

# European Union

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## Description of domestic natural gas sector

- 1 In general terms, describe the domestic natural gas sector, including the natural gas production, liquefied natural gas (LNG) storage, pipeline transportation, distribution, commodity sales and trading segments.

Although a net importer (to the rate of 42 per cent of EU natural gas consumption), the EU has significant domestic natural gas production – representing around 9 per cent of total worldwide gas production. The main EU natural gas producers are Denmark, the Netherlands and the United Kingdom. Other EU countries with natural gas production include Austria, Germany, Italy, Hungary and Poland. The majority of EU gas imports come from Norway, Russia and Algeria, with steadily increasing LNG supplies from Africa (eg, Nigeria) and the Middle East (eg, Qatar). While LNG shipments currently account for some 16 per cent of natural gas imports (with 84 per cent of EU natural gas imports accounted for by pipeline transportation), LNG imports are expected to increase as current investments in LNG facilities in the Middle East and re-gasification terminals in Europe come on stream over the next decade.

## Policy and legal framework

- 2 What is the statutory framework for the domestic natural gas sector?

EU regulation in the natural gas sector is principally a function of sector-specific legislation (regulations, directives, and guidelines) and the enforcement of generally applicable EU competition rules. Several other areas of EU law, however, may also have an impact on the natural gas sector (eg, rules on state aid, public procurement and the free movement of goods, services, and capital).

### Sector-specific legislation

The key elements of EU sector-specific legislation for natural gas are as follows:

- Directive 90/377/EEC of 29 June 1990, concerning the transparency of gas prices charged to industrial end-users (the Price Transparency Directive);
- Directive 94/22/EC of 30 May 1994 on the conditions for granting and using authorisations for the prospection, exploration and production of hydrocarbons (also referred to as the Hydrocarbon Licensing Directive or the Upstream Directive)
- Directive 2003/55/EC of 26 June 2003, concerning common rules for the internal market in gas (also referred to as the Second Gas Directive or the Acceleration Directive) – on which the Commission has issued a number of explanatory notes, dated 1 January 2004, dealing with (i) the unbundling

regime; (ii) the role of the regulatory authorities; (iii) public service obligations; (iv) practical measures for distribution resulting from the opening up to competition; (v) exemptions from certain provisions of the third-party access regime; (vi) security of supply provisions for gas, and (vii) third-party access to storage facilities (the Explanatory Notes). The Commission and the European Regulators Group for Electricity and Gas (EREG) have also issued non-binding Guidelines for Good TPA Practice for Storage System Operators dated 23 March 2005 (the EREG Guidelines);

- Directive 2004/67/EC of 26 April 2004 concerning measures to safeguard security of natural gas supply (the Security of Supply Directive); and
- Regulation 1775/2005 of 28 September 2005, on conditions for access to the natural gas transmission networks (the Gas Regulation).

The overriding EU policy objective over the past decade has been gradually to liberalise the natural gas sector and introduce a greater level of downstream gas-to-gas competition, while maintaining security of supply. The single most important item of sector-specific legislation in this regard has been the Second Gas Directive and its predecessor, the First Gas Directive (Directive 98/30/EC of 22 June 1998). The First Gas Directive sought to abolish import monopolies, open downstream markets, provide an option of regulated third-party access to transmission networks, and unbundle marketing and transmission accounting for vertically integrated network companies. The Second Gas Directive, complemented by the Gas Regulation, was intended to complete and accelerate the liberalisation of downstream natural gas markets.

More specifically, the Second Gas Directive provides that:

- commercial gas customers must be free to choose their gas supplier as of 1 July 2004;
- private households must be free to choose their gas supplier as of 1 July 2007;
- third-party access to gas transmission and distribution networks must be available on the basis of approved and published tariffs, while access to gas storage facilities must be available on either a negotiated or regulated basis; and
- large and medium-sized integrated network or distribution companies must unbundle the legal and management structures of their gas transmission and distribution activities.

Several member states have failed properly to implement the Second Gas Directive by the 1 July 2004 deadline. In 2006, the European Court of Justice ruled against Luxembourg and Spain in this regard, while infringement proceedings are pending

against Belgium, the Czech Republic, Greece, France, Ireland, Italy, Latvia, Lithuania, Poland and Slovakia before the European Commission. Moreover, even where the Second Gas Directive has been implemented, experience has been mixed. The Commission's 10 January 2007 Report on the Energy Sector Inquiry identified various shortcomings in the functioning of EU natural gas markets. This has, among other things, led the Commission to propose full ownership unbundling of transmission and distribution activities. At the time of publication, however, this proposal continued to meet strong political resistance from various member states (see also question 3).

