the Netherlands, for example) this has already played a role in constraining the scope of the regulatory bodies. Where a written constitution provides protection for private property there may be a basis for challenging the more ambitious attempts to tackle market structure by rigorous unbundling requirements. The European Convention on Human Rights should be noted as an influence on the administrative law framework in which regulators operate. This factor is significant in the UK, for example, where it represents a very recent addition to the regulatory

30 There are no specific provisions against interference by Government but the EC Treaty requires Member States to abstain from any measure which could jeopardise the attainment of the objectives of the Treaty (Article 10): in this case, this would be the creation of the internal market in energy.

landscape. The Charter of Human Rights contained in the draft Treaty on a Constitution for Europe can also be expected to play an important role if the Treaty is eventually adopted. As the powers of regulators expand with the implementation of the new Directives, it can only be expected that they will increasingly be subject to scrutiny by the courts as to their operation and scope. As they explore their new powers, the NRAs will find themselves in such kinds of new territory.

Regulation as a Process

The regulatory framework envisaged by the Directives and Regulations confirm that energy regulation in the EU is intended by the Commission and by the Member States to develop as a *process, and that we are still at a fairly early stage in that process*. The Directives on Electricity and Gas are the second framework laws made at EU level, repealing their predecessors and other less ambitious legal instruments that have served their purpose in a legislative programme that began as long ago as 1990. The Directives and the E-Regulation (and the impending G-Regulation) consolidate trends evident at Member State level and codify the progress made in the Forum settings. However, experience suggests that they will also act as catalysts in the *continuing* evolution of regulation in the Member States.

Evidence of this can already be found at this early stage in the development of soft law measures such as guidelines and codes of practice. These are being developed on the basis of an extended framework of *institutional* support. Taken together, the introduction of comitology and establishment of a special advisory body in the form of ERGEG, to build upon the tried and successfully tested Forum mechanisms, permitting a dialogue with industry and other non-governmental stakeholders, all suggest that soft law is accompanied by the use of a 'soft' institutional framework. This should act to deepen the impact of the Directives and Regulation(s).

Another 'process' feature concerns the NRAs. The impact of the Directives' requirements on harmonisation of national laws is likely to be accompanied by a further development of the powers of NRAs. Originally, the NRAs sprang up in response to specific national circumstances. The resulting diversity created a patchwork of regulatory entities with widely differing powers. The new legislation may rein in this heterogeneous regulatory development, with Member States such as Finland, Greece, Germany and Sweden being required to abandon their preference for *ex post* regulation. However, this is likely to prove a temporary brake, as some Member States and NRAs design a national regime that goes beyond the minimum competences in the Directives, and as both Member States and NRAs interpret the provisions differently. Pressure on the design and operation of regulatory regimes can also be expected to come from the enhanced co-operation between NRAs and the Commission. This will be in the direction not only of harmonisation but also of strengthening the NRAs' role vis-à-vis Member State governments. At the same time, the relationship between the NRAs and the ministries in their respective countries that have competence for energy matters can be expected to produce some frictions. The 'regulatory culture' is still a recent phenomenon in most Member States, so it is unlikely that the inter-relationship between these two partners will free from tensions.

For industry, this regulatory evolution is a prospect that is viewed with some apprehension. A report from the EU electricity industry association, Eurelectric, declared:

> Regulation is the single most important factor facing electricity utilities in the foreseeable future. The action and decisions of these sector specific regulatory authorities affects core company revenue, business processes, customer service, company structure and the nature of competition for most utilities.[31]

There is a genuine issue here of whether the expansion of regulatory powers will lead to companies becoming over-burdened with regulation and creating disincentives to the kind of large-scale

31 Eurelectric Report, 2004. *Regulatory Models in a Liberalised European Electricity Market*. January, at p. 2.

investment that is currently required in new and in ageing infrastructure. In the new context, what rate of return is an investor likely to get? What view will regulators take about profit? There is some evidence that such concerns are being treated seriously by the Commission in its emphasis upon quality of regulation ('better regulation'). However, two developments underline the ongoing concerns that industry (or some sections of it) may appear to have. Firstly, a new Directive on Electricity Security of Supply was introduced in 2003 and then rejected by the Council on the ground that it was unnecessary, a view shared generally by industry. It would have imposed an additional regulatory burden that was viewed as superfluous. Secondly, the need for investment in infrastructure—both new and ageing—requires mobilisation of major sources of capital. Without some exemptions from the scope of the second directives, such investment is unlikely to be forthcoming. The exemptions regime in the Gas Directive is one response to this, and its operation is still untested.

