

5

ENERGY MARKET LIBERALISATION

From monopolistic to traded markets in the European Union

*Sirja-Leena Penttinen**

1 Introduction

The European Union (EU) energy markets can be described as downstream energy markets.¹ The separation of upstream, midstream and downstream markets is more familiar to the oil and gas sectors, where the concepts refer to an oil or gas company's location in the supply chain; the closer the operating firm or function is to the end user, the further downstream the operations are.² This strict separation of different operations and activities has become somewhat blurred given the changing energy landscape, in particular because of the transition towards a low-carbon energy system with an increasing share of renewables and new roles and actors.³ Nevertheless, the concept of downstream still provides an overview on how the energy markets in the EU have been organised and what type of regulation has been used in order to break the national vertically integrated monopoly companies in particular in the electricity and gas sectors.

Due to the importance of the energy sector, the EU Member States have been unwilling to embrace the idea of extending their energy markets beyond national borders. The energy sector is considered to fall strictly under the umbrella of state sovereignty and this has been the main reason why Member States have been rather unwilling to allow the EU to exercise any competence in the sector.⁴ This is so, even if from the outset, in the Treaty establishing

* The chapter is part of the EL-TRAN-project funded by the Academy of Finland (project No. 293437).

1 See also L. S. Reins, 'Developments in Downstream Energy Regulation in the EU: Accommodating the Changing Role of Energy Consumers', 16 (3) *Oil, Gas and Energy Law (Special Issue on International Energy Law)* (2018).

2 See, e.g., Investopedia, 'Downstream', available at: <https://www.investopedia.com/terms/d/downstream.asp> (accessed December 2018).

3 Similarly, see, e.g., L. S. Reins, 'Developments in Downstream Energy Regulation in the EU: Accommodating the Changing Role of Energy Consumers', 16 (3) *Oil, Gas and Energy Law (Special Issue on International Energy Law)* (2018), pp. 2–3.

4 See, e.g., L. Hancher, 'A Single European Energy Market – Rhetoric or Reality?', 11 (2) *Energy Law Journal* (1990), p. 221. Article 194 Treaty of the Functioning of the European Union (TFEU), introduced in the Lisbon Treaty, provides the EU with a legal basis to adopt secondary legislation in order to achieve objectives related to the functioning of the energy market as listed in Article 194(1) TFEU, as energy falls under shared competences between Member States and the EU. Nevertheless, Article 194(2) TFEU includes a caveat, according to which EU measures 'shall not affect a Member State's rights to determine the conditions for exploiting its

the European Coal and Steel Community (the ECSC Treaty) and the Treaty establishing the European Atomic Energy Community (Euratom), the impression was conveyed that energy was indeed a common European concern.⁵

Member States' national energy sectors were structured in such a way as to ensure that the state exercised control at every stage of the process of energy supply. National energy companies were vertically integrated, often state-owned companies, which were in charge of generation, transportation and energy sales to the final consumer. These companies enjoyed a monopoly over electricity and gas extending through the whole energy value chain and thus dominated Member States' national markets, which were largely isolated from one another.⁶ However, it should be emphasised that despite characterising the national incumbents as state-owned utilities, it is the operation, and not the ownership itself, of the utility that is the determining factor that limits the possibilities for cross-border trade in energy.⁷

Companies did not face competition from other suppliers, whether internal or external, nor did they wish to do so. Almost all Member States' energy companies could have been characterised as 'inward-looking monopolies' and they had no interest in breaking out of their boundaries and entering the territories of neighbouring companies.⁸

The existing trade in electricity between Member States was largely conducted as a balancing activity between Member States' national monopoly companies. Whilst some interconnections between national systems existed, they did not provide capacity for substantial net trade. As was the case for electricity, gas trade only took place between national utilities in the Member States concerned and did not enhance competition at the level of the final consumer. Above all, most Member States were reluctant to rely to any significant extent on electricity supplies from outside their own borders. For both gas and electricity, a larger degree of interconnection was envisaged by making it possible to share supplies in emergency situations, thereby enhancing security of supply.⁹ Consequently, the creation of an EU-wide energy market area was frequently hindered by the specific features of Member States' domestic energy markets and their historical development.

energy resources, its choice between different energy sources and the general structure of its energy supply'. This caveat has been much discussed with reference to renewable energy, and in particular to the national targets set for Member States by the Renewable Energy Directive (Directive 2009/28/EC of the European Parliament and of the Council of 23 April 2009 on the promotion of the use of energy from renewable sources and amending and subsequently repealing Directives 2001/77/EC and 2003/30/EC, OJ L 140, 5.6.2009, pp. 16–62). For an analysis of Article 194(2) TFEU, see, e.g., A. Johnston and E. van der Marel, 'Ad Lucem? Interpreting the New EU Energy Provisions, and in particular the Meaning of Article 194(2) TFEU' 22 (5) *European Energy and Environmental Law Review* (2013), pp. 181–199. Nevertheless, the General Court recently provided the first interpretation concerning Article 194(2) TFEU and confirmed Member States' energy rights under 194(2) TFEU, see T-356/15 *Austria v Commission*, EU:T:2018:439, para. 105.

5 At EU level, the initial treaty framework focused specifically on energy; two of the three founding treaties evolved around energy products. The ECSC Treaty sought to establish a common market in coal and steel – coal being the main energy product at the time – and thereby ensure peace and further the reconstruction of post-war Europe. The Euratom, on the other hand, was initially created to coordinate the Member States' research programmes to facilitate the peaceful use of nuclear energy.

6 K. Talus, *Vertical Natural Gas Transportation Capacity, Upstream Commodity Contracts and EU Competition Law* (Kluwer Law International 2011), p. 197.