### Competition rules

For some time, the natural gas sector has been a priority area for the Commission in the enforcement of EU competition rules (articles 81, 82 and 86 of the EC Treaty and the EC Merger Regulation). The Commission's recent Report on the Energy Sector Inquiry highlighted the importance of strict competition law enforcement as a complement to sector-specific legislation (see questions 33 to 38 for more details on EU competition law in the gas sector).

- 3 Broadly speaking, what is the governmental policy for the domestic natural gas sector and which bodies set it?

EU policy seeks to guarantee a well-functioning energy market with secure energy supplies at competitive prices. To achieve this objective, EU legislation has sought to open up Europe's gas sector to competition and to create a single European energy market. Key to achieving this goal is the breaking up of national monopolies, removal of barriers to cross-border gas supply, introduction of third-party access to transport infrastructure and creation of uniform conditions of competition throughout the EU.

EU policy is shaped by the European Commission, the Council of the European Union (composed of heads of state) and the European Parliament. The Commission has the power to initiate EU legislation, which must be approved and adopted by the Council and Parliament. The Commission is also entrusted with enforcement of EU law. It can sue member states for failure to comply with EU law and can adopt binding decisions against companies under EC competition rules. Competition law enforcement is an important tool for the Commission in shaping its gas policy.

Within the Commission, the Commissioner for Energy (Andris Piebalgs) and the Commissioner for Competition (Neelie Kroes) have primary responsibility for achieving the objectives of EU gas policy. Both commissioners are strongly committed to creating competitive energy markets within the EU.

The Commission acts in close cooperation with national regulatory authorities. This cooperation takes place through the European Regulators Group for Electricity and Gas (EREG), which was set up in 2003, and the so-called Madrid Forum – an informal forum of national regulatory authorities, member states, the European Commission, transmission system operators, gas suppliers and traders, consumers, network users and gas exchanges that convenes once or twice a year in Madrid (see question 42).

### Regulation of natural gas production and importation

- 4 What percentage of the country's energy needs are met directly or indirectly with natural gas and LNG? What percentage of the country's natural gas needs are met through domestic production?

Natural gas consumption in the EU was approximately 492.5 billion cubic metres in 2005, representing some 24.8 per cent of the EU's primary energy consumption. As noted in question 1, the EU imports 58 per cent of its gas consumption. The proportion of imported gas is growing and predicted to total 67 per cent by 2020 and around 84 per cent by 2030. The proportion of gas imports accounted for by LNG, currently at 16 per cent, is also expected to grow.

- 5 What is the ownership and organisational structure for production and importation of natural gas (other than LNG)?

The ownership and organisational structure for the production and importation of natural gas is largely laid down at the national level and varies significantly between member states. At the EU level, the Hydrocarbon Licensing Directive prevents member states from maintaining natural gas production monopolies through the grant of perpetual and exclusive rights for the exploration and production of natural gas. In addition, European Court jurisprudence has clarified that national import and export monopolies for natural gas would violate EC Treaty rules on free movement of goods.

- 6 What governmental or administrative authorisations are required to carry out natural gas exploration and production? Does the government allow the lease of mineral rights? Are there laws or regulations governing when, where or how much natural gas may be produced? Is there a governmental authority that authorises or monitors drilling on public land?

Authorisations for natural gas exploration and production are granted at the national level, subject to the transparency and non-discrimination requirements of the Hydrocarbon Licensing Directive. Rules relating to the lease of mineral rights, the authorisation and monitoring of drilling on public land, or the permitted timing, location and quantities of natural gas production are equally set at the national level. The Hydrocarbon Licensing Directive, for example, expressly allows member states to impose production limits that are linked to the planned management of hydrocarbon resources or the need for secure tax revenues.

- 7 Generally, how does the government derive value from natural gas production?

EU institutions do not derive value from natural gas production. The extent to which member state governments derive value from natural gas production is not a matter specifically legislated at the EU level (and the Hydrocarbon Licensing Directive expressly recognises that member states may subject natural gas production to conditions and requirements to ensure "secure tax revenues").

### Regulation of natural gas pipeline transportation and storage

- 8 What is the ownership and organisational structure for pipeline transportation and storage of natural gas?