So far, the Forum process has shown that the various sides of industry are welcomed by both the Commission and the NRAs to contribute to the making of the detailed rules, regulations and guidelines for electricity and gas that are essential if the liberalised electricity and gas markets are to work well. New consultation procedures agreed by the ERGEG support this conclusion that industry input is welcome by the NRAs. However, one can expect that this positive view is shared by most but not necessarily all parties in the regulatory process.

4. Making the Instruments More Effective

The previous section had a lot to say about the impact the Directives have made by underpinning the NRAs' role as custodians and promoters of market opening. Of course, the Commission itself retains many supervisory and monitoring powers over the internal market process. This is particularly evident in the use of benchmarking reports, its role in the Forum processes and in supervising the transposition of the Directives. It may also bring forward proposals for new directives or regulations if it considers this is appropriate: for example, if it finds that the minimum standards set for regulatory independence in the Directives are too low or are not respected. It may also, subject to some conditions, take action to revise the Guidelines attached to the E- and G-Regulations, on matters such as TPA, congestion management and transparency requirements, if it considers this to be appropriate. For the moment however, it would be fair to say that the NRAs are in the front line in acting to promote competition and remove barriers to market opening.

In the front line too stands the Commission in its role as competition authority. In section 2 the principal areas of interest of DG Competition were set out with respect to electricity and gas (increasing energy supply competition, network related enforcement and freedom of customer choice, including challenging long-term agreements). It was noted that the decentralisation of competition law enforcement and the new ECN system offers scope for a different approach to competition policy in this area. The sector review will be a test of the Commission's mettle in this respect and of the initial workings of the new system. As the previous section shows, another factor that DG Competition, and indeed the ECN, has to take into account is the network of sector regulatory authorities, the NRAs. Some tasks will be best left to the NRAs but in other areas such as tackling the effects of long-term contracts there could be an overlap of competence, leading to friction and duplication of effort. Moreover, just as some NRAs are likely to be more pro-active than others, some competition authorities are likely to be more willing than others to engage in innovative and pioneering approaches to familiar problems. An example of an innovative and constructive approach is surely the guidelines introduced by the Bundeskartellamt in January 2005. They are worthy of note.

In a highly critical review of long-term contracts in the German gas industry, it concluded that such contracts are a major impediment to competition. To change this, it set out a set of principles that could be followed. Although these are not legally binding on the courts, the 'Principles of Evaluation of Long Term Gas Supply Contracts under Competition Law' contain several criteria according to which future gas supply contracts between wholesalers and distributors could be assessed under

competition law.[32] They calculate thresholds on the basis of actual requirements rather than contractually agreed quantities. For contracts of 2 to 4 years duration, the total contractually agreed supply provided by the main supplier must not exceed 80% of the actual requirement, while for longer term contracts, a secondary supplier must have the opportunity to effectively obtain at least 50% of the actual requirement. A second criterion states that the share of the financial risk assumed by the secondary supplier must not exceed his share of the total contractual supply quantity. A third criterion stipulates that several supply contracts between supplier and customer are to be considered as one contract in terms of their effect, in effect stopping any attempts at cheating through linking several short term contracts together into one contract de facto. The substantive contribution of the German competition authority's thinking on exclusivity arrangements, based also on discussions with the European Commission, is considerable, not least in its arguments in connection with a justification of exclusivity in relation to security of supply and financing. It is also notable is its willingness to take the initiative, at a time when the NRA in Germany is still limited in its operational scope.

The kind of actions taken by the German competition authority, in consultation with the European Commission, might give an early indication as to how the ECN system might work in providing significant support to the development of the internal market in gas, where long-term contracts act as a major impediment to competition (the situation in electricity, except among the new Member States is different). Nor is it the only competition authority to have sought innovative initiatives: the Danish competition authority is another example. It would be logical for the Commission to provide support when required for such initiatives. However, not all competition authorities are likely to be as pro-active, either because they are not as mature or because they have other priorities.