7 A. Lakatos, 'Overview of the Regulatory Environment for Trade in Electricity', in J. Bielecki & M. Geboye Desta (eds.) *Electricity Trade in Europe: Review of the Economic and Regulatory Challenges* (Kluwer Law International 2004), p. 131.

8 K. Talus, *EU Energy Law and Policy: A Critical Approach* (Oxford University Press 2013), p. 17.

9 The Commission of the European Communities, Communication from the Commission to the Council, New Community Energy Objectives, COM(85) 254 final, paras. 31–35.

The main barriers to the establishment of an EU-wide internal energy market has been the spectrum of different national approaches to energy, and the inability to find common ground and a solution that suits every party.¹⁰ Member States were reluctant to accept the limits that an integrated market would impose on their policy options given the strategic nature of the sector in question. This had already been highlighted as one of the reasons why the ECSC failed: the situation for which it was created never materialised and in its absence Member States preferred market segmentation to market integration – and the High Authority had no supranational powers at its disposal to trump national self-interest.¹¹

Similarly, players involved in the electricity and gas industries were of the view that nothing needed changing and that Brussels' involvement was neither necessary nor welcome. The reasons behind this approach reflected both the (monopolistic) industries' need to protect their substantial profits as well as simple fear of change. Both governments and industries alike expressed their differing concerns by relying on the language of security of supply and the need to protect public service obligations.¹²

Therefore, it is of the utmost importance to understand that when it comes to energy market liberalisation the sector in question differs fundamentally from other economic sectors, such as telecommunications, for example. An entire transformation has taken place from a state-driven and planned system to a market-based system. This has not been purely a question of eliminating barriers to a free trade area but has instead entailed a fundamental transformation, at an ideological level, of the approach taken to the organisation of energy markets.¹³

This chapter traces the historical development of energy market liberalisation and energy trading in the EU from a regulatory perspective. It portrays the political climate and legislative developments adopted at the EU level in order to integrate national energy markets into EU-wide energy markets. The emphasis is on electricity and gas, as the EU energy *acquis* focuses to a large extent on the regulation of these sectors. By contrast, EU energy regulation has not similarly touched upon oil markets because of their very different character from electricity and gas: oil markets are international in nature and they are not as dependent on infrastructure as electricity and gas.¹⁴ The remainder of the chapter follows the developments of the EU energy market's liberalisation from the 1980s onwards, and the conclusion addresses some of the future challenges that have an impact on the (regulation of the) energy sector.

2 Security of supply as the first driver for harmonisation measures at the EU level

Despite the fact that energy has been at the very heart of European integration since its early days, the process of integrating national energy markets into an EU-wide energy market in

10 On the early days of the EU's energy policy, see T. Daintith and L. Hancher, 'The Management of Diversity: Community Law as an Instrument of Energy and Other Sectoral Policies', 4 (1) *Yearbook of European Law* (1984), pp. 127–136.

11 K. J. Alter, *The European Court's Political Power: Selected Essays* (Oxford University Press 2009), p. 48; and M. Chick, *Electricity and Energy Policy in Britain, France and the United States Since 1945* (Edward Elgar 2007), p. 46.

12 J. P. Stern, *Competition and Liberalization in European Gas Markets: A Diversity of Models* (The Royal Institute of International Affairs, Energy and Environmental Programme 1998), p. 90.

13 K. Talus, *EU Energy Law and Policy: A Critical Account* (Oxford University Press 2013), p. 99.

14 K. Talus, *Vertical Natural Gas Transportation Capacity, Upstream Commodity Contracts and EU Competition Law* (Wolters Kluwer 2011), p. 4; P. J. Slot, 'Energy and Competition', 31 (3) *Common Market Law Review* (1994), p. 516.

which energy can flow freely has moved forward extremely slowly.¹⁵ Although the Treaty of Rome establishing the European Economic Community (EEC) included provisions on free movement and competition, which, in principle, also applied to the energy sector,¹⁶ energy markets were nationally segmented and dominated by national and heavily regulated energy monopoly companies, which were either publicly owned or publicly supported.¹⁷ These national monopoly companies were often granted either *de jure* or *de facto* the exclusive right to sell, import and export energy, and to construct infrastructure in their particular area.¹⁸

Energy was considered to fall under the category of a ‘public service’,¹⁹ which meant that it had to be provided universally to all citizens. Given the strategic nature of energy, self-sufficiency was held by national governments to be the main objective of energy policy.²⁰

Some of the first regulatory tools that explicitly concerned the energy sector were adopted to ensure the security of the energy supply. While the ECSC Treaty provided the Commission with broad powers in relation to monitoring the market, including emergency powers to deal with issues such as scarcity in the supply of oil and steel, within this particular framework these powers did not bring about any substantial progress in respect of such issues.²¹

However, the EU began to make modest steps in this area a few decades later. The political volatility in the Middle East during the 1970s resulted in shortages of petroleum exports in addition to elevated prices. This also had repercussions in Europe.²² While oil supplies were vulnerable, the Commission decided to focus on the pressing issues of the time, such as security of supply, the management of scarcity, reducing energy import dependency and increasing energy savings.²³ Some of the initiatives that addressed these pressing issues ultimately led to the adoption of secondary legislation.²⁴ The main aim of this was to set up

15 For an overview, see e.g., S-L. Penttinen, ‘Free Movement and the Energy Sector in the European Union: The Role of the European Court of Justice’ (Routledge 2020).

