3

UNBUNDLING

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A. Introduction

(1) Background

The history of German energy networks is replete with examples of cross-shareholdings and the limitations that this created for new entry, both up- and downstream. Other Member States, including the UK, had a monolithic, vertically integrated structure through which energy supplies were provided, and typically one which was State-owned. In the UK in the 1980s and 1990s, the experience of the liberalization of various utilities (particularly in telecommunications[1] but also in the energy field) led it to promote unbundling in general, and ownership unbundling (OU) in particular, whilst encouraging various actors in the energy **3.01**

[1] For a critical comparative survey of unbundling in this sector, see JA Hausman and JG Sidak, 'Did Mandatory Unbundling Achieve its Purpose? Empirical Evidence from Five Countries' (2005) 1(1) *Journal of Competition Law and Economics* 173.

sector to campaign in favour of (increasingly stringent) unbundling requirements in EU legislation. Furthermore, a competition law-type analysis of vertical integration and cross-subsidies, building upon areas like refusals to supply and essential facilities under what is now Article 102 TFEU has often shown suspicion of the ability of a vertically integrated undertaking to leverage its power at one level of the value chain into other levels, thus distorting competition on linked or closely related markets.[2]

3.02 It is clear that the Commission's use of EU competition law in the energy sector is on the increase in general, and recent investigations and settlements have addressed the ownership of energy transmission networks directly (E.ON, RWE, ENI). The Commission's Energy Sector Inquiry garnered extensive information for the Commission about the energy sector, its structure, contracts, and operation. Both this and its monitoring of the implementation of the Second Package led it to pursue the parallel tracks of: the Third Package legislative proposals (aiming at full ownership unbundling, but trying to offer a model which would address some ongoing vertical integration: discussed in detail in this chapter); and competition law enforcement aimed, in part at least, at securing divestment of network assets by the vertically integrated perpetrators of various infringements of the EU competition rules.

3.03 As will become clear from the discussion below of unbundling under the Third Package Directives, there is also a clear link between stronger unbundling provisions and the growing powers of national regulatory authorities (NRAs) (seeking to ensure transparency, easing regulatory oversight, checking respect for the often detailed rules laid down where some degree of vertical integration is allowed to remain, etc). The general provisions on NRAs and their role and powers are discussed later in this work (in Chapter 5).

3.04 Finally, it cannot be overlooked that unbundling measures have been subject to legal challenges. EU and national law constitutional constraints have been raised against far-reaching ownership unbundling proposals: strong objections have been raised by industry and government in Germany, while Dutch moves towards distribution system operator (DSO) unbundling were later successfully challenged on free movement of capital grounds in June 2010. These issues will be treated briefly at the end of our discussion on unbundling, examining possible moves to full OU (see paras 3.117 ff).

[2] See, eg, Joined Cases 6 and 7/73 *ICI and Commercial Solvents v Commission* [1974] ECR 223 and Case C-333/94 P *Tetra Pak International v Commission* [1996] ECR I-5951 and Commission Decisions such as *Sealink/B&I Holyhead* (IV/34.174) [1992] 5 CMLR 255 and *Sea Containers v Stena Sealink* [1993] OJ L15/8.

(2) Development of unbundling through the first and second generations of the EU Energy Directives

3.05 The First and Second Energy Packages developed a regime which required the functional, accounting, and eventually, legal separation of the legal entities engaged in the activities of generation, transmission, distribution, and supply. These were minimum harmonization provisions, however, which allowed some Member States to go further than the Directives required (eg the UK introduced full OU for both electricity and gas transmission system operators (TSOs)).

3.06 Regular benchmarking and monitoring reports were published by the Commission on progress in creating the Internal Energy Market, and it consistently complained of Member State delays in implementation of, *inter alia*, the unbundling requirements, as well as the inadequacy of those unbundling rules in securing a liberalized and competitive energy market (or series of markets) within the EU.[3] This led to far-reaching proposals in the Third Package for full ownership unbundling of TSOs, and increased regulatory scrutiny of the activity of TSOs and DSOs; these proposals were subjected to intense negotiation during the legislative process, with strong views expressed by stakeholders, the Commission, the Member States in Council, and by the various committees of the European Parliament.[4]

(3) Basic position reached under Third Package

3.07 Ultimately, the default position for TSOs is full ownership unbundling (while DSOs are only required to go so far as legal unbundling, although some Member States have sought to go further), with the other options with regard to the TSO styled as alternatives, perhaps even derogations. *De facto*, however, these options are not treated as some kind of hierarchy, but rather as equally valid options on the menu, as will be discussed in what follows.

3.08 In spite of the relative setback suffered by the Commission with regard to its proposals for full OU as *the* approach under the Third Package, its Competition Directorate General has continued to pursue energy companies under the EU's competition rules, and in some cases has secured commitments from infringing undertakings which have resulted and/or will result in the sale of various network businesses. This point will also be addressed briefly at paras 3.125 ff.

