

# European Union

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## POLICY

1 Broadly speaking, what is the governmental policy and legislative framework for the electricity sector?

EU energy policy pursues three objectives:

- creating a competitive internal market;
- maintaining an adequate level of security of supply; and
- increasing the effectiveness of environmental protection.

The European Commission's Directorate-General for Transport and Energy is primarily responsible for determining EU electricity policy whereas the Competition Directorate-General enforces the competition rules in the electricity sector. In 1995, the European Commission also launched a high-level group (HLG) on competitiveness, energy and the environment. The HLG is intended to provide advice for action on a number of issues, including the functioning of the energy markets, and energy and renewables.

National regulatory authorities are also responsible for enforcing the EU rules at national level. The European Regulators Group (EREG), which was set up in 2003 by the Commission, facilitates cooperation between the European Commission and national regulators. Further, the European Commission, member states, national regulators, transmission system operators, electricity traders and other stakeholders meet at the Florence Electricity Regulatory Forum once or twice a year to discuss progress on the creation of a single EU electricity market.

### The creation of a single internal market

The creation of the single energy market in the EU has proceeded in stages. Initially, measures were taken to ensure the transparency of prices to final consumers and to facilitate the transit of electricity between the Community's major grids (Directive 90/377 of 29 June 1990). The next step was to remove certain restrictions so that companies would enjoy equal access to explore and prospect for hydrocarbons (Directive 94/22 of 30 May 1994 on the conditions for granting and using authorisations for the prospection, exploration and production of hydrocarbons).

The liberalisation process of the electricity industry in the EU began in the 1990s. The objective of liberalisation is to create a fully operational EU-wide internal market for electricity (rather than 27 national markets) with a view to achieving efficiency gains and price reductions and increasing competitiveness.

The first important piece of Community legislation aimed at liberalisation of the electricity sector was Directive 96/92 (the First Electricity Directive). The purpose of the Directive was to open up the electricity market through the gradual introduction of competition. The Directive introduced the distinction between a regulated part of the market (network) and competitive parts of the market

(generation and supply), removing legal monopolies by requiring member states to gradually allow large electricity customers to choose their suppliers (through the concept of eligible customers). Vertically integrated companies were also required to introduce a minimum level of separation between their network business and their other activities (unbundling) and to grant third parties access to their transmission and distribution networks (third-party access).

The gradual market opening introduced by the First Electricity Directive was, however, incomplete and significantly differed among member states. To address these concerns, further measures were proposed by the Commission leading to the adoption of Directive 2003/54 (the Second Electricity Directive) and Regulation No. 1228/2003 (the Cross Border Electricity Trading Regulation).

The objective of the Second Electricity Directive is to achieve full market opening, which had to take place by July 2004 for non-household electricity customers (industrial, commercial and professional customers), and shall by July 2007 for all customers across the EU. Accordingly, from July 2007, all EU customers will be able freely to elect their electricity supplier. The provisions of the Second Electricity Directive include rules on unbundling of network activities from other activities, the appointment of an independent national regulator, the application of transmission tariffs to all system users on a non-discriminatory basis and public and universal service obligations. Member states were required to implement the Directive by 1 July 2004. However, in response to significant delay in the implementation of the Directive at national level, the European Commission sent letters of formal notice to 17 member states in April 2006 for failure to implement the Second Directive properly, followed by reasoned opinions in December 2006. It also brought proceedings before the European Court of Justice against Spain and Luxembourg for failure to notify implementation of the Directive. Luxembourg was condemned by the Court in September 2006.

The Cross Border Electricity Trading Regulation sets rules for transmission of electricity between member states. The Regulation is directly applicable Community law without any need for further implementing measures by member states. It entered into force on 1 July 2004. The Regulation addresses issues relating to cross-border trading in electricity, such as harmonised principles for payments between transmission system operators and for tariff setting, as well as congestion management and the allocation of cross border capacity. The Regulation also contains mandatory guidelines on congestion management, which were amended by the Commission in November 2006.

Overall, although some progress has been made, a single, competitive European energy market is not yet in place and the degree of liberalisation still varies greatly between member states.