The ownership and organisational structure for pipeline transportation and storage of natural gas is largely laid down at

the national level, subject to the minimum requirements of the Second Gas Directive. For example, the Second Gas Directive requires legal and management unbundling of gas transmission infrastructure from production (since 1 July 2004) or distribution and supply activities (by 1 July 2007, for legal unbundling), subject to an exemption for small distribution companies (ie, those serving fewer than 100,000 customers, which are subject only to accounting unbundling). The Second Gas Directive also requires accounting unbundling for storage and LNG infrastructure. The unbundling obligations are accompanied by the requirement that transmission, LNG, storage and distribution activities be operated in a transparent and non-discriminatory manner by designated system operators (which, in case of transmission and distribution activities, must be independent from any other gas-related businesses).

Several member states have gone beyond the unbundling requirements of the Second Gas Directive to require ownership unbundling between transmission and distribution and other gas-related activities. Following its recent Energy Sector Inquiry, the Commission believes that full ownership unbundling of transmission and distribution activities should be mandatory throughout the EU – a move that for the moment does not appear to have gained sufficient political support at member state level.

**9** What governmental or administrative authorisations are required to construct and operate natural gas transportation pipelines and storage facilities?

Authorisations for the construction and operation of natural gas transportation pipelines and storage facilities are granted at the national level, subject to the minimum transparency and non-discrimination requirements of the Second Gas Directive. The Second Gas Directive also requires that refusals to grant such authorisations be reasoned and subject to appeal before an independent judicial body.

**10** In general, how does a company obtain the land rights to construct a natural gas transportation or storage facility?

EU law does not affect national systems of property ownership and does not regulate the transfer of land rights.

**11** How is access to the natural gas transportation system and storage facilities organised?

The Second Gas Directive separately regulates third-party access to transmission (and distribution) and third-party access to storage facilities.

Third-party access to transmission (and distribution) systems must be available to all eligible customers on the basis of objective, non-discriminatory criteria and approved and published tariffs (so-called regulated access). The Gas Regulation stipulates further detailed requirements governing third-party access to transmission networks. To eliminate complexity for shippers requiring access to multiple transmission networks, the Gas Regulation establishes minimum criteria for:

- access charges, which must be subject to approval by national regulators, transparent and reflect actual costs (but may provide for an appropriate return on investment);
- services to be provided by transmission service operators, including long-term and short-term contracts, and interruptible transmission;
- relocation of unused capacity and physical congestion;

- transparent and non-discriminatory balancing systems;
- secondary trading markets for capacity in transmission networks.

Third-party access to storage facilities (including linepack) must be available either on the basis of regulated or negotiated access. Regulated access allows eligible customers access to storage or linepack on the basis of published tariffs. Negotiated access involves free negotiations on access terms with the storage system operator (but storage operators must annually publish their main commercial conditions for the use of storage).

The Commission and ERGEG have also implemented non-binding Guidelines, which provide a minimum set of rules required for the organisation of the market for storage capacity, and are designed to ensure that operators provide storage on a fair, non-discriminatory and transparent basis, and maintain a secure, reliable and efficient operation of the storage system. The ERGEG Guidelines also require storage operators to cooperate with transmission operators to ensure interoperability and to allow bundled and unbundled services to be freely tradable on the secondary market.

Third-party access to transmission and storage services may be refused: (i) where there is lack of capacity; (ii) where access would prevent the undertaking from carrying out public service obligations; (iii) where serious economic and financial difficulties with take-or-pay contracts would arise; and (iv) for major new infrastructure and infrastructure which has been subject to significant modifications or increase in capacity. In the case of upstream transportation systems third-party access may be refused on grounds of (i) technical incompatibility, (ii) difficulties that could prejudice current and planned production of hydrocarbons, (iii) the need to respect reasonable needs of the network owner or operator, and (iv) the interest of other users.

**12** To what degree are pipeline systems interconnected with one another and by what means is cooperation between such systems established?

The EU gas pipeline system is dense and highly interconnected, with over 200,000 km of high-pressure pipelines and over 1.5 million km of distribution pipelines stretching across all EU member states. Over 60 per cent of current EU gas consumption crosses at least one border, with only the Finnish and Greek gas grids currently unconnected to other member states (Malta and Cyprus have no natural gas grids).