[3] See, eg, Commission Communication, 'An Energy Policy for Europe', COM(2007) 1 (10 January 2007), 4: 'legal and functional unbundling do not solve the fundamental conflict of interest within integrated companies, whereby the supply and production interests aim to maximize their sales and market share while the network operator is obliged to offer non-discriminatory access to competitors'.

[4] For the various stages of the negotiation, see <http://ec.europa.eu/prelex/apcnet.cfm?CL=en>.

B. Unbundling in the Electricity and Gas Directives After the Third Package

(1) Introduction

3.09 The electricity and gas internal market Directives, both in the Second and the Third Package legislation, require network operations to be legally and functionally separated from supply and generation or production activities. Member States have complied with this requirement by applying different organizational structures. The requirements of legal and functional unbundling have made a positive contribution to the emergence of competitive electricity and gas markets in several Member States.

3.10 The European Commission has noted that '[s]everal Member States have created a totally separate company for network operation, while others have created a legal entity within an integrated company'. The European Commission added that, notwithstanding the implementation that has occurred:

> experience has shown that where the transmission system operator is a legal entity within an integrated company, three types of problems arise. First, the transmission system operator may treat its affiliated companies better than competing third parties. In fact, integrated companies may use network assets to make entry more difficult for competitors. Second, under the current unbundling rules, non-discriminatory access to information cannot be guaranteed as there is no effective means of preventing transmission system operators releasing market sensitive information to the generation or supply branch of the integrated company. Third, investment incentives within an integrated company are distorted.[5]

3.11 Most of the ex-incumbent electricity and gas companies were typically vertically integrated, which created difficulties for liberalizing these markets. As one text has neatly summarized the point, '[t]hey have an inherent interest in retaining their customers, market share, and thus profitability. When competition is introduced, the ex-monopolists hold a 100 per cent market share. Thus, any gain in market share by new competitors means a loss in market share by the ex-incumbent. It is perfectly natural that the ex-incumbent will endeavour to prevent any loss of market share. Where the ex-incumbent owns the network, it has a natural incentive to make third party access to it as difficult as possible'.[6]

3.12 The solution to this problem is to require the effective separation of the network business, both at transmission and distribution level, from generation and supply

[5] Proposal for a Directive of the European Parliament and of the Council amending Directive 2003/54/EC concerning common rules for the internal market in electricity (presented by the Commission), Brussels, 19 September 2007, COM(2007), final, 2007/0195 (COD), 4.

[6] C Jones (gen ed), *EU Energy Law—Volume I: The Internal Energy Market—The Third Liberalisation Package* (3rd edn, Leuven: Claeys & Casteels, 2010), 10.

activities. More effective unbundling of transmission system operators has been regarded as a necessity. Different degrees of unbundling can be envisaged, as has been seen in the development over time of the internal market directives in this area.

3.13 The Third Package electricity and gas internal market Directives reinforce these unbundling requirements, requiring the use of one of the three following models:

(1) the ownership unbundling model (which is the basic principle and the default model from the EU Commission's perspective);
(2) the independent system operator (ISO); and
(3) the independent transmission operator (ITO).

3.14 From the preparatory works of the Third Package Directives, it is clear that the preferred option of the Commission was, and remains, ownership unbundling.[7] The second option was the ISO: here, ownership of the network could still be held by the vertically integrated entity, but the transmission network itself must be managed by an independent system operator, which must be entirely separate from the vertically integrated company and which is to perform all network operator functions. Third, and developed only during the negotiations which led up to the final adoption of the Third Package, was the ITO: under this arrangement, separation of the transmission activities must be achieved through the establishment of an ITO, which must be responsible for the maintenance, development, and operation of the networks, even though those networks remain the property of the vertically integrated companies.

3.15 The ISO and ITO models allowed by the Directives are optional, must fulfil strict requirements, and are applicable in both gas and in electricity. The models are also applicable to various jurisdictions: Member States are likely to implement the Directives and Regulations in different ways, insofar as those measures' provisions allow them to do so.

(2) Ownership unbundling of the transmission system operator

3.16 In various Member States, many networks are, or historically have been, owned by vertically integrated companies, responsible for generation, transmission, distribution, and supply.

3.17 It has been asserted that, 'at the time of the Second Package of Directives, there was already a general recognition that ownership unbundling was the best way to prevent any discrimination, to minimise the need for regulation, and to ensure that the network is operated in a manner likely to promote a competitive market'.[8] But,

[7] Proposal for a Directive of the European Parliament and of the Council amending Directive 2003/54/EC concerning common rules for the internal market in electricity (presented by the Commission), Brussels, 19 September 2007, COM(2007), final, 2007/0195 (COD), 5.