By September 2005, 10 EU member states – Denmark, Germany, Spain, Ireland, the Netherlands, Austria, Portugal, Finland, Sweden and the United Kingdom – had fully opened their electricity markets to competition. In most of the remaining countries, markets were open for business consumers. However, a significant number of markets remain largely national and are dominated by a small number of companies.

### Security of supply

Maintaining security of supply is one of the essential objectives of EU energy policy. To that effect, the Second Electricity Directive contains a number of provisions relating to the security of electricity supply and requires member states or the national regulators appointed by member states to monitor security of supply issues. More specifically, in January 2006, Directive 2005/89 was adopted. It contains a comprehensive set of rules to safeguard security of electricity supply and infrastructure investment and establishes measures to ensure an appropriate level of interconnection between member states for the development of the internal market. It requires member states to ensure that an appropriate level of network security is maintained and that stable and transparent market rules are in place regarding any action taken to balance supply and demand. In addition, networks must set performance objectives and the regulatory framework must provide appropriate signals for network development and facilitate appropriate network maintenance. The Directive has to be implemented by member states by 1 December 2007 and the implementing legislation must be in force by 24 February 2008.

The European Union also finances electricity transmission infrastructure projects under its trans-European networks policy. Guidelines on trans-European energy networks set out which projects are eligible for funding.

### Environmental protection and renewable energy

To improve environmental protection and sustainable development, the EU has also adopted a set of legislative measures.

Directive 2001/77 on the promotion of electricity produced from renewable energy sources in the internal electricity market (the Renewable Electricity Directive) is intended to encourage the development of power generation from renewable sources, most of which would otherwise be unattractive for investment. It requires member states to set national targets to meet the Community target of increasing the share of electricity consumption from renewable sources to 22 per cent by 2010 and encourages member states to apply various support mechanisms in favour of 'green' electricity production. Sections covered by the Directive include the power sector.

Directive 2003/87 establishing a scheme for greenhouse gas emission allowance trading within the Community (the Emissions Trading Directive) requires member states to ensure that all plants with a rated thermal input exceeding 20MW emitting CO<sub>2</sub> only operate if they have a greenhouse gas permit.

Directive 2004/8 on the promotion of cogeneration based on useful heat demand in the internal electricity market provides a framework for the promotion of high efficiency cogeneration of heat and power. Electricity produced from a renewable source or from cogeneration is also promoted by the 2001 Community Guidelines on state aid for environmental protection, which set out the conditions under which aid will be regarded as compatible with the common market. The Guidelines expire at the end of 2007 and are currently being reviewed by the Commission. The new guidelines should be integrated into a new block exemption regulation.

Finally, Directive 2006/32 on energy end-use efficiency and energy services adopted in April 2006 sets out clear indicative

targets for annual energy intensity savings at member state level including the retail, supply and distribution of electricity (9 per cent from 2008 to 2017). The Directive requires member states to draw up national action plans to achieve 1 per cent yearly energy savings (1 per cent being an indicative target) to be submitted to the Commission for approval every year and reviewed every three years. The Directive also provides incentives and other mechanisms to help remove existing market barriers to energy efficiency. Most provisions must be transposed into national law by May 2008.

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## ORGANISATION OF THE MARKET

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- 2 In general, what is the organisational structure for the generation, transmission, distribution and sale of power (including electricity and other electric products)?

Competitive activities in the sector include generation (power production), supply and trading, while network activities – ie, transmission and distribution – are still by their nature regarded as natural monopolies to be operated under regulated conditions.

### Generation

Generation is defined in the Second Electricity Directive as the production of electricity. Under the Second Electricity Directive, generation must be open to competition in member states.

### Transmission

Transmission is defined in the Second Electricity Directive as the transport of electricity on the extra high-voltage and high-voltage interconnected system with a view to its delivery to final customers or to distributors but does not include supply. Electricity transmission is regarded as a natural monopoly and is subject to regulated access. Transmission tariffs must be non-discriminatory, transparent and fairly priced. The methodologies used to calculate tariffs or the tariffs themselves must be approved by national energy regulators.