The Second Gas Directive aims to ensure interoperability by requiring member states to adopt and publish objective and non-discriminatory minimum technical design and operational requirements for connection to downstream transportation systems and storage facilities. More detailed rules on technical interoperability were drawn up within the context of the Madrid Forum (see question 42) and made legally binding through the Gas Regulation. These rules relate, inter alia, to congestion management, capacity allocation and transparency. The Gas Regulation also requires that transmission system operators publish detailed descriptions of the gas transmission system indicating all relevant interconnection points. The ERGEG Guidelines referred to above in question 11 are also relevant in facilitating cooperation between transmission and storage operators.

- 13** Can customers, other natural gas suppliers or an authority require a pipeline or storage facilities operator to expand its facilities to accommodate new customers? If so, who bears the costs of interconnection or expansion?

The Second Gas Directive provides that, in the event that third-party access is refused based on lack of capacity, the relevant member state may require that the system operator make the necessary investments in incremental capacity if it is economic to do so or if a potential customer is willing to pay. It further provides that, in circumstances where no further authorisations to build and operate distribution pipelines in a particular area are granted, member states must require the system operator to invest in incremental capacity if requested. The terms under which such expansion may be required are a matter for national legislation.

There have also been attempts to characterise refusals to expand transmission infrastructure as a violation of EC article 82. In 2006, for example, the Italian Competition Authority found that ENI had abused its market position by discontinuing works on the expansion of a main import pipeline into Italy. ENI was fined and ordered to provide third-party access to expanded capacity in the pipeline by 1 October 2008.

- 14** Describe any regulation of the prices or terms of service for pipeline or storage services.

The Second Gas Directive provides a framework for the national regulation of third-party access terms (see question 11 above), mainly to ensure that they are proportionate and non-discriminatory.

- 15** Describe any statutory and regulatory requirements applicable to the processing of natural gas to extract liquids and to prepare it for pipeline transportation.

The extraction and processing of natural gas liquids is not regulated at the EU level.

- 16** Describe the contractual regime for transportation and storage.

The content of transportation and storage agreements is not specifically regulated at the EU level, subject to the constraints of the Second Gas Directive and generally applicable competition rules.

### Regulation of natural gas distribution

- 17** What is the ownership and organisational structure for the local distribution of natural gas (transportation from pipeline to consumer)?

The ownership and organisational structure for the local distribution of natural gas is largely laid down at the national level, subject to the legal and management unbundling, designated independent system operator and other applicable requirements of the Second Gas Directive (similar to the requirements for gas transmission companies outlined in response to question 8).

- 18** What governmental or administrative authorisations are required to operate a distribution network? To what extent are gas distribution utilities subject to public service obligations?

Authorisations for the construction and operation of natural gas transportation pipelines and storage facilities are granted at the national level, subject to the minimum transparency, non-dis-

crimination, and judicial review requirements of the Second Gas Directive (see question 9).

The Second Gas Directive provides for several public service obligations that member states may implement at the national level. Member states can impose public service obligations relating to security of supply, regularity, quality and price of supply, and environmental protection. Member states may also impose supply obligations in favour of certain categories of customers or customers located in a particular area. The Explanatory Note on public service obligations for gas provides guidance on the scope of the obligations that member states may impose and the way in which companies may be compensated for carrying out such obligations.

In addition, the Security of Supply Directive requires member states to implement minimum standards to ensure security of gas supplies (in particular for household customers) through measures to (i) enhance the flexibility of production, importation and transmission systems, (ii) develop interruptible demand, (iii) diversify sources of gas supply, (iv) increase domestic production and (v) enter into long-term contracts.

- 19** How is access to the natural gas distribution grid organised?

The Second Gas Directive regulates access to distribution grids in the same way as access to natural gas transportation and storage systems (see question 11). An Explanatory Note provides guidance on the requirements that may be imposed on operators of distribution systems relating to, inter alia, allocation of switching costs, provision of information to consumers, quality of supply and metering.

- 20** Describe any regulation of the prices for distribution services. In which circumstances can a rate or term of service be changed?

The Second Gas Directive provides a framework for the national regulation of third-party access terms to distribution, including balancing services, mainly to ensure that they are proportionate and non-discriminatory (see question 11).

- 21** May the regulator require a distributor to expand its system to accommodate new customers? May the regulator require the distributor to limit service to existing customers so that new customers can be served?

Similar considerations apply as outlined in response to question 13. There is no requirement at EU level for distributors to limit services to existing customers so that new customers can be served.

- 22** Describe the contractual regime in relation to natural gas distribution.