[8] C Jones (gen ed), *EU Energy Law—Volume I: The Internal Energy Market—The Third Liberalisation Package* (3rd edn, Leuven: Claeys & Casteels, 2010), 90. Certainly, the Commission

taking into account the situation of the vertically integrated companies in various Member States, and the political resistance which this generated from certain Member States in the Council as a result, ownership unbundling was considered too drastic a requirement to be imposed across the board. Doubts were also raised as to whether it would satisfy tests of subsidiarity (under what is now Article 5(3) TEU) and proportionality (a general principle of EU law and also an important consideration in many national legal systems).[9] Nevertheless, some Member States (eg the Netherlands and the UK) decided to go beyond the minimum requirements of those Directives and introduced ownership unbundling in their national law.

3.18 In the discussions which led to the Third Package, the first option was ownership unbundling. This was clearly the Commission's preference, making a clear ownership separation between TSOs and any supply undertakings. The preamble to the Third Package Directives states that:

> Only the removal of the incentive for vertically integrated undertakings to discriminate against competitors as regards network access and investment can ensure effective unbundling. Ownership unbundling, which implies the appointment of the network owner as the system operator and its independence from any supply and production interests, is clearly an effective and stable way to solve the inherent conflict of interests and to ensure security of supply.[10]

3.19 In what follows, this model will be called 'ownership unbundling' (OU).

3.20 First, Article 9(1) of the Third Electricity and Gas Directives provides for ownership unbundling:

> Member States shall ensure that . . . :
> (a) each undertaking which owns a transmission system acts as a transmission system operator;
> (b) the same person or persons are entitled neither:
> (i) directly or indirectly to exercise control over an undertaking performing any of the functions of generation or supply, and directly or indirectly to exercise control or exercise any right over a transmission system operator or over a transmission system; nor
> (ii) directly or indirectly to exercise control over a transmission system operator or over a transmission system, and directly or indirectly to

firmly believed this to be the case; various Member States, incumbent vertically integrated undertakings, and others often disagreed.

[9] For discussion, see J-C Pielow, G Brunekreeft, and E Ehlers, 'Legal and Economic Aspects of Ownership Unbundling in the EU' (2009) *Journal of World Energy Law & Business* 96, and the response by K Talus and A Johnston at 117. See further, A Johnston, 'Ownership Unbundling: Prolegomenon to a Legal Analysis', in MK Bultermann, H Sevenster, L Hancher, and A McDonnell (eds), *Views of European Law from the Mountain—Liber Amicorum Piet Jan Slot* (Alphen aan den Rijn: Kluwer Law International, 2009), ch 23.

[10] Recitals 11 to the Third Electricity and 8 of the Third Gas IEM Directive.

> exercise control or exercise an right over an undertaking performing any of the functions of generation or supply.[11]

3.21 Under OU, therefore, the same person may not exercise control over an undertaking performing generation or supply activities, while coterminously exercising control or any right over a TSO or a transmission system (Article 9(1)(b)(i)). Article 9(3)[12] of each Directive clarifies that the OU requirements of Article 9(1)(b) also apply *across* the electricity and gas sectors, in order to prevent influence via vertical integration being exercised by virtue of linkages between gas and electricity markets (eg given natural gas's highly significant role in electricity generation).

3.22 Indeed, the preamble to the Third Electricity IEM Directive asserts that OU is 'the most effective tool by which to promote investments in infrastructure in a non-discriminatory way, fair access to the network for new entrants, and transparency in the market. Under ownership unbundling, Member States should therefore be required to ensure that the same person or persons are not entitled to exercise control over a generation or supply undertaking and, at the same time, exercise control or any right over a transmission system operator or transmission system'.[13]

3.23 The same restriction applies in the inverse situation (Article 9(1)(b)(ii)): it is possible for an undertaking to exercise control or rights over an undertaking performing generation or supply functions, *or* one fulfilling the functions of a transmission system, but not over both at the same time.

3.24 Second, Article 9(1) in each of the Third Package IEM Directives provides further that:

> (c) the same person or persons are not entitled to appoint members of the supervisory board, the administrative board or bodies legally representing the undertaking, of a transmission system operator or a transmission system, and directly or indirectly to exercise control or exercise any right over an undertaking performing any of the functions of generation or supply; and
> (d) the same person is not entitled to be a member of the supervisory board, the administrative board or bodies legally representing the undertaking, of both an undertaking performing any of the functions of generation or supply and a transmission system operator or a transmission system.[14]

3.25 In the OU model, there is thus a prohibition on persons being members of the board of directors of the TSO and also exercising any functions of generation or supply.

[11] Art 9 of the Third Electricity and Third Gas IEM Directives.
[12] Recitals 14 to the Third Electricity and 11 to the Third Gas IEM Directive.
[13] Recital 11 to the Third Electricity IEM Directive.
[14] Art 9 of the Third Electricity and Third Gas IEM Directives.

3.26 Third, Member States shall ensure that neither commercially sensitive information held by a TSO which was part of a vertically integrated undertaking, nor the staff of such a TSO, is transferred to undertakings performing any of the functions of generation and supply.