### Distribution

Distribution is defined in the Second Electricity Directive as the transport of electricity on high-voltage, medium voltage and low-voltage distribution systems with a view to its delivery to customers but does not include supply. Electricity distribution is regarded as a natural monopoly activity. Distribution tariffs are therefore regulated by the national regulators, who define or approve the level of tariffs or profits that distributors are allowed to set or make.

### Supply

Supply encompasses the sale and resale of electricity to customers. The Second Electricity Directive provides for the full opening of the supply market to competition, which is to take place gradually. From 1 July 2004, all non-household users were entitled to freely choose their supplier. This will be extended to all users by July 2007.

In practice, however, the right of a customer to freely choose their supplier depends on proper implementation of the Directive by individual member states and the degree of market-opening currently in place in a particular member state. At present, competitive retail markets have developed or are developing in Sweden, Finland, Denmark, Belgium, Germany, Austria, Spain and the United Kingdom.

### Trading

Trading refers to the selling and buying of electricity on wholesale markets. The trading of electricity in competitive wholesale markets forms an essential part of liberalisation. Wholesale trading in

standardised contracts takes place on power exchanges (organised market places), via over-the-counter transactions or bilateral transactions.

#### REGULATION OF ELECTRICITY UTILITIES – POWER GENERATION

- 3 What governmental or administrative authorisations are required to construct and operate generation facilities?

Under the Second Directive, member states are required to adopt an authorisation procedure for the construction of new generating capacity. The criteria for the grant of authorisations must be objective, transparent and non-discriminatory and may relate to the safety and security of the electricity system, installations and associated equipment, protection of public health and safety, protection of the environment, land use and siting, use of public ground, energy efficiency, the nature of the primary sources, characteristics particular to the applicant (such as technical, economic and financial capabilities), and the size and limited impact of small generation. Where the generating capacity being built on the basis of the authorisation procedure is insufficient, member states may also provide for new capacity or energy efficiency or demand-side management through a tendering procedure.

- 4 What are the policies with respect to interconnection of generation to the transmission grid?

Companies involved in power generation can gain access to the transmission grid on the basis of third-party access (TPA). Member states may however require transmission system operators (TSOs) and distribution system operators (DSOs) to give priority to generating installations using renewable energy sources or waste or producing combined heat and power. Further, for reasons of security of supply, priority may be given to the dispatch of generating installations using indigenous primary energy fuel sources to a limited extent (maximum: 15 per cent of the overall primary energy necessary to produce the electricity consumed in the member state concerned).

- 5 Does the governmental policy (or legislation) foster power generation based on alternative energy sources such as renewable energies or combined heat and power?

The development of renewable energy – particularly energy from wind, water, solar power and biomass – is one of the objectives of the European Commission's energy policy. As indicated under question 4, the Second Electricity Directive enables member states to require TSOs and DSOs to give priority to generating installations using renewable energy sources or waste or producing combined heat and power.

Further, Directive 2001/77 of September 2001 on the promotion of the electricity produced from renewable energy sources aims to increase the EU's share of electricity produced from renewable energy sources to 21 per cent (up from 15.2 per cent in 2001), thus contributing to attainment of the overall target of 12 per cent of energy consumption from renewables by 2010.

#### REGULATION OF ELECTRICITY UTILITIES – TRANSMISSION

- 6 What governmental or administrative authorisations are required to construct and operate transmission networks?

Transmission system operators are appointed by each member state or by the transmission systems owner. The duration of the

appointment is left to each member state's discretion, taking into account considerations of efficiency and economic balance.

- 7 Who is eligible to obtain transmission services and what are the requirements that must be met to obtain access?

Under the provisions of the Second Electricity Directive, transmission infrastructure, including electricity interconnectors linking different member states, must be operated under a regulated TPA regime. Third-party access to the transmission grid must be based on published tariffs, applied to all eligible customers in an objective and non-discriminatory fashion. The European Court of Justice has made it clear that these non-discrimination rules preclude national measures granting preferential treatment to imports resulting from long-term electricity supply contracts concluded prior to the Second Electricity Directive (Case C-17/03).