The content of natural gas distribution agreements is not specifically regulated at the EU level, subject to the constraints of the Second Gas Directive and generally applicable competition rules.

### Regulation of natural gas sales and trading

- 23** What is the ownership and organisational structure for the supply and trading of natural gas?

The ownership and organisational structure for companies engaged in supply or trading activities is not regulated at the EU level, subject to the legal and management unbundling requirements of the Second Gas Directive for supply and trading firms

that are vertically integrated into transportation, distribution, storage or LNG activities.

- 24** To what extent are natural gas supply and trading activities subject to governmental oversight?

Supply and trading of gas is not regulated at the EU level, other than through the Gas Regulation, which requires transmission operators to provide for the trading of capacity rights and the constraints of generally applicable competition rules.

- 25** How are physical and financial trades of natural gas typically completed? Please describe the processes, agreement forms and standard terms.

Physical and financial trades have not been harmonised by EU law and may vary across member states. The European Federation of Energy Traders publishes a standardised general agreement for the delivery and acceptance of gas.

- 26** Must wholesale and retail buyers of natural gas purchase a bundled product (the natural gas commodity and transmission or distribution) from a single provider? If not, describe the range of services and products that customers can procure from competing providers.

The Second Gas Directive requires vertically integrated firms to separate the legal and management structure of their supply and trading activities from their transportation and distribution activities and to keep separate accounting for storage and LNG activities (see questions 8 and 17). Therefore, as of 1 July 2007, there should be no single providers of transportation and distribution, and supply and trading services, except in certain limited circumstances.

### Regulation of liquefied natural gas (LNG)

- 27** What is the ownership and organisational structure for LNG, including liquefaction and export facilities, and receiving and regasification facilities?

The ownership and organisational structure for companies engaged in LNG activities is largely laid down at the national level, subject to the accounting unbundling, designated system operator and other applicable requirements of the Second Gas Directive (see question 8).

- 28** What governmental or administrative authorisations are required to build and operate LNG facilities and which are the responsible authorities to grant such approvals?

Authorisations for the construction and operation of LNG facilities are granted at the national level, subject to the minimum transparency, non-discrimination and judicial review requirements of the Second Gas Directive (see question 9).

- 29** Describe any regulation of prices and terms of service in the LNG sector.

The Second Gas Directive provides that third-party access to LNG facilities must be available on the basis of objective, non-discriminatory criteria and approved and published tariffs (so-called regulated access, similar to the requirements for third-party access to pipeline transportation and storage systems outlined in the response to question 11).

### Regulators

- 30** Which governmental or administrative authorities determine regulatory policies governing the production, transmission, distribution and supply of natural gas?

Competence for regulatory policy is split between the European Commission and the member state authorities. The European Commission enforces sector-specific EU regulation (DG Transport and Energy) as well as EU competition rules (DG Competition). As noted in response to question 3, the Commission has the exclusive power to propose new legislation, which must be adopted by the Council of the European Union and the European Parliament.

The Second Gas Directive requires that member states establish national sector-specific energy regulators tasked with ensuring non-discrimination and effective competition, and with regulating access tariffs. An Explanatory Note, as well as the chapters of this volume that cover the different EU member states, provide further details on the functions of these national regulators.

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

The European Commission safeguards the proper implementation of existing EU law (sector-specific legislation and generally applicable rules). It monitors developments in the EU energy sector and has the power to propose new legislation. For example, the Commission publishes an annual 'benchmarking' report that provides detailed information on the EU gas market as well as details on the status of the implementation of the European regulatory framework for natural gas in the various member states, highlighting areas of progress and areas of non-compliance.

Ultimately, the Commission has the power to bring an action against a member state before the European Court of Justice for failure to comply with EU law or failure to transpose a Directive correctly. In addition, where the Commission identifies infringements of competition rules in the gas sector, it can impose fines and require remedial action. The Commission can also require remedies as a precondition for approval of merger transactions.

The scope of the national regulators' authority will be addressed in the chapters of this volume that cover the different member states.

- 32** How is each regulator established? To what extent are they independent of the regulated business and of government?

The European Commission is a collegiate body composed of 27 Commissioners (one per member state), each of whom heads a Directorate General of civil servants. EU law provides that Commissioners must be chosen on the grounds of their general competence and that their independence must be 'beyond doubt'. The Parliament may veto the Commission (in its entirety) if it harbours doubts over its members. Currently, the Commissioner responsible for energy is Andris Piebalgs, and the Commissioner for competition is Neelie Kroes, both of whom have been in office since 2004.