3.27 Further, the vertically integrated undertaking has the obligation to divest its controlling shares in the TSO, so that it does not maintain control over it and in fact has no influence over it.

3.28 Therefore, the same company cannot at the same time hold control over a supply undertaking and also have control or influence over a TSO or transmission system, whether through a majority shareholding, voting rights, or the right to appoint key personnel.[15] However, it is possible for the vertically integrated undertaking to retain or acquire a minority shareholding in a TSO and/or receive dividends therefrom, although such shareholdings may not be used to control or influence the TSO in any way, lest the TSO's independence and autonomy be compromised.

3.29 To preserve fully the interests of the shareholders of vertically integrated undertakings, Member States should have the option of implementing OU either by direct divestiture or by splitting the shares of the integrated undertaking into shares of the network undertaking and shares of the remaining supply and generation undertakings, provided that compliance with the requirements resulting from OU is secured.[16]

3.30 Since OU requires, in some instances, the restructuring of undertakings, Member States that decide to implement OU should be granted additional time to apply the relevant provisions. Figure 1 shows how OU can be implemented: the supplier and TSO owning the network are part of two different groups.

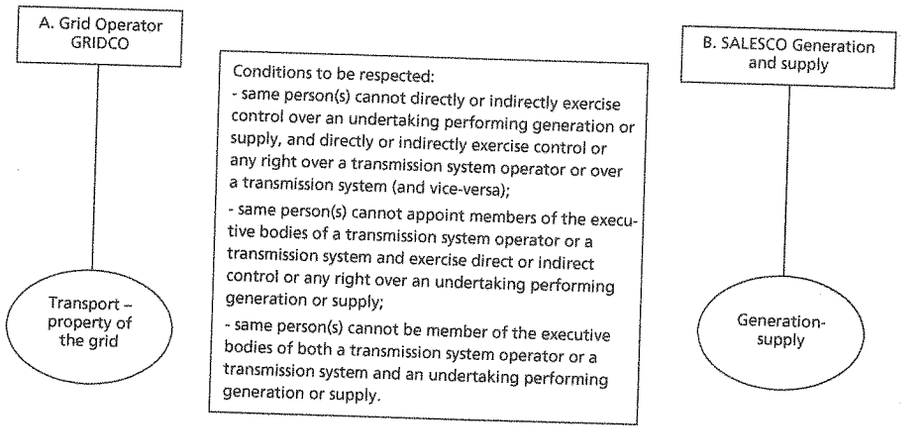


Figure 1 Ownership Unbundling

[15] C Jones (gen ed), *EU Energy Law—Volume I: The Internal Energy Market—The Third Liberalisation Package* (3rd edn, Leuven: Claeys & Casteels, 2010), 96.
[16] Recital 18 to the Third Electricity and 15 to the Third Gas IEM Directive.

Finally, the NRA is charged under Article 10 of each Directive with the responsibility of approving and designating an undertaking which owns a transmission system as a TSO. The certification procedure applies to the TSO under all models and so will be discussed separately at paras 3.99 ff. **3.31**

(3) Independent system operator

(a) Description: In the independent system operator (ISO) model, the supplier and network can remain in the same group, but the network operator must be an entirely separate legal entity: the network is leased to the network operator. Under this model, therefore, the vertically integrated company may still *own* the network assets; however, the transmission network itself must be managed by an independent system operator, whose full independence from production and supply interests must be preserved. **3.32**

Whilst the Commission considered that OU remains the preferred option, the Directives do, however, provide this alternative option for Member States which choose not to introduce OU. The European Commission insisted that: '[t]his option must, however, provide the same guarantees regarding independence of action of the network in question and the same level of incentives on the network to invest in new infrastructure that may benefit competitors'.[17] **3.33**

Articles 13 and 14 of the Third Electricity IEM Directive and Articles 14 and 15 of the Third Gas IEM Directive make provision for this model. Article 13 of the Electricity Directive and Article 14 of the Gas Directive provide that: **3.34**

> Where the transmission system belongs to a vertically integrated undertaking on 3 September 2009, Member States may decide not to apply Article 9(1) and designate an independent system operator upon a proposal from the transmission system owner.[18]

In the OU model, the vertically integrated company is obliged to sell all network assets so that it is controlled by shareholders not active in the generation, production, and sale of electricity or gas. A Member State may decide not to apply the rules on OU and instead designate an ISO, so that the ISO does not become the owner of the transmission system. To maintain the independence of the network and to ensure that it can perform its vital functions, an ISO must respect specific requirements and commitments on a variety of topics (Articles 13 of the Third Electricity and 14 of the Third Gas IEM Directive). In **3.35**

[17] Proposal for a Directive of the European Parliament and of the Council amending Directive 2003/54/EC concerning common rules for the internal market in electricity (presented by the Commission), Brussels, 19 September 2007, COM(2007), final, 2007/0195 (COD) (available at <http://ec.europa.eu/prelex/apcnet.cfm?CL=en>), 5 and 6.
[18] Art 13 of the Third Electricity IEM Directive.

particular, the relationship of the ISO with the transmission system *owner* in the context of investments is a key priority (see, eg, Article 13(5) of the Third Electricity IEM Directive).