16 Despite the fact that electricity lacks some of the fundamental qualities of a good, in the early case of 6/64 *Costa v ENEL*, EU:C:1964:66, the Court held – though without specifically confirming that it is to be considered as a good – that an electricity monopoly falls within the scope of Article 37 TFEU. Decades later, in C-393/92 *Almelo*, EU:C:1994:171, the Court explicitly confirmed the status of electricity as a good. See ‘also S.-L. Penttinen, ‘The Treaty Freedoms in the Energy Sector – Overview and State of Play’ in S.-L. Penttinen & I. Mersinia (eds), *Energy Transitions: Regulatory and Policy Trends* (Intersentia 2017), pp. 75–107.

17 K. Talus, *EU Energy Law and Policy: A Critical Account* (Oxford University Press 2013), p. 15.

18 C. Jones, ‘Introduction’, in C. Jones (ed.), *EU Energy Law: Volume I, The Internal Energy Market* (Claeys & Casteels Publishing 2016), p. 1.

19 C-157/94 *Commission v Netherlands*, EU:C:1997:499; C-158/94 *Commission v Italy*, EU:C:1997:500, and C-159/94 *Commission v France*, EU:C:1997:501. See also L. Hancher and W. Sauter, ‘Public Services and EU Law’, in C. Barnard and S. Peers (eds.), *European Union Law* (Oxford University Press 2014), pp. 539–566.

20 See, e.g., J. Bielecki, ‘Electricity Trade: Overview of Current Flows and Infrastructure’, in J. Bielecki & M. Geboye Desta (eds.), *Electricity Trade in Europe: Review of the Economic and Regulatory Challenges* (Kluwer Law International 2004), pp. 8–9.

21 T. Daintith & L. Hancher, ‘The Management of Diversity: Community Law as an Instrument of Energy and Other Sectoral Policies’, 4 (1) *Yearbook of European Law* (1984), p. 126.

22 See also Commission of the European Communities, ‘Problems, Resources and Necessary Progress in Community Energy Policy 1975–1985’, available at: <http://aei.pitt.edu/36270/1/A2480.pdf> (accessed December 2018).

23 Today, the two concepts of energy savings and energy efficiency are closely intertwined by both environmental and security of supply objectives, see S-L. Penttinen and L. Reins, ‘System Boundaries of Nearly Zero-Energy Buildings in the European Union—Rethinking the Legal Framework for Active Consumer Participation’ 37 (4) *Journal of Energy and Natural Resources Law* (2019), pp. 389–404.

24 See, e.g., Council Directive 68/414/EEC of 20 December 1968 imposing an obligation on Member States of the EEC to maintain minimum stocks of crude oil and/or petroleum products, OJ L 308, 23 Dec. 1968,

an emergency system within the EU,²⁵ since – as the Commission itself emphasised – ‘[e]nergy supply problems are today so largely world problems that attempts to solve them at the national level appear doomed in advance’.²⁶ These measures, however, remained rather modest in their scope, as they merely served as a tool of coordination and information-sharing rather than a regulatory tool imposing stringent obligations on Member States. In practice, almost all Member States relied primarily on the International Energy Agency’s emergency oil-sharing mechanisms once the oil crisis hit Europe. Furthermore, although the EU adopted ambitious long-term goals in respect of energy production, consumption and imports after the first oil shock, no common ground on the concrete measures to be taken to achieve these goals was found.²⁷ Instead, by holding tightly onto their energy sector sovereignty, each Member State did what they thought was best for them. For example, France decided to invest in nuclear energy in order to make the country less vulnerable to import shortages.

Despite the Commission’s acknowledgement of the universal nature of energy supply issues, its approach to energy policy within the EU – and, more precisely to the development and enforcement of EU law in relation to the energy sector – in that period has been characterised as the ‘management of diversity’.²⁸ This essentially denotes an appreciation that Member States chose their own different paths towards the energy policy objectives of both the EU and Member States based on their individual situations.²⁹ This approach guided the Commission’s approach to the energy sector after it became clear that there was no scope to develop and implement a genuinely coordinated energy at EU level at the time, despite the fact that the first energy policy objectives at EU level had been stated as early as 1968. At the time the energy sector fell strictly under the sovereignty of Member States, and their characteristics were regarded as being too different for a common energy policy to be a viable proposition.³⁰ Instead of seeking full uniformity of energy sector policies among Member States, the Commission aimed to bring about equivalent effort and collective discipline on the part of Member States in the establishment and pursuit of their own national energy policies.³¹

3 The first steps towards restructuring the market at the EU level: the first and second energy packages

Developments in respect of the integration of the EU energy markets can be roughly divided into two main time periods, where different priorities in the underlying policy aspects can clearly be seen to pave the way for legal developments. The first period comprises early

p. 14–16; Council Directive 72/425/EEC of 19 December 1972 amending the Council Directive of 20 December 1968 imposing an obligation on Member States of the EEC to maintain minimum stocks of crude oil and/or petroleum products, OJ L 291, 28 Dec. 1972, p. 154.

25 K. Talus, *EU Energy Law and Policy: A Critical Account* (Oxford University Press 2013), p. 16.

26 Communication from the Commission to the Council, Necessary Progress in Community Energy Policy, COM(72) 1200 final, 4 October 1972, para. 3.

27 J. S. Duffield & V. L. Birchfield, ‘Introduction’, in V. L. Birchfield & J. S. Duffield, *Toward a Common European Union Energy Policy: Problems, Progress, and Prospects* (Palgrave Macmillan 2011), p. 4.

28 T. Daintith & L. Hancher, ‘The Management of Diversity: Community Law as an Instrument of Energy and Other Sectoral Policies’, 4 (1) *Yearbook of European Law* (1984), pp. 123–167.

29 T. Daintith & L. Hancher, ‘The Management of Diversity: Community Law as an Instrument of Energy and Other Sectoral Policies’, 4 (1) *Yearbook of European Law* (1984), p. 123.