In general terms, two important tasks will fall to DG Competition. Firstly, it will have to monitor, in conjunction with the NRAs and the other parts of the Commission, the operation of the competition network to ensure that potential conflicts and duplications of effort are avoided. This is essential if confusion is to be avoided—and for potential investors, to avoid the kind of regulatory uncertainty that may be fatal to the taking of a major investment decision in new or ageing infrastructure. The absence of large-scale investment in such facilities may already have done considerable damage to the creation of competition in the EU. Secondly, it has to show greater leadership than was necessary before the adoption of the second E- and G-Directives. To a large extent this involves positive support to those innovative national competition authorities as mentioned above, but also a continuation and intensification of the supportive approach it has adopted in recent years. Some evidence of this was evident in the GDP case in 2004, but much more is required vis-à-vis the larger Member States for this initial sample of evidence to constitute part of a trend to a stricter competition policy for the electricity and gas sectors.

Ultimately, an enhanced role for competition law in the electricity and gas sectors is constrained by the simple fact that some problems are beyond its reach. The crucial problem of market structure, discussed in section 1, can be tackled only to a limited extent by means of measures against abuses of a dominant position. The NRAs have greater scope to press for change through a rigorous application of unbundling measures. The instrument of merger control is certainly available, but it may be argued that in this case, the damage has been done already by allowing a series of mergers through in the years prior to the adoption of these new Directives (even taking into account the constraints placed on the parties involved). On access to interconnectors, competition policy has to take into account the balance between competition aims and the large-scale financing required for these facilities (and their eventual reinforcement): in practice, this is a very significant constraint. In these areas, the NRAs should take the lead unless they prove unable or unwilling to do so.

32 Bundeskartellamt, 8th Decision Division, B3—113/03, 25.1.2005.

Conclusions

1. There are two limits to the effectiveness of **any** of the three instruments discussed in this paper, whether individually or in combination. Neither limit is legal in character. Firstly, some of the key elements in a liberalised market such as network access and ownership unbundling, as well as independent regulation, are still of very recent origin in a number of Member States, with Germany as a conspicuous and important example. The efficacy of any of the above instruments suffers as a result. Secondly, liberalisation of electricity and gas markets—whether in the EU or elsewhere—is usually a slow process and therefore the pro-competitive instruments have to be applied in a persistent (and sometimes opportunistic) manner for success to be achieved. Any assessment of the EU instruments' potential or track record has to take these factors into account.
2. With respect to the first and primary instrument—legislation, any assessment about its effectiveness must be a provisional one. It is still too early to gauge the impact of the second generation of legislation on electricity and gas. The package entered into force on 1 July 2004 but the slow approach to transposition and indeed the manner of implementation in some Member States has rightly given the Commission some cause for concern. The operation of the E-Regulation should be easier to assess since no transposition is necessary. A simple test of operability can be applied: does it work to achieve its objectives? Again, initial signs have given rise to concerns but—as a part of the overall package of measures and dependent upon them for full operation—it is still too early to reach a firm conclusion. However, the narrow time-frame between entry into force of the Directives and Regulation and the date for 'completion' of the internal market means that an assessment of their impact will have to be made soon, at the latest by the end of 2005, if further action is to be taken to meet that deadline. If the assessment discovers areas where improvement is required, a further legislative initiative seems likely. A future directive might cover a much narrower range of issues since public service obligations, consumer protection and security of supply seem to be well served by the current legislation. The subjects of market structure (further unbundling) and regulatory regime design would seem to be prime candidates for inclusion if, in the course of 2005, it becomes clear that they are presenting barriers to market opening.
3. With respect to the second instrument, there appears to be scope for greater effectiveness. So far, the role of competition law in the single market process has been one that complements and supports the sector specific legislation embodied largely in the framework directives. Given the very limited aims of the first generation of directives, this strategy may have been understandable. This is emphatically no longer the case. The modernisation of competition law enforcement, and the criticisms of these earlier efforts (for example, that undertakings given as a result of the merger control process are not being honoured) make this earlier role untenable. The existence of a decentralised competition network, comprising often quite mature authorities, offers a new and very encouraging dimension to pro-competitive actions in the EU energy market. Against this, it is clear that some competition authorities are likely to be more vigorous and innovative than others in this respect, and that the existence of the network alongside a new network of sector regulatory authorities poses challenges of co-ordination for both sides.
4. The use of soft law instruments and the 'soft institutional setting' of the Regulatory Forum has been valuable and is likely to continue in spite of evident weakness in relation to the other two instruments. It contains a strong voluntaristic element. The role of Guidelines as legally enforceable instruments has been highlighted in this paper, even though it remains untested and subject to vigorous debate. The institutional setting for the development of the Guidelines' content may change with the development of the ERGEG and its public consultation procedures. The Forum setting may turn out to be too loose, too informal and too closely co-ordinated by the European Commission for the making of detailed rules than the mechanisms provided by the ERGEG. It seems highly unlikely that this particular institutional mechanism (the Forum) will continue indefinitely in its present form.