3.36 For a Member State to be permitted to choose this ISO model, the transmission system must have been owned by a vertically integrated undertaking at the time of the entry into force of the Directives. The Directives require legal, functional, and personal unbundling. Functional unbundling rules must ensure that the ISO is independent of the network owner. In this way, Article 14 of the Third Electricity IEM Directive and Article 15 of the Third Gas IEM Directive provide:

> (1) A transmission system owner, where an independent system operator has been appointed, which is part of a vertically integrated undertaking shall be independent at least in terms of its legal form, organisation and decision making from other activities not relating to transmission.
> (2) In order to ensure the independence of the transmission system owner referred to in paragraph 1, the following minimum criteria shall apply:
> (a) persons responsible for the management of the transmission system owner shall not participate in company structures of the integrated electricity undertaking responsible, directly or indirectly, for the day-to-day operation of the generation, distribution and supply of electricity;
> (b) appropriate measures shall be taken to ensure that the professional interests of persons responsible for the management of the transmission system owner are taken into account in a manner that ensures that they are capable of acting independently; and
> (c) the transmission system owner shall establish a compliance programme, which sets out measures taken to ensure that discriminatory conduct is excluded, and ensure that observance of it is adequately monitored. The compliance programme shall set out the specific obligations of employees to meet those objectives. An annual report, setting out the measures taken, shall be submitted by the person or body responsible for monitoring the compliance programme to the regulatory authority and shall be published.
> (3) The Commission may adopt Guidelines to ensure full and effective compliance of the transmission system owner with paragraph 2 of this Article. Those measures, designed to amend non-essential elements of this Directive by supplementing it, shall be adopted in accordance with the regulatory procedure with scrutiny referred to in Article 46(2).[19]

[19] Art 14 of the Third Electricity IEM Directive.

These rules are illustrated in Figure 2. **3.37**

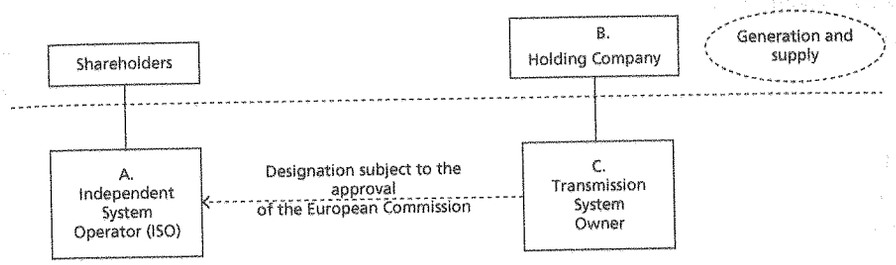


Figure 2 Independent System Operator

In addition, to ensure that the operator remains independent from, and acts truly independently of, the vertically integrated company, a regulatory regime and permanent regulatory monitoring must be put in place. **3.38**

(b) Specific duties of the national regulatory authority: When an ISO is designated, Article 37(3) applies. According to Article 37(3): **3.39**

> In addition to the duties conferred upon it under paragraph 1 of this Article, when an independent system operator has been designated under Article 13, the regulatory authority shall:
> (a) monitor the transmission system owner's and the independent system operator's compliance with their obligations under this Article, and issue penalties for non-compliance in accordance with paragraph 4(d);
> (b) monitor the relations and communications between the independent system operator and the transmission system owner so as to ensure compliance of the independent system operator with its obligations, and in particular approve contracts and act as a dispute settlement authority between the independent system operator and the transmission system owner in respect of any complaint submitted by either party pursuant to paragraph 11;
> (c) without prejudice to the procedure under Article 13(2)(c), for the first ten-year network development plan, approve the investments planning and the multi-annual network development plan presented annually by the independent system operator;
> (d) ensure that network access tariffs collected by the independent system operator include remuneration for the network owner or network owners, which provides for adequate remuneration of the network assets and of any new investments made therein, provided they are economically and efficiently incurred;

(e) have the powers to carry out inspections, including unannounced inspections, at the premises of transmission system owner and independent system operator; and
(f) monitor the use of congestion charges collected by the independent system operator in accordance with Article 16(6) of Regulation (EC) No 714/2009.[20]

3.40 These provisions endow the NRAs with specific regulatory competences, which they must exercise in addition to their general functions and powers laid down in the two internal market Directives (discussed in Chapter 5). Those NRA competences will be an important tool to oversee and check the relationship between the ISO and the network owner: eg approving the contracts between them, monitoring their communications inter se and their relations, supervising the tariffs applied between the ISO and the network owner, etc. The NRA's role here includes certain powers to approve particular ISO plans, including those relating to network development and investment (Articles 37(3)(c) (Electricity) and 41(3)(c) (Gas)).