30 K. Talus, *EU Energy Law and Policy: A Critical Account* (Oxford University Press 2013), p. 17.

31 T. Daintith & L. Hancher, ‘The Management of Diversity: Community Law as an Instrument of Energy and Other Sectoral Policies’, 4 (1) *Yearbook of European Law* (1984), pp. 123–167.

developments from the 1980s to the adoption of the first and second energy packages in the mid-1990s and early 2000s. The second period covers the adoption of the third energy package and the climate change legislation.³²

The EU's focus on energy gradually increased following the example provided by the evolution of 'general' single market integration.³³ In particular, examples from certain US states provided the necessary push for the ideological change that was needed. Similarly, in Europe, the UK in particular offered an example of a successful change in the organisation of energy markets.³⁴ The ideological movement from heavily regulated monopolies that ensured self-sufficiency in energy towards new policies promoting competition and liberalisation of energy markets slowly began to get underway, and this approach started to resonate from the UK first, and then the rest of Europe.³⁵

While the previous approach was based on the assumption that the energy industry was a natural monopoly, the new approach rejected this premise. Instead, it was felt that at least the segments of generation, marketing and distribution could be subjected to competition and that this would lead ultimately to improved economic efficiency.³⁶ Once the system of energy monopolies was challenged by examples of alternative approaches from the other side of the Atlantic, the sole purpose of the existence of monopoly structures started slowly to be questioned. In particular, consumers realised that the high tariffs they were charged did not reflect the costs involved in securing the functioning of the system and that, after these costs had been met, the surplus income was going into the pockets of the employees and managers of the utilities and the politicians that provided the political and legal support to maintain the monopolistic structures. The wave of changes that occurred ultimately culminated in a wide-ranging corruption investigation in several Member States, which has been considered to have amounted to the reading of the last rites in respect of the legal and moral legitimacy of monopolistic structures within the energy sector, particularly in the eyes of consumers.³⁷

This change in the political climate also represented the turning point in terms of the Commission's purpose in relation to the sector, i.e., the aim of achieving a common market in energy through coordinated action at EU level instead of 'just' managing Member States' divergent approaches. This political change indicated a movement towards deregulation and privatisation throughout the economy, and the energy sector was no exception to this.³⁸ The new ideological approach involved fair and free competition between energy

32 A similar grouping is outlined, e.g., in P. Thaler, 'The European Commission and the European Council: Coordinated Agenda Setting in European Energy Policy', 5 (38) *Journal of European Integration* (2016), p. 571.

33 For a more comprehensive overview on the Single Market Programme of the late 1980s and early 1990s, please refer to P. Craig & G. de Búrca, *EU Law: Text, Cases and Materials*, 6th edition (Oxford University Press 2015), pp. 609–619.

34 See, e.g., M. Chick, *Electricity and Energy Policy in Britain, France and the United States since 1945* (Edward Elgar 2007).

35 J. Bielecki, 'Electricity Trade: Overview of Current Flows and Infrastructure', in J. Bielecki & M. Geboye Desta (eds.), *Electricity Trade in Europe: Review of the Economic and Regulatory Challenges* (Kluwer Law International 2004), p. 9.

36 Ibid.

37 K. Talus, *EU Energy Law and Policy: A Critical Account* (Oxford University Press 2013), p. 18. See also T. Wälde & A. Gunst, 'International Energy Trade and Access to Networks: The Case of Electricity', in J. Bielecki & M. Geboye Desta (eds.), *Electricity Trade in Europe: Review of the Economic and Regulatory Challenges* (Kluwer Law International 2004), pp. 182–183.

38 P. J. Slot, 'Energy and Competition', 31 (3) *Common Market Law Review* (1994), p. 511. However, in the context of EU energy markets, that idea of 'deregulation' is to a certain extent misleading. The concept of deregulation

companies across the EU. This was expected to lead to large efficiency gains, lower and less divergent prices for consumers across the EU, increased competitiveness for energy-intensive industries and, finally, economic growth that would go hand in hand with increased welfare.³⁹

In the aftermath of the launch of the general Single Market Programme the Commission decided it was time to focus more explicitly on the internal energy market. This led to the Working Document on the Internal Energy Market in May 1988,⁴⁰ which contained the first comprehensive discussion of the European energy sector.

The Commission's Working Document dealt with the general issues involved in the realisation of a single energy market. It specifically identified potential obstacles to achieving free energy flow in Europe and endorsed a competition-oriented approach. This latter provided impetus for further measures in a new political climate that was open to ideological – and further substantive – change. Since then, development has been rapid and the legislation targeting different aspects of liberalisation of energy, in particular the electricity and gas markets, has evolved quickly. To date, three sets of enactments aimed at liberalising the EU's internal energy market have been adopted.⁴¹ These are referred to as the 'energy packages' and comprise different means of addressing, among other things, market access, the need to support the increase of and improvement in interconnection capacity and infrastructure, transparency, security of supply, consumer protection and various issues relating to sustainability and environmental protection.

The Commission presented its first proposals for regulations and directives concerning the energy market following the adoption of the Single European Act in 1986. However, it took several years of negotiation for these to develop into the first energy package, and during the course of the negotiations it became clear that a number of Member States and industry players viewed many of the Commission's proposals as being too ambitious. Despite the differences between electricity and gas, it should be noted that the broad aims of the directives concerning each sector were largely the same.⁴² However, it became clear during the early stages of the market opening development that the electricity industry was far more prepared to concede that liberalisation could bring efficiencies and advantages to the industry than were representatives of the European gas industries, who regarded the introduction of

is often used in the context of privatisation and has therefore also been utilised in respect of discussions on energy market liberalisation in the EU. However, deregulation, in general, refers to the process of decreasing state regulation in a given field. No clear role has been played in the energy sector by regulatory authorities in the implementation and policing of competition and liberalisation. Instead, a major part of the EU energy market liberalisation efforts rely on the creation of EU and national level regulatory institutions and regimes, and therefore the concept of deregulation is, within the EU context, quite misleading as these developments should instead be referred to by reference to the concept of 'reregulation'. See, e.g., J. P. Stern, *Competition and Liberalization in European Gas Markets: A Diversity of Models* (The Royal Institute of International Affairs, Energy and Environmental Programme 1998), pp. xxii–xxiii.