5. The main challenges in making progress in the single energy market task lie with the NRAs, and especially with the bodies that have a representational role for them on the EU stage, the ERGEG and the CEER. They have an important role too in advising on the modalities of co-operation between sector regulators and competition authorities. At the same time, there is already some evidence that their powers vis-à-vis their own governments are fragile in a number of Member States. Their independence is a matter that may require further legislative support at the EU level.
6. It might be argued that the use of the instrument of an EU framework directive leads inevitably to a situation in which regulatory intervention in the interests of harmonisation is necessary after adoption. If this is correct, a significant difference between these Directives and their predecessors is that they take effect when the timetable for market opening is much further advanced, with formal completion by 2007 in sight. The diverging patterns triggered by the first generation of directives are therefore less likely to emerge, and the mechanisms for taking remedial action are certainly more extensive under the second directives than before.
7. One thing is very clear from recent experience. If the timetable for completion of the single energy market has any chance of being met in the near future, action has to be taken to improve the efficacy of the existing legal instruments. In doing so, a *vast potential now exists in the new institutional framework in the Member States (NRAs and competition authorities), which could be drawn upon to support the new Directives. If the many different actors can be encouraged to focus their efforts on an agreed list of priority issues, such a channelling of skills and experience would do much to restore vigour to the application of law in this area.*

Recommendations

1. The CEER and ERGEG have an important role at this juncture in taking steps to ensure a positive development of the relationship between energy regulatory and competition authorities in the Member States, with as much harmonisation of principles and practices as is required to create a level playing field. In 2003-2004 the EU institutions have put the legal architecture in place, but in the short to medium term the next steps will require action by a different set of actors: Member States, NRAs, and national competition authorities. The CEER and ERGEG should ensure that from the outset regulatory competition and confusion is minimised. To do so, they might consider drawing up a set of Guidelines for Co-operation between the two sets of authorities on issues affecting the electricity and gas sectors. However, the institutional design of co-operation is less important than the end result, and indeed the expression of a wish to co-operate.
2. A more vigorous application of competition law is now required, both by the European Commission and by the national competition authorities. The possibility that this could be done in a harmonised and systematic way is greatly increased by the existence of the ECN. Given the stage that the single market process has reached, the obstacles that remain to be overcome by 2007, and the establishment of a new system for competition law enforcement, there has to be a significant tightening up and probably expansion of the competition authorities' role in the EU electricity and gas sectors. This should take the form of some high-profile cases that would establish general precedents. It should also involve encouragement of and support for innovative solutions by national competition authorities, involving gas-release programmes, pro-competitive interpretations of long-term contracts and measures aimed at tackling problems created by the current market structure. In achieving this, the work of the Competition Directorate's sector review could be of great importance. The Commission has powers to require companies and associations to deliver to it information in various forms including agreements. On the basis of this information, it should be possible for the Commission to build up a case against incumbents if an abuse is found to be widespread (say, in capacity reservation in long term gas supply contracts) and to propose solutions.

3. A principal advantage of the Forum processes was their incorporation of industry input and the channelling of it into the processes of regulating on important matters of detail in EU energy law and regulation. Such input is crucial for the design of measures that achieve a balance between the goals of security of supply, a continued and robust financing in infrastructure, and a recognition of commercial realities generally, with the wider goals of market opening and the achievement of a single market in energy. This role for industry should continue within the developing ERGEG procedures, especially if (as we expect) the Forum processes exhibit a relative decline in influence in the discussion of soft law measures.
4. The non-EU regional dimension of the Internal Market in Energy programme should be reviewed. The legal instruments under consideration in this paper have a remit in the 25 Member States, but that is tested severely when they are confronted with the realities of the international gas market. While electricity fares much better in this respect, the implementation of the Gas Directive has been continually slowed by policy considerations that have more to do with external relations than the internal market. The pragmatic but principled approach taken by the Commission in the destination clauses cases should be applied in other cases when internal market principles and European law tackle arrangements between EU companies and non-EU suppliers.