(4) Independent transmission operator

3.41 (a) **Description:** In the independent transmission operator (ITO) model, the vertically integrated company retains ownership of the network; the network, however, is *operated* by another undertaking, and one which may have no connection with the integrated holding company. The roles of the vertically integrated company are thus: lessor of the transmission assets to that independent ITO; and financial investor in the network business, while the ITO is to take all operational decisions concerning network.[21]

3.42 Again, it is possible for the supplier and network operator to remain in the same corporate group; but both the owner of the network and the network operator must respect the detailed rules under the Third Package, which are designed to ensure the independence of the ITO from the network's owner. This structure thus allows for the retention of vertically integrated *ownership*, but tries to ensure the autonomy and managerial independence of the ITO.[22] After all, the point of these alternatives to full OU is to secure the competitive benefits of clear separation between the different levels of the value chain, while allowing the maintenance of the pre-existing ownership structure.

3.43 As is also the case for the ISO model, the ITO option may only be chosen by an implementing Member State if, at the time of the entry into force of these Directives, the relevant sector contained a vertically integrated undertaking.

[20] Art 37(3) of the Third Electricity IEM Directive.
[21] C Jones (gen ed), *EU Energy Law—Volume I: The Internal Energy Market—The Third Liberalisation Package* (3rd edn, Leuven: Claeys & Casteels, 2010), 11.
[22] C Jones (gen ed), *EU Energy Law—Volume I: The Internal Energy Market—The Third Liberalisation Package* (3rd edn, Leuven: Claeys & Casteels, 2010), 98.

3.44 The ITO model allows the TSO to remain part of an integrated undertaking. However, the Directives have provided rules which aim to preserve effective unbundling. These rules are set in Articles 17 to 23 (Chapter V) of the Third Electricity Directive and in Articles 17 to 23 (Chapter IV) of the Third Gas Directive.

3.45 Concerning the assets, equipment, staff, and identity of the network operator, Article 17(1) of the Third Electricity Directive provides that:

> Transmission system operators shall be equipped with all human, technical, physical and financial resources necessary for fulfilling their obligations under this Directive and carrying out the activity of electricity transmission . . .[23]

3.46 The activities, services, and systems which will have to be carried out and owned by the ITO are also listed in this provision. Under Article 17(4):

> The transmission system operator shall not, in its corporate identity, communication, branding and premises, create confusion in respect of the separate identity of the vertically integrated undertaking or any part thereof.[24]

3.47 The ITO's full autonomy requires that it has the financial, human, and material resources and assets which it needs to operate and develop the network independently from the vertically integrated entity. The rules concerning this independence of the ITO are set in Article 18:

(1) The transmission system operator shall have:
  (a) effective decision-making rights, independent from the vertically integrated undertaking, with respect to assets necessary to operate, maintain or develop the transmission system; and
  (b) the power to raise money on the capital market in particular through borrowing and capital increase.
(2) The transmission system operator shall at all times act so as to ensure it has the resources it needs in order to carry out the activity of transmission properly and efficiently . . .

3.48 Article 19 of the Third Electricity IEM Directive contains specific rules on the independence of the staff and the management of the TSO. The ITO should also have the ability to pursue network development and the powers to make investment decisions (Article 22 of the Third Electricity IEM Directive). To ensure the independent management of the ITO, managing personnel should comply with the appropriate 'cooling off period', ranging from six months to four years in duration (see paras 3.54 ff).

[23] Art 17(1) of the Third Electricity IEM Directive.
[24] Art 17(4) of the Third Electricity IEM Directive.

3.49 The Commission will adopt a 'specific detailed report' on the ITO option and its functioning by 3 March 2013, which should assess whether in practice it leads to effective unbundling.[25]

3.50 (b) **Specific duties of the national regulatory authority:** Under the ITO model, a Supervisory Body must be appointed by the vertically integrated undertaking. The financial independence of the ITO must be safeguarded:

> . . . without prejudice to the decisions of the Supervisory Body under Article 20, appropriate financial resources for future investment projects and/or for the replacement of existing assets shall be made available to the transmission system operator in due time by the vertically integrated undertaking following an appropriate request from the transmission system operator.[26]

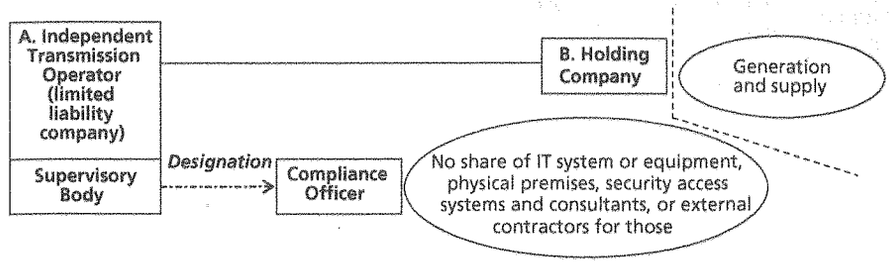
3.51 So, the structural dependence which may exist between the ITO and the vertically integrated undertaking is to be counteracted by significant control over the ITO's investments and the role of the vertically integrated undertaking therein. The ITO should submit a ten-year network development plan (Article 22 of the Electricity IEM Directive). The ITO should also make the necessary network investments: if these should not be carried out, then important powers are granted to the NRA according to Article 22, in order to ensure 'that the investment in question is made'.