39 See, e.g., P. O. Eikeland, 'EU Internal Energy Market Policy: Achievements and Hurdles', in V. L. Birchfield & J. S. Duffield, *Toward a Common European Union Energy Policy: Problems, Progress, and Prospects* (Palgrave Macmillan 2011), p. 13.

40 Commission Working Document on the Internal Energy Market, COM(88) 238 final.

41 The first electricity directive was adopted in 1996, whereas the first gas directive followed in 1998. The second energy package, comprising electricity and gas directives was adopted in 2003, and the third energy package in 2009. See Chapter 6 in this book by Formosa Herrera-Anchustegui and Formosa.

42 H. Vedder, A. Rønne, M. Roggenkamp & I. del Guayo, 'EU Energy Law', in M. Roggenkamp, C. Redgwell, A. Rønne & I. del Guayo (eds.), *Energy Law in Europe: National, EU and International Regulation*, 3rd edition (Oxford University Press 2016), p. 256.

liberalisation ‘as the equivalent of the end of civilization’.⁴³ This is one of the reasons why the electricity sector was able to proceed faster on the details concerning how and when electricity market liberalisation could be introduced.⁴⁴

The original electricity and gas market liberalisation proposals included, among other things, rules on unbundling (the separation of the management and accounting of production, transmission and distribution operations in vertically integrated undertakings), the creation of a transparent and non-discriminatory system for granting licences for the production of electricity and the building of networks and the introduction of a system of third-party access.⁴⁵ While in principle Member States affirmed the importance of aiming towards more open, transparent, efficient and competitive electricity and gas markets, they also expressed reservations about the Commission’s proposals. Furthermore, the legal basis for the very first proposals was what used to be Article 90(3) of the EEC Treaty,⁴⁶ which was criticised by both Member States and industry players alike for being undemocratic.⁴⁷

In response to this opposition, the Commission amended its proposals into something characterised as ‘heavily watered-down versions’,⁴⁸ reflecting the intense negotiation that the proposals required. First of all, the Commission relied on Article 100(a) of the EEC Treaty, which provided for a consensus-based approach, as the legal basis. Unbundling was no longer required; instead the accounts of the utilities were to be drawn up to ensure transparency. Third party access – an important tool in the opening up of national monopolies – was to be realised either through a negotiated third-party access technique (in which conditions of access to the network are subject to negotiations between the transmission system operator and suppliers and customers), regulated access (an obligation to provide access to the network under non-discriminatory and transparent conditions) or by relying on a single buyer procedure (a system in which only a single entity buys and sells electricity).⁴⁹ The last option was considered particularly problematic vis-à-vis the establishment of cross-border trade, as the procedure enables a single national company to retain full control over imports.⁵⁰ The single buyer option, however, applied only to electricity. While the electricity and gas markets directives followed the same logic, the main difference between them is that in relation

43 J. P. Stern, *Competition and Liberalization in European Gas Markets: A Diversity of Models* (The Royal Institute of International Affairs, Energy and Environmental Programme 1998), pp. 90–91.

44 J. P. Stern, *Competition and Liberalization in European Gas Markets: A Diversity of Models* (The Royal Institute of International Affairs, Energy and Environmental Programme 1998), p. 91.

45 P. J. Slot, ‘Energy and Competition’, 31 (3) *Common Market Law Review* (1994), p. 544.

46 This article provides the competence for the Commission to take unilateral action.

47 P. J. Slot, ‘Energy and Competition’, 31 (3) *Common Market Law Review* (1994), p. 543.

48 P. O. Eikeland, ‘EU Internal Energy Market Policy: Achievements and Hurdles’, in V. L. Birchfield & J. S. Duffield, *Toward a Common European Union Energy Policy: Problems, Progress, and Prospects* (Palgrave Macmillan 2011), p. 19. See also P. J. Slot, ‘Cases C-157/94, Commission v. Netherlands; C-158/94, Commission v. Italy; C-159/94, Commission v. France; C-160/94, Commission v. Spain; C-189/95, Harry Franzén; judgments of 23 October 1997, Full Court, [1997] ECR I-5699, I-5789, I-5815, I-5851, I-5909’, 35 (5) *Common Market Law Review* (1998), p. 1185.

49 Articles 17 and 18 of Directive 96/92/EC of the European Parliament and of the Council of 19 December 1996 concerning common rules for the internal market in electricity, OJ L 27, 30 Jan. 1997, pp. 20–29; and Articles 15 and 16 of Directive 98/30/EC of the European Parliament and of the Council of 22 June 1998 concerning common rules for the internal market in natural gas, OJ L 204, 21 July 1998, pp. 1–12.