Table 1: Timetable

Date	Event
July 2004	Entry into Force of E- & G-Directives and E-Regulation: market opening for non-household customers and legal/operational unbundling
End 2004	Fourth Benchmarking Report/first under Art 28(1) and 31(1) of the new Directives
Jan. 2005	Emissions Trading Scheme commences operation
End 2005	Fifth Benchmarking Report/second under new Directives, covering public services issues and matters related to full market opening by 2006/7
July 2006	Entry into force of Gas Regulation Report on implementation of E-Regulation
July 2007	Full market opening Proposals to Parliament and Council to ensure full and effective independence of DSOs. When necessary, they will address issues of market dominance, market concentration and predatory or anti-competitive behaviour

Annex A: Summary of Regulation under the E- and G-Directives

The legal status of NRAs has been significantly enhanced in two ways.[33] Firstly, there is an obligation on Member States to charge one or more competent bodies with the function of regulatory authorities. The requirement is more precise than in the previous directives.[34] However, regulatory functions may be spread over several authorities if that is deemed appropriate by the Member State, permitting, say, local or regional regulatory bodies, but also a combination of NRA, ministry and say, a competition authority. The independence of the regulatory authority (or authorities) is obligatory but is defined in relation to the interests of the electricity and gas *industries* rather than in relation to existing government structures. Nonetheless, those Member States with state-owned utilities may have to develop mechanisms to separate the regulatory authority from the ministerial body that supervises the state-owned energy utility. In addition, Member States are required to take measures to ensure that the regulatory authorities are able to carry out their duties in an efficient and expeditious manner.[35]

Secondly, while Member States continue to set out the functions, competences and administrative powers of the regulatory authorities, a minimum set of functions and competences is set out in the Directives in the interests of harmonisation.[36] In particular, their supervisory role over network access and the setting or approval of network tariffs (or at least the methodologies underlying the calculation of the tariffs) has been given a basis in European law. An additional development of importance is the enhanced European co-operation and co-ordination that the Directives and supporting measures provide.[37] In this way, the decisions of NRAs could be—and should be—harmonised.

What the Regulator Must Do

The Directives set out three general responsibilities for the NRAs: to ensure non-discrimination, effective competition and the efficient functioning of the market.

More specifically, they specify a list of eight activities that constitute the minimum that the NRAs shall monitor. Each item listed has to be included in an annual report on the outcome of monitoring. The activities are:

- The rules on the management and allocation of interconnection capacity (in conjunction with the regulatory authority or authorities of those Member States with which interconnection exists);
- Any mechanisms to deal with congestion on the national electricity or gas network;
- The time taken by transmission and distribution system operators to make connections and carry out repairs;
- The publication of appropriate information by transmission and distribution system operators concerning interconnectors, grid usage and capacity allocation to interested parties, taking into account the need to treat non-aggregated information as commercially confidential;

33 Art 23 E-Directive and Art 25 G-Directive.

34 Compare the wording in Art 22 of the first Electricity and Gas Directives: 'Member States shall create appropriate and efficient mechanisms for regulation, control and transparency so as to avoid any abuse of a dominant position'. In practice, however, the regulatory competences of national authorities have usually gone far beyond this. This wording reappears in the new Directives as Art 23(8) E-Directive and Art 25(8) G-Directive.

35 Art 23 (7).

36 Recital 15 E-Directive; Recital 13 G-Directive. There are also some requirements imposed by the Directives on Member States that they may elect to devolve to NRAs, such as those on providing tendering procedures for additional capacity in the interest of security of supply and ensuring that reliable information is provided to customers about the energy sources for the electricity supplied.

37 Recital 16 E-Directive; Recital 14 G-Directive. Commission Decision of 11 November 2003 on establishing the European Regulators Group for Electricity and Gas, 2003/796/EC.

- The effective unbundling of accounts to ensure that there are no cross subsidies between generation, transmission, distribution and supply activities (and in the case of gas, storage and LNG);
- The terms, conditions and tariffs for connecting new producers of electricity to guarantee that these are objective, transparent and non-discriminatory, in particular taking full account of the costs and benefits of the various renewable energy sources technologies, distributed generation and combined heat and power; in the case of gas, this activity is defined as the access conditions to storage, line pack and other ancillary services;
- The extent to which TSOs and DSOs fulfil their tasks in accordance with the Directives' provisions, and
- The level of transparency and competition.

Tariff Supervision is Key

In addition to the monitoring functions, the Directives charge the NRAs to be responsible for fixing or approving, prior to their entry into force (*ex ante*), at least the methodologies used to calculate or establish the terms and conditions for the connection and access to national networks, including transmission and distribution tariffs.[38] These tariffs, or methodologies, are to allow the necessary investments in the networks to be carried out in a manner that allows these investments to ensure the viability of the networks. In addition, the NRAs are to be responsible for fixing or approving the methodologies used to calculate or establish the terms and conditions for the provision of balancing services.