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

Commission decisions can be appealed to the European Court of First Instance and subsequently to the European Court of Justice. An appeal to the Court of First Instance can invoke errors of fact and errors of law (including misuse of powers, lack of competence, infringement of procedural requirements and the

infringement of EC Treaty rules and secondary EU legislation). Subsequent appeals before the European Court of Justice are limited to points of law only.

An appeal must be brought within two months and ten days after notification of the decision. Appeal proceedings break down into a written phase with exchange of written pleadings and an oral phase with a hearing before the Court. Typically appeal proceedings take between two and three years until final judgment.

A further avenue to bring regulatory disputes before European Courts is to invoke EC law in litigation before national courts. In cases where EC rules are invoked, national courts may request a preliminary ruling from the European Court of Justice on the interpretation of these rules under EC article 234, with national courts of final instance having an obligation to do so.

### Mergers and competition

**34** Which governmental body may prevent or punish anti-competitive practices in the natural gas sector?

The European Commission is responsible for the application and enforcement of EU competition rules, including in the natural gas sector. National competition authorities also exist in all EU member states, and are competent to apply national as well as EU competition rules. The Commission retains a central role in the enforcement of competition rules in the EU, since it must be consulted and has the power to intervene in all national competition proceedings with cross-border effects.

**35** What substantive standards does that governmental body apply to determine whether conduct is anti-competitive?

The key EU competition law provisions are EC articles 81, 82 and 86.

- EC article 81 prohibits all agreements and concerted practices that have appreciable adverse effects on competition and trade within the EU, subject to an exemption possibility. This covers both horizontal restrictions among competitors (such as price fixing, customer or geographic market sharing and collective boycotts) and vertical restrictions between different levels of trade (such as export and import restrictions, tying, or other exclusionary arrangements). The Commission has issued a substantive body of guidelines and so-called block exemptions that clarify its enforcement policy in this area.
- EC article 82 prohibits the abuse of a dominant market position. By way of example, this may cover refusals to grant access to essential facilities without objective justification, the application of discriminatory or excessive tariffs or other trading conditions, or exclusionary tying arrangements.
- Finally, EC article 86 provides that member states and public undertakings are also subject to EU competition rules. However, companies entrusted with services of a general economic interest may be exempt from competition laws to the extent necessary for the proper performance of the tasks assigned to them.

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

Where the Commission finds that EU competition rules have been violated, it can order companies to cease the infringement and take measures necessary to restore competition. Contractual provisions that violate EC article 81 are automatically void and

unenforceable. Finally, the Commission can fine companies up to 10 per cent of their annual worldwide group turnover.

Competition law enforcement in the gas sector has been intense in recent years, mostly resulting in informal settlements. Important developments include:

- the GFU, Dong and Corrib cases, in which the Commission aggressively pursued national and field-specific upstream joint sales arrangements in Norway, Denmark and Ireland;
- the Marathon case, in which the Commission pursued an alleged refusal to grant access to German, French and Dutch pipeline transportation networks. Each of the various owners ultimately agreed to settle and commit to a number of remedies, which varied from case to case and included, among other things, providing for an 'entry-exit' system for capacity booking, 'use it or lose it' rules for capacity reservations, the implementation of online screen-based booking procedures and gas release programmes;
- a number of parallel investigations of export bans, destination clauses, profit-sharing mechanisms and other restrictions on the re-sale of LNG and natural gas (including intra-EU supplies and supplies from Russia, Nigeria and Algeria). Most of these cases were settled informally (a formal ruling was adopted only against agreements between Gaz de France and ENI/Enel), with companies agreeing to drop the resale prohibitions. ENI and OMV, moreover, were persuaded to commit to increase the capacity of pipelines for the transmission of gas from Russia to Italy and Austria, respectively; and
- the Gas Natural/Endesa case, in which the Commission acted against a long-term supply agreement in Spain and the parties ultimately agreed to reduce both the duration and volumes covered by the agreement.

**37** Does any governmental body have authority to approve or disapprove mergers or other changes in control over businesses in the sector or acquisition of production, transportation or distribution assets? If so, what criteria and procedures apply? How long does it typically take to obtain a decision approving or disapproving the transaction?