- 8 Is there any tariff or other regulation regarding the rates, terms or conditions for the provision of transmission services?

Terms and conditions, including tariffs, for the provision of services by TSOs must be submitted to the national regulator for approval before they can enter into force. They must be non-discriminatory and cost-reflective.

- 9 Which entities are responsible for assuring reliability of the transmission grid and what are their authorities and responsibilities?

Transmission service operators are responsible for assuring reliability of the transmission grid. As such, they are also responsible for contributing to security of supply, managing energy flows on the system taking into account exchanges with other interconnected systems, providing information to operators of other systems with which their system is interconnected, ensuring non-discrimination between system users and providing system users with necessary information to access the system efficiently. Transmission service operators may also be responsible for dispatching the generating installations in their area and for determining the use of interconnectors with other systems.

To limit the risks of discrimination and cross subsidies associated with the existence of vertically integrated companies, the Second Electricity Directive requires legal unbundling – in addition to accounting and management unbundling – between network activities (transmission and distribution) and all other activities. In practice, this means that transmission grid operators must be independent in their legal form, organisation and decision-making (separate headquarters and separate board of directors).

#### REGULATION OF ELECTRICITY UTILITIES – DISTRIBUTION

- 10 What governmental or administrative authorisations are required to construct and operate distribution networks?

Distribution system operators are appointed by each member state or by the undertakings owning or responsible for the distribution system. The duration of the appointment is left to each member state's discretion, taking into account considerations of efficiency and economic balance.

- 11** Who is eligible to obtain access to the distribution grid and what are the requirements that must be met to obtain access?

The Second Electricity Directive established regulated access to the distribution grid as a rule. Third-party access to the distribution grid must be based on published tariffs and applied objectively and without discrimination to all eligible customers.

- 12** Is there any tariff or other regulation regarding the rates, terms or conditions for the provision of distribution services?

Where DSOs are responsible for balancing the electricity distribution system, terms and conditions, including tariffs for the provision of distribution services, must be non-discriminatory and cost-reflective and must be submitted to the national regulator for approval before they can enter into force.

#### REGULATION OF ELECTRICITY UTILITIES – SALES OF POWER

- 13** What governmental or administrative authorisations are required for the sale of power to customers and which are the responsible authorities to grant such approvals?

The right of a customer to choose his or her supplier freely depends on the degree of market-opening currently applied in a given EU member state. Though large industrial customers are designated as 'eligible' – ie, entitled to choose their supplier – throughout the European Union, competitive mass retail markets are presently developing in Austria, Belgium, Denmark, Finland, Germany, the Netherlands, Norway, Spain, Sweden and the United Kingdom. All customers, including small households, will have the right to choose their supplier with effect from 1 July 2007 at the latest.

- 14** Is there any tariff or other regulation regarding power sales?

Supply of electricity is subject to full competition for all eligible customers: from 2004, this included all non-household customers and, from July 2007, this will include all customers. Retail price regulation is, however, applied in a number of member states (eg, France, Hungary, Italy, Poland, Portugal and Spain).

- 15** To what extent are electricity utilities that sell power subject to public service obligations?

Member states may impose on undertakings operating in the electricity sector public service obligations that may relate to security – including security of supply – regularity, quality and price of supplies and environmental protection, including energy efficiency and climate protection. Such obligations must be clearly defined, transparent, non-discriminatory and verifiable, and must guarantee equality of access for EU electricity companies to national consumers. Member states must also ensure that all household customers and, if appropriate, all small enterprises enjoy universal service (ie, the right to be supplied with electricity of a specified quality within their territory at reasonable, easily and clearly comparable and transparent prices) and may appoint a supplier of last resort for that purpose. They are required to inform the European Commission of all measures adopted to fulfil public and universal service obligations.

#### REGULATORY AUTHORITIES

- 16** Which governmental or administrative authorities determine the regulatory policy with respect to the electricity sector?