50 P. O. Eikeland, ‘EU Internal Energy Market Policy: Achievements and Hurdles’, in V. L. Birchfield & J. S. Duffield, *Toward a Common European Union Energy Policy: Problems, Progress, and Prospects* (Palgrave Macmillan 2011), p. 19.

to gas Member States had to make a choice between a system of negotiated access and one involving regulated access.⁵¹

Despite the adoption of the first energy package, the legislative development was regarded as having been fairly modest in scope and the directives were considered to be relatively weak documents in comparison with the aspirations voiced in the late 1980s.⁵² In particular, as the Commission had to agree to certain options in respect of third-party access regimes⁵³ that are not considered sufficiently effective, the vertically integrated companies were still left with opportunities to obstruct access on the part of competing power supply businesses.⁵⁴ While there was an obligation for tariffs to be non-discriminatory and transparent, the directives did not provide any guidance on the methodology to be used to calculate them.⁵⁵ Furthermore, they only allowed for partial market opening: only industrial consumers were given the right to choose their electricity supplier.

In addition to the electricity and gas market directives adopted to open up the national electricity and gas markets, some progress was made in relation to the environment as the rise of environmental policy at EU level also impacted upon the energy sector.⁵⁶

These first package directives obliged the Commission to regularly report on possible additional measures that might be needed to harmonise national regulations to remove the remaining barriers to trade and the physical flow of electricity and gas across national borders.⁵⁷ Over the years, the Commission produced several reports in which it indicated the remaining shortcomings in the markets.⁵⁸ Furthermore, several Member States lagged behind in terms of transposing the obligations imposed by the directives into their national laws and regulations. While some Member States went beyond the obligations stemming from the directives, others maintained systems that were not in line with the directives, and were therefore hampering liberalisation efforts.⁵⁹ In this sense, Hancher has described the first electricity directive as:

a framework in the loosest sense of the word: its objectives are laid down in very general terminology and moreover, Member States are given a substantial degree of choice

51 J. P. Stern, *Competition and Liberalization in European Gas Markets: A Diversity of Models* (The Royal Institute of International Affairs, Energy and Environmental Programme 1998), p. 95.

52 J. P. Stern, *Competition and Liberalization in European Gas Markets: A Diversity of Models* (The Royal Institute of International Affairs, Energy and Environmental Programme 1998), p. 100.

53 On different third-party access regimes, see K. Talus, *Introduction to EU Energy Law* (Oxford University Press 2016) pp. 19–24.

54 P. O. Eikeland, 'EU Internal Energy Market Policy: Achievements and Hurdles', in V. L. Birchfield & J. S. Duffield, *Toward a Common European Union Energy Policy: Problems, Progress, and Prospects* (Palgrave Macmillan 2011), p. 19.

55 J. P. Stern, *Competition and Liberalization in European Gas Markets: A Diversity of Models* (The Royal Institute of International Affairs, Energy and Environmental Programme 1998), pp. 93, 99.

56 J. S. Duffield & V. L. Birchfield, 'Introduction', in V. L. Birchfield & J. S. Duffield, *Toward a Common European Union Energy Policy: Problems, Progress, and Prospects* (Palgrave Macmillan 2011), pp. 4–5.

57 Article 25(1) of Directive 96/92/EC of the European Parliament and of the Council of 19 December 1996 concerning common rules for the internal market in electricity, OJ L 27, 30 Jan. 1997, pp. 20–29; and Article 27 of Directive 98/30/EC of the European Parliament and of the Council of 22 June 1998 concerning common rules for the internal market in natural gas, OJ L 204, 21 July 1998, pp. 1–12.

58 See, for example, Commission Staff Working Paper, 'First Report on the Implementation of the Internal Electricity and Gas Market' SEC(2001) 1957.

59 P. O. Eikeland, 'EU Internal Energy Market Policy: Achievements and Hurdles', in V. L. Birchfield & J. S. Duffield, *Toward a Common European Union Energy Policy: Problems, Progress, and Prospects* (Palgrave Macmillan 2011), p. 20.

in how they are about introducing more competition into their electricity markets. Indeed, the margin is so substantial that it would seem possible for the determined anti-market countries to avoid introducing any meaningful degree of competition at all.⁶⁰

Against this background, the Commission was asked to prepare a second energy package.

This second package – the so-called acceleration energy package of 2003 – imposed an obligation on the Member States to fully open their electricity and gas markets by improving the existing third-party access regime, which provided for regulated third-party access. It also laid down rules on the legal, operational and information-related unbundling of historically incumbent energy utilities.⁶¹ As distinct from the rules brought in under the first energy package, all consumers were now given the right to choose their supplier. Whereas the first energy package introduced measures aimed at opening up the market and shifted the focus from a state-oriented to a liberalised market, the second energy package focused more on the competition side as the new liberalised markets needed regulation. In addition, environmental policy was on the rise during this time, and a number of directives were adopted in order to promote electricity generation from renewable sources, encourage the use of biofuels and improve energy efficiency.⁶²

In 2005 – even though the process of implementing the earlier measures was still unfinished – the Commission launched a sector inquiry into the functioning of the European electricity and gas markets. The inquiry was prompted by the dissatisfaction voiced by energy consumers, who claimed that they were experiencing higher tariff levels than before as well as discrimination in access to grids on the part of vertically integrated companies.⁶³ The sector inquiry revealed several shortcomings in the EU energy markets. In particular, the Commission was concerned about the continuing market power exercised by national incumbents in many Member States, the inadequate separation of network and supply companies, which had led to new entrants being shut out of the market and had hindered investment, and the lack of cross-border integration of networks and cross-border regulatory supervision. The final report produced by this inquiry revealed several enduring deficiencies in the energy markets, including the following:

- too much market concentration in most national markets
- a lack of liquidity, preventing successful new entry

60 L. Hancher, 'Delimitation of Energy Law Jurisdiction: The EU and Its Member States: From Organisational to Regulatory Conflicts', 16 (1) *Journal of Energy and Natural Resources Law* (1998), p. 42.