Mergers, acquisitions, and so-called 'full function' joint ventures (ie, joint ventures that "perform on a lasting basis all the functions of an autonomous entity") must be notified to the European Commission, and are subject to a standstill obligation, if they meet certain size thresholds. Transactions that do not meet the EU size thresholds may be subject to notification under national merger control laws. (There is also a system for referrals of the review of all or part of a transaction between Commission and national regulators.) Formal merger review proceedings before the Commission typically range from 25 business days, in easy cases, to 105 business days or more for a full 'in-depth' investigation (although pre-notification discussions can considerably lengthen this period).

The substantive test in EU merger control is whether the transaction creates a "significant impediment to effective competition" within the EU. This standard is largely similar to that applied in the United States and at the national level in the EU, and focuses on so-called unilateral effects (ie, will the merged entity have the ability and incentive unilaterally to increase prices) and coordinated effects (ie, will the merged entity have the ability and incentive to increase prices through tacit coordination with its principal competitors). The Commission has the power to block transactions or to approve them only subject to the implementation of remedies (typically, the divestiture of part of the business).

### Update and trends

On 10 January 2007, the European Commission published the findings of a wide-ranging sector inquiry into the EU gas and electricity markets. The Commission concluded that there remain 'serious competition problems' in the energy sector. In particular, it found high levels of market concentration, unequal access to and insufficient investment in infrastructure, and possible collusion and market sharing arrangements between incumbent operators.

On the same day, the Commission simultaneously launched its Energy Policy for Europe aimed at combating climate change and boosting energy security and competitiveness. The package sets out a series of targets on greenhouse gas emissions and renewable energy and aims to create a true internal market for energy and to strengthen effective regulation.

In light of the findings of the Sector Inquiry, the Commission has announced its intention make full use of its powers under EC competition rules to:

- scrutinise market concentration and future mergers, paying particular attention to divestitures and gas release programmes as possible remedies (which have been required in previous merger decisions in the gas sector in 2006, see question 37);
- investigate the impact of long-term upstream contracts on downstream concentration;
- make use of possible structural remedies under Articles 81 and 82;
- rigorously apply state aid rules;
- investigate possible collusion between incumbents to share markets;

- address vertical integration between supply and generation and infrastructure businesses, which in the Commission's view increases competition problems by creating unequal access to essential market information and enabling incumbents to engage in strategic behaviour;
- address the lack of access to infrastructure, such as transmission and distribution networks and storage facilities, especially cross-border access; and
- address the lack of investment by transmission companies with vertically integrated supply companies.

The Commission also announced its intention to propose a number of legislative measures in order to achieve the objective of completing the internal energy market by January 2009 as part of the Energy Policy for Europe. The Commission seeks in particular:

- to prevent discrimination, through a clearer separation of energy production and energy distribution, which may include a requirement for full ownership unbundling, although this has already met with opposition from member states (see question 8);
- to reinforce regulatory oversight by establishing a new single regulatory body at EU level, or a European network of independent regulators;
- to speed up investments in key bottlenecks;
- to increase transparency by introducing new minimum requirements for information provision; and
- to introduce common minimum, binding network security standards.

The Commission has recently examined a number of high-profile mergers in the natural gas sector. Important developments include:

- In EDP/ENI/GDP, the Commission prohibited a merger between two Portuguese natural gas and electricity companies on the grounds that, inter alia, the transaction would foreclose competing gas companies from supplying EDP's power plants. Conversely, the Commission found that, once the market for retail gas supply would be opened to competition, the transaction would eliminate EDP as the most likely entrant into this market.
- In E.ON/MOL, the Commission required the merged entity to release the equivalent of 14 per cent of Hungary's total gas consumption up until 2015. The merging parties also committed to ownership unbundling of their gas production and transmission activities. In a recent development in the case, E.ON has appealed to the European Court of First Instance for what it claims are attempts by the Commission to alter the starting price laid down in the gas release auction.
- In DONG/Elsam/E2, the merging parties were required to divest one gas storage facility, and committed to implement a gas release programme releasing the equivalent of 10 per cent of Danish demand for gas for seven years. Moreover, the remedy sought to maximise intra-EU trade by setting up a system of gas swaps.
- In Gaz de France/Suez, the Commission approved the transaction subject to a number of divestments, including Suez divesting its holding in the incumbent Belgian gas operator, Distrigaz, and in the Belgian gas network and gas storage

operator, Fluxys. The Commission also required that the gas network be managed by an independent system operator and that the parties develop infrastructure capacities in France and Belgium so as to promote new entry.