3.52 A compliance officer must also be appointed by the ITO to ensure non-discrimination:

> The overall management structure and the corporate statutes of the transmission system operator shall ensure effective independence of the transmission system operator in compliance with this Chapter. The vertically integrated undertaking shall not determine, directly or indirectly, the competitive behaviour of the transmission system operator in relation to the day to day activities of the transmission system operator.[27]

3.53 The NRA also has specific competences related to the ITO. For instance, if the vertically integrated undertaking does not invest in the network, the regulator can force the ITO to invest, for example by imposing a capital decrease or third party investment (for further possibilities, see Article 22(7) of the Third Electricity IEM Directive). Figure 3 provides a summary of the conditions which an ITO must respect in order to comply with the Directives.

[25] Art 47(3) of the Third Electricity IEM Directive.
[26] Art 17(1)(d) of the Third Electricity IEM Directive.
[27] Art 18(4) of the Third Electricity IEM Directive.



Conditions to be respected by the ITO:

- owner of the necessary assets, including the grid;
- employs the necessary staff (including for legal, accountancy, and IT services);
- no confusion with the Holding Company or its entities;
- no leasing of personnel and rendering of services to and from any other parts of the Holding

  Company, except if: (i) no discrimination between system users; and (ii) with the approval of the Regulator;
- accounts audited by an auditor different from the one auditing the Holding Company or any part of it;
- effective decision-making rights;
- power to borrow money on the capital market;
- no shareholding in holding subsidiaries performing supply and/or generations and vice versa;
- anteriority clause for the appointment of the persons responsible for the management and/or members of the administrative bodies of the ITO (majority: three years/minority: six months);
- no position, or responsibility, interest or business relationship with any part of the Holding Company or with its controlling shareholder.

Figure 3 Independent Transmission Operator

3.54 (c) **Rules concerning ITO independence and particular issues:** Article 17 of the Third Electricity Directive imposes rules of independence on the assets, equipment, and staff of the ITO. It provides:

(1) Transmission system operators shall be equipped with all human, technical, physical, and financial resources necessary for fulfilling their obligations under this Directive and carrying out the activity of electricity transmission, in particular:

(a) assets that are necessary for the activity of electricity transmission, including the transmission system, shall be owned by the transmission system operator;

(b) personnel, necessary for the activity of electricity transmission, including the performance of all corporate tasks, shall be employed by the transmission system operator;

(c) leasing of personnel and rendering of services, to and from any other parts of the vertically integrated undertaking shall be prohibited. A transmission system operator may, however, render services to the vertically integrated undertaking as long as:

(i) the provision of those services does not discriminate between system users, is available to all system users on the same terms and conditions and does not restrict, distort or prevent competition in generation or supply; and

(ii) the terms and conditions of the provision of those services are approved by the regulatory authority;

(d) without prejudice to the decisions of the Supervisory Body under Article 20, appropriate financial resources for future investment projects and/or for the replacement of existing assets shall be made available to the transmission system operator in due time by the vertically integrated undertaking following an appropriate request from the transmission system operator.

3.55 The ITO has to be autonomous in these different aspects: financial, human, and technical. These resources should be available for the management of the electricity or gas network. Some of the issues raised by Article 17 are analysed in the following paragraphs.

3.56 *(i) Requirement of independence of the TSO towards the vertically integrated company:* With regard to personnel, both Directives require the independence of the staff and the management of the TSO. The Third Directives make it clear that the personnel necessary for the managing of the network should be employed directly by the TSO.

3.57 Moreover, the overall management structure of the ITO shall be independent from the vertically integrated undertaking. Article 19(3) in both the Third Electricity IEM Directive and Third Gas IEM Directive therefore provide:

> [n]o professional position or responsibility, interest or business relationship, directly or indirectly, with the vertically integrated undertaking or any part of it or its controlling shareholders other than the transmission system operator shall be exercised for a period of three years before the appointment of the persons responsible for the management and/or members of the administrative bodies of the transmission system operator who are subject to this paragraph.[28]

[28] Arts 19(3) of the Third Electricity and 19(3) of the Third Gas IEM Directive.