The European Commission is organised into Directorates-General

(DGs), which are each responsible for a particular policy area and are headed by a director-general who is answerable to one of the commissioners.

The Directorate-General for Energy and Transport of the European Commission (DG TREN) is responsible for the development of EU energy policy. It develops legislative proposals on energy in consultation with key stakeholders, governments and regulatory bodies in each of the member states to be presented to the Council of the European Union and the European Parliament and ensures that directives are implemented properly at national level. The Competition Directorate-General (DG Comp) is responsible for the enforcement of the competition rules in the electricity sector (antitrust, merger control, liberalisation and state aid).

The development of an effective EU energy policy is thus achieved by means of both ex ante sector-specific regulation (DG TREN) and ex post competition law regulation (DG Comp).

At national level, in accordance with the provisions of the Second Electricity Directive, each member state has appointed a national energy regulator. These are responsible for ensuring non-discrimination, effective competition and the effective functioning of their market market. The powers of regulators, however, vary between member states.

To foster closer cooperation between national regulators, a European association of independent national energy regulators from the EU and European Economic Area (EEA) member states was created: the Council of European Energy Regulators (CEER). Its overall objective is to facilitate the creation of a single competitive, efficient and sustainable internal market for gas and electricity in Europe and to provide a forum for discussion and the development of common positions.

National regulators also provide advice to the Commission on legislative and other projects through the European Regulators Group for Electricity and Gas (EREG) which was set up in 2003 (Decision 2003/796). EREG consists of the heads of the national energy regulatory authorities from the 27 EU member states; regulators from the candidate countries and the European Economic Area hold observer status.

There is currently no real European energy regulator. However, the Green Paper on Energy Policy published in March 2006 by the Commission (see Update and Trends below) proposes the creation of such a body to reinforce cooperation between national regulators and national grid operators and to deal with cross-border issues.

- 17** What is the scope of each regulator's authority?

Under the EC Treaty, the Commission is responsible for ensuring that Community law in the electricity sector is correctly applied at national level. The Commission may commence infringement proceedings under article 226 EC against any member state which the Commission believes is infringing Community law, eg, by failing to implement the provisions of a directive. The Commission will seek to bring the infringement to an end, and, if necessary, may refer the case to the European Court of Justice. Thus, as indicated under question 1, in December 2006, the Commission sent reasoned opinions to 16 member states for failure to implement the provisions of the Second Electricity Directive properly. It has also brought proceedings before the European Court of Justice against Spain and Luxembourg for failure to notify implementation of the Directive, leading to the condemnation of Luxembourg in September 2006.

The European Commission is also responsible for enforcing the EC competition rules. It may impose fines for violation of articles

81 and 82 of the EC Treaty and order companies to terminate infringements. Under Regulation 1/2003 on the implementation of the rules on competition laid down in articles 81 and 82 of the Treaty, it may also conduct sector enquiries. Further, it is responsible for reviewing 'Community-dimension' mergers, acquisitions of control and structural joint ventures. Finally, the Commission has exclusive jurisdiction to review the compatibility of state aid with the common market.

In May and December 2006, the Commission made use of its powers to enforce the competition rules in the electricity sector and carried out unannounced inspections at the premises of a number of electricity companies in Germany and Hungary.

- 18** How is each regulator established and to what extent, if any, is it considered to be independent of the regulated business and of elected officials?

The European Commission consists of 27 commissioners: one from each member state. Commissioners are appointed by member states in agreement with the president of the Commission and must then receive approval from the European Parliament. They are appointed for a period of five years. The Commission is intended to represent the interests of the citizens of the EU as a whole. Commissioners are therefore not permitted to take instructions from the government of the country that appointed them.

Andris Piebalgs and Neelie Kroes are currently the commissioners in charge of energy and competition respectively.

At national level, under the Second Electricity Directive, member states are required to set up national electricity regulators that are wholly independent from the interests of the electricity industry. They otherwise enjoy wide discretion as to the make-up of the regulator(s).

- 19** To what extent can decisions of the regulator be challenged or appealed, and to whom? What are the grounds and procedures for appeal?