This regulatory power on the fixing or approving of tariff methodologies may be limited, since Article 23 (3) E-Directive and Article 25(3) G-Directive provides that Member States may require the NRAs to submit for formal decision to the relevant body in the Member State the tariffs or at least the methodologies. In such cases, the relevant body may have the power to either approve or reject a draft decision submitted by the regulatory authority. These tariffs or methodologies or modifications relating to them are to be published together with the decision on formal adoption. Any formal rejection of a draft decision is also to be published together with the reasons for its decision. Both TSOs and DSOs (and in gas, LNG operators) may be required to modify their terms and conditions, tariffs, rules, mechanisms and methodologies by the NRAs to ensure that they are proportionate and applied in a non-discriminatory manner.[39]

Cross-Border Issues

On issues arising from cross-border electricity transfers, the NRAs are required to:

- Approve operational and planning standards of the TSOs, including schemes for the calculation of the total transfer capacity;[40]
- Decide on exemptions to normal access rules for new investments,[41] and
- Ensure compliance with all guidelines adopted under the Regulation, and impose fines, where necessary, for a failure to respect the requirements of the Regulation or the Guidelines,[42] and
- Provide information to the Commission to carry out its duties under the Regulation (such as adopting or amending guidelines).[43] If the NRA does not provide this information within the

38 See generally in this context, the DG TREN Interpretation Note, 'The Role of the Regulatory Authorities', 14.1.2004.

39 E-Directive, Art 23(4)

40 Guidelines, Annex to E-Regulation.

41 E-Regulation, Art 4.

42 Ibid, Art 9. It is not necessarily the energy regulator that is the administrative body with the power to impose the fine. The Member States have discretion in this area.

given time-limit, the Commission may request the information directly from the undertakings concerned. Failure by them to comply may result in the imposition of penalties.

Dispute Settlement

Any party with a complaint against a TSO or a DSO on the matters set out in the preceding sections may refer the complaint to the regulatory authority.[44] This does not preclude any complaint under rights of appeal according to Community and national law. The procedure is deliberately intended to facilitate speedy decision-making when a complaint is made, in contrast to the approach usually found in cases brought under competition law.

Co-ordination among Regulators

The NRAs are required to contribute to the development of the internal market and a level playing field by cooperating with each other and with the Commission in a transparent manner.[45] To facilitate this, the Commission established an independent advisory group called the European Regulators Group for Electricity and Gas (ERGEG) in November 2003. Its membership comprises the heads of the competent NRAs in the Member States, with the EEA countries participating as observers. Its aim is to facilitate consultation, coordination and cooperation between the regulatory bodies in Member States and between these bodies and the Commission, to consolidate the internal market and to ensure the consistent application in all the Member States of the two Directives and E-Regulation.[46] It tenders advice to the Commission and assists it in the preparation of draft implementing measures in electricity and gas. It acts either at its own initiative or at the request of the Commission. Under Article 4 of the Decision, the ERGEG is required to 'consult extensively and at an early stage with market participants, consumers and end-users'. The establishment of this advisory body was strongly supported by the European Parliament during the debates on the Directives. It mirrors the roles of similar bodies already established in the telecommunications and financial services sectors.[47] According to its Rules of Procedure, the ERGEG will submit an annual report of the Commission, which will then be transmitted to the Parliament and Council.[48] The Chair reports to the Parliament when requested to do so, a process that began in autumn 2004.

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(Contd.)

43 Ibid, Art 10(1), (2) and (5).

44 E-Directive, Art 23(5), G-Directive, Art 25(5). This includes the possibility of appeals against decisions or proposed decisions by the NRA on the methodology.

45 E-Directive, Art 23(12); G-Directive, Art 25(12); E-Regulation, Art 9.

46 Decision, Recital (6) (see n 44).

47 The ERGEG is in practice (if not formally) an offshoot of the Council of European Energy Regulators (CEER). It shares a common chairperson and members, and ERGEG relies on the CEER for funding and expertise. The CEER is a voluntary association that includes most of the EU energy regulators, and has been highly active in the Electricity and Gas Forums since its establishment in March 2000. It has a number of working groups: www.ceer.org.

48 Rules of Procedure, Article 9 (Accountability): www.ergeg.org

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