61 Directive 2003/54/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in electricity and repealing Directive 96/92/EC, OJ L 176, 15.7.2003, p. 37–56; Directive 2003/55/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in natural gas and repealing Directive 98/30/EC, OJ L 176, 15 July 2003, p. 57–78; Regulation (EC) No. 1228/2003 of the European Parliament and of the Council of 26 June 2003 on conditions for access to the network for cross-border exchanges in electricity, OJ L 176, 15 July 2003, pp. 1–10; Regulation (EC) No. 1775/2005 of the European Parliament and of the Council of 28 September 2005 on conditions for access to the natural gas transmission networks, OJ L 289, 3 Nov. 2005, pp. 1–13.

62 See, e.g., Directive 2001/77/EC of the European Parliament and of the Council of 27 September 2001 on the promotion of electricity produced from renewable energy sources in the internal electricity market, OJ L 283, 27 Oct. 2001, pp. 33–40 and Directive 2003/30/EC of the European Parliament and of the Council of 8 May 2003 on the promotion of the use of biofuels or other renewable fuels for transport, OJ L 123, 17 May 2003, pp. 42–46.

63 P. O. Eikeland, 'EU Internal Energy Market Policy: Achievements and Hurdles', in V. L. Birchfield & J. S. Duffield, *Toward a Common European Union Energy Policy: Problems, Progress, and Prospects* (Palgrave Macmillan 2011), p. 21; C. Jones, 'Introduction', in C. Jones (ed.), *EU Energy Law: Volume I, The Internal Energy Market* (Clays & Casteels Publishing 2016), p. 4.

- too little integration between Member States' markets
- an absence of transparently available market information, leading to distrust in pricing mechanisms
- an inadequate level of unbundling between network and supply interests, which had negative repercussions for market functioning and investment incentives
- customers being tied to suppliers through long-term downstream contracts
- current balancing markets and small balancing zones that favour incumbents.⁶⁴

The findings identified in the sector inquiry spurred the Commission into taking further action in the form of proposing further regulatory and structural measures. The Commission identified four key areas that called for urgent action: (1) achieving effective unbundling of network and supply activities; (2) removing the regulatory gaps, particularly in relation to cross-border issues; (3) addressing market concentration and barriers to entry; and (4) increasing transparency in market operations.⁶⁵

In addition to the sector inquiry, the Commission published in 2006 a Green Paper on developing a common, coherent European energy policy.⁶⁶ This development was initiated by the European Council and ultimately led to the adoption of the third energy package.

4 Towards competitive EU-wide markets: deepening integration through the third energy package

To tackle the shortcomings identified in the inquiry, the Commission started to pursue individual cases under the competition rules.⁶⁷ It also started to push for improvements in the regulatory framework. The objective of the third energy package was to liberalise the national energy markets to a greater extent, and to bring about further unbundling of transmission system operations from different interests, i.e. production, supply and trading.

The process of creating a competitive internal energy market within the EU accelerated rapidly with the adoption of the third energy package in July 2009.⁶⁸ This imposed significant requirements on transmission companies with regard to ownership unbundling (requiring real and effective separation of transmission companies from those involved in generation and supply),⁶⁹ better coordination of the operation and development of networks across borders within Europe, and the introduction of a new actor in the energy sector: the Agency for the Cooperation of the Energy Regulators (ACER).⁷⁰ While the ACER was established by

64 Communication from the Commission, Inquiry pursuant to Article 17 of Regulation (EC) No. 1/2003 into the European gas and electricity sectors (Final Report) COM(2006) 851 final.

65 Communication from the Commission – Inquiry pursuant to Article 17 of Regulation (EC) No. 1/2003 into the European gas and electricity sectors (Final Report), COM(2006) 851 final, p. 3.

66 Commission of the European Communities, Green Paper: A European Strategy for Sustainable, Competitive and Secure Energy, COM(2006) 105 final, Brussels 8.3.2006.

67 See Chapter 7 in this volume by Bergqvist and Herrera Anchustegui.

68 C. Jones, 'Introduction', in C. Jones (ed.), *EU Energy Law: Volume I, The Internal Energy Market* (Claeys & Casteels Publishing 2016), p. 1.

69 See also I. Herrera-Anchustegui, 'Transmission Networks in Electricity Competition: Third-Party Access and Unbundling – a Transatlantic Perspective', in J. I. Ruiz Peris, and C. Cerdá Martínez-Pujalte, C (eds), *Competencia en mercados con recursos esenciales compartidos: telecomunicaciones y energía* (Aranzadi 2019), pp. 91–128.

70 Directive 2009/72/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC, OJ L 211, 14 Aug. 2009, pp. 55–93; Directive 2009/73/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC, OJ L 211, 14 Aug.

a regulation included in the third energy package,⁷¹ it later had new powers conferred upon it under Regulation (EU) No 1227/2011 of the European Parliament and of the Council.⁷² The Commission's proposals were accepted with some modifications by the Council and the European Parliament during the negotiations.⁷³

In addition to these regulatory developments, the European Court of Justice had to deal, within a short time period, with numerous preliminary references focusing on various aspects of the newly liberalised sector. The judgments handed down by the Court concerned both the interpretation of the existing secondary legislation on energy and the application of general EU law to the energy sector, and the interpretation of that law.⁷⁴

Furthermore, the package introduced parallel measures aimed at responding to environmental concerns, particularly the need for climate change mitigation. These environmental measures covered various matters that fell under the umbrella concept of 'sustainability', including the promotion of renewable energy, energy efficiency, carbon capture and storage and the EU's emissions trading system.⁷⁵ This 'environmentally friendly' approach was either embodied in specific measures intended to address environmental concerns or formed part of more general considerations, proposals and policy documents.⁷⁶ However, the increase in environmental measures aside, the competition-oriented energy packages concern not only environmental issues but also security of supply. This issue has of course always been on the EU's agenda, although the degree of emphasis placed on it has varied depending on the context.