Subject to the rules on standing, decisions adopted by the Commission may be challenged before the Court of First Instance and the Court of Justice of the European Communities. The four main grounds for appeal are lack of competence, breach of procedural requirements, infringement of the provisions of the EC Treaty or any rule of law relating to its application, and misuse of powers. An action for annulment must be brought within two months of the notification or publication of the decision, or of the day when the applicant became aware of it.

#### ACQUISITION AND MERGER CONTROL; COMPETITION

- 20** Which governmental body or bodies have the authority to approve or disapprove mergers or other changes in control over businesses in the sector (including the acquisition of ownership interest in an electricity utility) or acquisition of utility assets?

The European Commission has exclusive jurisdiction to review concentrations (ie, full mergers, acquisitions of control and structural joint ventures) that bring about a lasting change of control and meet the jurisdictional thresholds set out under article 1(2) and (3) of Regulation 139/2004 on the control of concentrations between undertakings (the Merger Regulation). In all cases, however, the Commission liaises closely with member states directly concerned by a merger.

Referrals to national competition authorities are, however, possible either at the parties' request or at a member state's request in specific circumstances.

Mergers and other changes of control that do not meet the EU thresholds may nevertheless have to be notified to national competition authorities, if they meet national merger thresholds.

- 21** What criteria and procedures are applied with respect to the review of mergers, acquisitions and other transfers of control? How long does it typically take to obtain a decision approving or disapproving the transaction?

A Community-dimension concentration must be notified to the Commission for clearance and may not be implemented until approval or expiry of the relevant time limits. In exceptional circumstances, the Commission may waive the suspensory requirement.

The Commission has 25 working days from notification either to clear the merger or to start Phase II proceedings (extended to 35 working days if a member state asks for referral of the merger back to the national competition authority or if commitments (remedies) are offered by the parties). If the Commission starts Phase II proceedings, it has a further 90 working days to take a final decision; this may be extended to 105 working days where remedies are offered. In addition, Phase II may be extended by up to 20 working days at the request of the parties during the first 15 working days, or at any time at the request of the Commission and with the consent of the parties. The running of time may also be suspended in certain limited circumstances.

The Commission's role is to assess the likely impact of a merger on the competitive structure of any EU markets that would be affected. The Commission will prohibit a merger if it concludes that it would significantly impede effective competition, in the common market or in a substantial part of it, in particular as a result of the creation or strengthening of a dominant position (article 2(3) of the Merger Regulation). Unless the Commission concludes that a merger would have such an effect, it must approve it.

- 22** Which governmental or administrative authorities have the power to prevent or prosecute anti-competitive practices in the electricity sector (other than through the exercise of authority over acquisitions and mergers)?

The Competition Directorate-General of the European Commission (DG Comp) is the EU authority responsible for competition law, policy and enforcement. Besides the Commission, national competition authorities (NCAs) are also responsible for the application of articles 81 and 82 of the EC Treaty. To this end, a network of competition agencies – the European Competition Network (ECN) – consisting of the Commission and the NCAs has been established. This network is based on the mutual exchange of information and the execution of investigative measures by one agency on behalf of another. Regulation 1/2003 provides procedural rules for the enforcement of articles 81 and 82 EC and defines the respective powers of the European Commission and NCAs.

DG Comp is also responsible for enforcing the state aid rules in the electricity sector.

- 23** What substantive standards are applied to determine whether conduct is anti-competitive?

The EC competition rules are contained principally in articles 81 and 82 of the EC Treaty. Article 81 EC prohibits both vertical and horizontal anti-competitive agreements between undertakings. Article 81(1) EC prohibits agreements, decisions of associations and concerted practices that have the object or effect of preventing, restricting or distorting competition within the EU and are likely to affect trade between member states. Article 81(1) EC contains

### Update and trends

#### Green Paper on energy policy

In March 2006, the Commission published a Green Paper on A European Strategy for Sustainable, Competitive and Secure Energy, launching a debate on a future common European Energy Policy and inviting interested parties to comment by September 2006.