These transactions highlight the power of the Commission to require far-reaching remedies in merger control proceedings, which it can use to pursue broader regulatory policy goals.

**38** In the purchase of a regulated gas utility, are there any restrictions on the inclusion of the purchase cost in the price of services?

There is no express restriction on the inclusion of the purchase cost of a utility in the price of services, and the Gas Regulation expressly recognises that access charges may include 'an appropriate return on investment'. The extent to which a proportion of the purchase costs could be recovered in this way is unclear, although it should be borne in mind that excessive pricing can constitute an abuse of dominance (see question 35).

**39** Are there any restrictions on the acquisition of shares in gas utilities? Do any corporate governance regulations or rules regarding the transfer of assets apply to gas utilities?

EU law does not restrict the acquisition of shares in gas utilities. Any member state seeking to introduce such a restriction would have to comply with EU rules relating to the free movement of capital.

**International**

- 40** Are there any special requirements or limitations on foreign companies acquiring interests in the natural gas sector?

EU law guarantees the free movement of capital and the freedom of establishment within the EU. Restrictions on the ability of EU companies to acquire interests in the EU gas sector are generally not permitted. In a number of cases, for example, the European Court of Justice has held that 'golden share' arrangements through which member states seek to protect domestic companies from takeover are in breach of EC free movement rules. Unlawful 'golden share' arrangements can take many forms, including a cap on the shareholding that can be held by nationals of other member states, restrictions on the sale or use of strategic assets or special voting, or veto rights attached to the state's (minority) shareholding. Article 21(4) of the EC Merger Regulation further circumscribes the ability of member states to prevent takeovers of domestic companies.

In 2006, the Commission acted against Spain for imposing a number of regulatory conditions on E.ON's bid for Endesa that in the Commission's view were designed to discourage a takeover of Endesa and were incompatible with the EU Merger Regulation. In the same year, the Commission urged the German government to relinquish its golden share in E.ON, which allows the German government to veto any acquisition of E.ON's gas assets. These cases highlight the Commission's commitment to oppose restrictions on cross-border transactions in the gas sector.

- 41** To what extent is regulatory policy affected by treaties or other multinational agreements?

The EU is party to trade agreements with non-EU countries that also include gas. These agreements usually contain a prohibition against customs duties or restrictions having an equivalent effect. Member states are bound by these agreements and the Commission has recently taken action against Italy for introducing a tax on gas imports from Algeria. International discussions and agreements between the EU and third countries – for example the energy dialogue between the EU and Russia – moreover, may be influenced by EU energy policies, such as the importance of security of supply.

- 42** What rules apply to cross-border sales or deliveries of natural gas?

Under the Second Gas Directive's "reciprocity rule", member state A may prevent gas imports from member state B where the

relevant customers in member state A cannot be freely supplied in member state B. This represents an exception to EC articles 28 and 29, which prohibit quantitative restrictions on cross-border trade between EU member states. As a general rule, national measures restricting imports and exports are outlawed unless they can be justified on the basis of article 30 or on the basis of "imperative requirements".

With the exception of the "reciprocity rule", the Second Gas Directive does not set out a particular legal framework for the cross-border supply of gas. In an attempt to fill this gap, the European Commission has set up the Madrid Forum, which convenes twice a year and consists of various interested parties, including the Commission, member states, national regulatory authorities, gas transporters, gas suppliers, consumers and network users. The non-binding codes of conduct drawn up at the Madrid Forum cover many aspects of cross-border supplies of gas and have been codified in the Gas Regulation. The Madrid Forum is currently considering tariffs for cross-border gas exchanges, the allocation and management of scarce interconnection capacity and other technical and commercial barriers to the creation of a fully operational internal gas market.

**Transactions between affiliates**

- 43** What restrictions exist on transactions between a natural gas utility and its affiliates?

Through unbundling requirements and non-discrimination and transparency obligations, the Second Gas Directive aims to ensure that transactions between gas utilities and their affiliates are at arm's length terms. In addition, in partly liberalised markets, the Second Gas Directive prohibits companies that enjoy a legal monopoly in one market segment from using profits from this segment to support lower prices in a liberalised market segment where they face competition. Such cross-subsidising may also infringe competition rules.

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

The enforcement of affiliate restrictions is primarily up to member states, and in particular the national energy regulators. However, the European Commission, national competition authorities and courts can all act against discrimination in favour of affiliates where this behaviour violates competition rules.

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