This development reflects how the relatively single-minded approach adopted towards establishing an EU-wide energy market has gradually developed to involve the pursuit of a wider range of goals.⁷⁷ While the liberalisation of national energy markets has been the objective of regulatory reform at EU level, the electricity and gas directives also provide for derogations from the principal competition-oriented rules that they lay down. Consequently, the simultaneous pursuit of other objectives – for instance, general objectives such as environmental protection or more specific objectives such as ensuring security of supply in emergency situations – have been acknowledged in the directives contained in the third energy package.⁷⁸

2009, pp. 94–136; Regulation (EC) No 713/2009 of the European Parliament and of the Council of 13 July 2009 establishing an Agency for the Cooperation of Energy Regulators, OJ L 211, 14 Aug. 2009, pp. 1–14; Regulation (EC) No 714/2009 of the European Parliament and of the Council of 13 July 2009 on conditions for access to the network for cross-border exchanges in electricity and repealing Regulation (EC) No 1228/2003, OJ L 211, 14 Aug. 2009, pp. 15–35; Regulation (EC) No 715/2009 of the European Parliament and of the Council of 13 July 2009 on conditions for access to the natural gas transmission networks and repealing Regulation (EC) No 1775/2005, OJ L 211, 14 Aug. 2009, pp. 36–54.

71 Regulation (EC) No 713/2009 of the European Parliament and of the Council of 13 July 2009 establishing an Agency for the Cooperation of Energy Regulators, OJ L 211, 14 Aug. 2009, pp. 1–14.

72 Regulation (EU) No 1227/2011 of the European Parliament and of the Council of 25 October 2011 on wholesale energy market integrity and transparency, OJ L 326, 2 Dec. 2011, pp. 1–16.

73 C. Jones, 'Introduction', in C. Jones (ed.), *EU Energy Law: Volume I, The Internal Energy Market* (Claeys & Casteels Publishing 2016), p. 8.

74 For an overview of the Court's case-law over the course of the process of energy market liberalisation, see S.-L. Penttinen, 'The Role of the Court of Justice of the European Union in the Energy Market Liberalisation', in K. Talus (ed.), *Research Handbook on International Energy Law* (Edward Elgar 2014), pp. 241–271.

75 See also S.-L. Penttinen, 'Sustainability in the Energy Sector: Policy Directions and Implementing Measures', 3 (16) *Oil, Gas and Energy Law (Special Issue on International Energy Law)* (2018), pp. 1–4.

76 A. Johnston & G. Block, *EU Energy Law* (Oxford University Press 2012), p. 26.

77 A. Johnston & G. Block, *EU Energy Law* (Oxford University Press 2012), p. 25.

78 *Ibid.*

5 Conclusion

The regulatory approach taken in respect of the energy sector has resulted from the changing political climate and encouraging experiences both from within and outside Europe. Due to the ideological changes that have taken place and the regulatory approach that has been adopted, the European energy markets have undergone a gradual and progressive change. The privatisation of national energy companies has, at least to a certain extent, gradually removed the governmental protection those companies traditionally received. This has pushed those companies independently to look for new markets beyond their national borders in order to compensate at least to a degree for the market share lost to new market entrants.⁷⁹ Furthermore, cross-border trade has grown due to increased interconnection capacity – technical trade barriers have partially been overcome over the past few decades.

However, while some of the old problems have been overcome, the energy sector is in a state of constant change and new challenges have appeared, of which the growing concern over climate change mitigation is one of the most prominent. In recent years, both environmental concerns and security of supply issues have reappeared on the EU's energy agenda, though in a slightly different light than before. This particularly relates to the challenge posed by 'energy transition'. The key focus of this transition is that of lowering the environmental impacts that arise from energy production and consumption, in particular by increasing the share of renewable energy in the energy mix and improving energy efficiency.⁸⁰ Depending on whether the focus is global, EU-wide or local, the energy transition is also anticipated to further several other objectives, ranging from improvement of the security of the energy supply to stimulating different technology innovations. The boost given to the use of clean technology by supporting a sustainable business approach includes, apart from energy efficiency and carbon mitigation, resource reduction and management, pollution control, end of life strategy and waste reduction. Because energy markets within the EU have traditionally evolved around the supply side where (national) monopoly energy companies produce energy from conventional energy sources (fossil fuels), energy transitions require a major shift in the whole ideology underpinning energy production and energy markets.⁸¹

Although the challenge of energy transition is global, it is being addressed at EU level under the Energy Union framework.⁸² The so-called Clean Energy Package has finally been adopted. The rules under the Clean Energy Package reflect the technological, societal and political developments that must be taken into consideration in the changing energy landscape.

79 J. P. Stern, *Competition and Liberalization in European Gas Markets: A Diversity of Models* (The Royal Institute of International Affairs, Energy and Environmental Programme 1998), pp. 174–175.

80 For an overview, see S.-L. Penttinen, 'Sustainability in the Energy Sector: Policy Directions and Implementing Measures', 3 (16) *Oil, Gas and Energy Law, Special Issue in International Energy Law* (2018), pp. 1–22.

81 I. Mersinia and S.-L. Penttinen, 'Introduction: Examining Different Aspects of the Energy Transition', in S.-L. Penttinen and I. Mersinia, *Energy Transitions: Regulatory and Policy Trends* (Intersentia 2017), p. 1.

82 Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee, the Committee of the Regions and the European Investment Bank, 'A Framework Strategy for a Resilient Energy Union with a Forward-Looking Climate Change Policy' COM (2015) 80 final.