The Green Paper identified six areas where action is necessary: (i) competitiveness and the completion of the internal EU energy market, (ii) security of supply, (iii) diversification of the energy mix, (iv) the development of a common European strategy to address climate change, (v) a strategic energy technology plan to prevent overlaps in national technology and research programmes and (vi) the development of an external EU energy policy. It puts forward a number of suggestions to remedy the major concerns identified, completing the opening of European gas and electricity markets and stepping up relations with major suppliers such as Russia and OPEC, boosting renewable energy, energy efficiency, and research on low-carbon technologies.

#### Energy Efficiency Action Plan

Following the publication of its 2005 Green Paper on Energy Efficiency and of the Green Paper on a European Strategy for Sustainable, Competitive and Secure Energy in March this year, in October 2006, the European Commission launched an Action Plan for Energy Efficiency. The plan's overall objective is to outline a set of policies and measures to help reduce EU energy consumption by 20 per cent by 2020. It proposes 10 priority actions to be put in place and implemented in the next six years, including appliance and equipment labelling and minimum performance requirements, making power generation and distribution more efficient, facilitating appropriate financing of energy efficiency investments for enterprises and promoting a coherent use of taxation.

#### January 2007 Energy Package

In January 2007, the Commission intends to adopt a set of new measures relating to energy. The package will include a progress report on liberalisation of the energy markets, including detailed country reviews on the implementation

of the liberalisation directives and the functioning of the markets. This review will enable the Commission to draw conclusions about the additional measures that are needed both at member state and Community levels. Further regulatory measures will also be proposed. In that respect, Energy and Transport Commissioner Piebalgs has already indicated that measures might be adopted to ensure greater harmonisation of the powers and responsibilities of national regulators and harmonisation of technical rules to facilitate cross-border trade.

The package will also include the final report on the energy sector inquiry launched by DG COMP in June 2005 to assess competitive conditions on the European gas and electricity markets and identify market malfunctioning and barriers to competition. In February 2006, the Commission issued a preliminary report identifying five main barriers: (i) market concentration, (ii) vertical integration of generation, supply and network activities, (iii) low level of cross-border trade resulting in a lack of market integration, (iv) lack of transparency and (v) complex price formation which is not determined on the basis of effective competition. This was followed by a two-month consultation period. DG Comp will issue the final report of the inquiry in January 2007, integrating the comments from the public consultation. Based on the preliminary findings of the sector inquiry, the Commission also carried out several unannounced inspections at the premises of electricity companies in Hungary and Germany in May 2006.

In addition to these reports, the package will contain a Strategic EU Energy Review setting out the Commission's vision for energy in view of global warming and the decline of the EU's domestic energy production and proposing precise medium and long-term goals. Finally, it will contain a Priority Interconnection and Infrastructure Plan addressing the need for additional infrastructure, a Long-Term Renewables Road Map, a Communication on Nuclear Energy in the EU and a Communication on Clean Coal.

The final report of the sector enquiry, the Strategic Energy Review and the progress report on liberalisation of the energy markets will provide the basis for discussions at the European Council summit in Spring 2007 to define the EU's future energy policy.

a non-exhaustive list of examples of anti-competitive agreements (fixing purchase or selling prices or other trading conditions, limiting or controlling production, markets, technical development or investment, sharing markets or sources of supply, etc). An agreement that is restrictive of competition within the meaning of article 81(1) EC may nonetheless be permitted if it satisfies all the exemption conditions of article 81(3) EC.

Article 82 EC prohibits conduct by one or more undertakings that amounts to an abuse of their dominant position. For instance, such abuse may consist in charging discriminatory prices, refusal to grant access to an essential facility, predatory pricing, tying, etc.

In the electricity sector, DG Comp is currently focusing on restrictive practices involving long-term downstream contracts closing off the electricity market and on practices restricting access to electricity interconnectors between member states.

The EC Treaty also contains rules on state aid preventing

member states from granting aid to domestic companies except in limited circumstances

#### 24 What authority does the governmental body have to preclude or remedy anti-competitive practices?

The European Commission may impose fines (up to 10 per cent of worldwide turnover) or remedies on undertakings for anti-competitive practices. The Commission is entitled to impose behavioural and structural remedies (such as divestiture or break-up of an enterprise). With respect to state aid, the Commission may order the reimbursement of aid that is not compatible with the common market.

National competition authorities are also entitled to apply articles 81 and 82 EC to impose fines. The scope of their powers differs between member states.

In addition to these governmental authorities, national courts may also apply articles 81 and 82 EC, grant interim relief where the conditions for such relief are met and award damages.

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#### INTERNATIONAL

- 25** Are there any special requirements or limitations on acquisitions of interests in the electricity sector by foreign companies?

Article 56 of the EC Treaty on the free movement of capital prohibits restrictions on the acquisition of interests in the electricity sector by companies established in other member states or in non-member countries save on a limited number of grounds, including public security. Restrictions, such as the suspension of voting rights attached to holdings in excess of a percentage of the share capital of undertakings operating in the energy sector or the obligation to secure prior approval from the government beyond a particular shareholding, are contrary to article 56 EC.

- 26** What rules, if any, apply to cross-border electricity supply, especially interconnection issues (including cross-border fees)?

Regulation 1228/2003 provides a regulatory framework for cross-border exchanges in electricity establishing a compensation mechanism for cross-border flows of electricity and introducing harmonised principles on cross-border transmission charges and the allocation of available interconnection capacities between national transmission systems. Transmission service operators receive compensation for costs incurred as a result of hosting cross-border flows of electricity on their networks, which must be paid by the operators of national transmission grids from which those flows originate. Charges must be transparent and take into account the need for network security and reflect costs incurred. They may not, however, be distance-related. Further, the rules on non-discrimination contained in the Regulation and the Second Electricity Directive, as interpreted by the case law, preclude national measures from granting preferential treatment to imports resulting from long-term electricity supply contracts.

The recently amended Congestion Management Guidelines annexed to Regulation 1228/2003 seek to improve the way in which the electricity transmission system is operated in the EU, and, in particular, improve cooperation between TSOs to allocate cross-border flows. The Guidelines set out a series of rules on the allocation of available transfer capacity of interconnections between national systems, seeking to promote efficient use of the European electricity network while ensuring security. In particu-

lar, they require market based capacity allocation methods to be used on all electricity interconnectors and capacity allocation at an interconnection to be coordinated and implemented using common allocation procedures by the TSOs involved.

The adoption of European Grid Code ensuring common rules and standards and harmonised grid access conditions is currently under discussion.

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#### TRANSACTIONS BETWEEN AFFILIATES

- 27** What restrictions, if any, exist on transactions between electricity utilities and their affiliates?

The liberalisation process was accompanied by a set of measures regarding unbundling of network activities from other activities to avoid discrimination between customers. Unbundling is regarded as necessary at the TSO level to ensure a competitive wholesale market and at the DSO level to allow for effective retail competition. Unbundling of accounts (separating and allocating costs between network and competitive businesses) and functional unbundling (independence of network activities in terms of organisation and decision-making from other activities not related to the network) are required for TSOs and DSOs. Legal unbundling (independence in terms of the company's legal form) is required for TSOs and DSOs. Member states may, however, postpone the requirement of legal unbundling for DSOs until 1 July 2007. With respect to DSOs serving less than 100,000 connected customers, an exemption from the requirements of functional and legal unbundling is possible.

In its report on the development of EU energy markets to the European Commission in December 2006, ERGEG called for the adoption of further legislation on 'unbundling' that would fully separate network ownership from service delivery and reinforce the powers of national regulatory authorities. Competition Commissioner Neelie Kroes has also expressed a preference for ownership unbundling to avoid discrimination between customers.

- 28** Who enforces the affiliate restrictions and what are the sanctions for non-compliance?

National energy regulators are responsible for ensuring effective unbundling of energy companies to avoid cross-subsidies. Where failure to comply with affiliate restrictions translates into infringements of the competition rules (eg, state aid or cross-subsidies under article 82 EC), DG Comp and the national competition authorities may also impose sanctions. National courts may also award damages for breach of the competition rules.

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