3.58 In the same way, the Third Electricity and Gas IEM Directives provide that:

> [t]he persons responsible for the management and/or members of the administrative bodies of the transmission system operator who are not subject to paragraph 3 shall have exercised no management or other relevant activity in the vertically integrated undertaking for a period of at least six months before their appointment.[29]

3.59 With regard to the requirement of independence of the persons in charge of the management and/or members of the administrative bodies of the manager of the TSO for the period of three years (Article 19(3)) and the period of six months (Article 19(8)), a key question is whether these periods apply retroactively before the date of entry into force of the Third Package Directives.

3.60 Articles 19(3) and 19(4) of the Directives require a strict independence of the management and/or members of the administrative bodies of the transmission system operator, so holding that role can never be compatible with any activity in the vertically integrated company. The Commission's Interpretative Note on this topic mentions that the persons in charge of the ITO's management cannot hold any commercial relation, activity or professional responsibility with the vertically integrated undertaking or part of it, for a three-year period before their nomination.[30] As these provisions make no reference to the entry into force of the Directives, it is submitted that this rule also applies to periods before the Directives had entered into force: the key date, rather, is that of nomination.

3.61 Indeed, the draft of the Commission's Interpretative Note specified that an exemption from this rule existed with regard to the persons responsible for the management of the network itself:

> A derogation to this rule relates to the TSO itself: the management of the TSO already in place before the setting up of the ITO can stay in function (Article 19(3) of the Electricity and Gas Directive).[31]

3.62 According to the draft Interpretative Note, the persons in charge of the management who were already named before the installation of the ITO may remain in their functions. Those persons could thus remain in their functions even if they had a professional responsibility within the vertically integrated company.

[29] Arts 19(8) of the Third Electricity and 19(5) of the Third Gas IEM Directive.

[30] Commission Staff Working Paper, 'Interpretive Note on Directive 2009/72/EC concerning Common Rules for the Internal Market in Electricity and Directive 2009/73/EC concerning common rules for the Internal Market in Natural Gas: The Unbundling Regime' (22 January 2010) (hereafter, 'Interpretive Note: Unbundling'), 18.

[31] Commission Staff Working Paper, 'Draft Interpretative Note on directive 2009/72/EC concerning common rules for the internal market in electricity and Directive 2009/73/EC concerning common rules for the internal market in natural gas: the unbundling regime' (22 January 2010) (hereafter, 'Draft of the Interpretive Note'), 14.

Thus, if one wanted to maintain a director within a company managing the network, it was enough that he or she was already in post before the creation of the ITO. This exemption, however, no longer appears expressly in the final text of the Interpretative Note.

3.63 *(ii) The recruitment of personnel:* The recruitment of TSO personnel within a vertically integrated undertaking will often have been decided at the level of the vertically integrated undertaking. The question that may be asked is whether, in the future, the vertically integrated undertaking may itself still recruit personnel for the transmission system operator.

3.64 Article 19(1) of the Third Electricity and Gas IEM Directives deals with the independence of the TSO's personnel, and provides that:

> [d]ecisions regarding the appointment and renewal, working conditions including remuneration, and termination of the term of office of the persons responsible for the management and/or members of the administrative bodies of the transmission system operator shall be taken by the Supervisory Body of the transmission system operator appointed in accordance with Article 20.

3.65 Moreover, Article 19(4) of the Third Directives provides that those persons shall have no other professional position or responsibility, interest or business relationship, directly or indirectly, with any other part of the vertically integrated undertaking or with its controlling shareholders.

3.66 The persons responsible for the management and/or members of the administrative bodies of the TSO may not be appointed, and thus may not be 'hired' by any other organ than the Supervisory Body of the TSO. The situation is thus restrictive for the people responsible for the management and/or the members of the administrative bodies of the TSO.

3.67 With regard to other personnel, Article 17(1)(b) of each of the Third Directives provides that:

> Transmission system operators shall be equipped with all human, technical, physical and financial resources necessary for fulfilling their obligations under this Directive and carrying out the activity of electricity transmission, in particular:
> . . .
> (b) personnel, necessary for the activity of electricity transmission, including the performance of all corporate tasks, shall be employed by the transmission system operator . . .

3.68 Moreover, Member States shall ensure that the personnel of a TSO which was part of a vertically integrated undertaking are not transferred to undertakings performing any of the functions of generation and supply.[32]

[32] Art 9(7) of the Third Electricity IEM Directive.

3.69 Leasing of personnel is also prohibited under Article 17(1)(c) of the Third Directives: 'leasing of personnel and rendering of services, to and from any other parts of the vertically integrated undertaking shall be prohibited'.

3.70 According to the Directives, and taking into account the requirement of independence of the management of network, owing to the fact that the personnel must be employed by the TSO (Article 17(1)(b)) and that the leasing of personnel is prohibited (Article 17(1)(c)), it thus appears clear that, within this framework, it would be unacceptable that the personnel of the manager of the grid system be 'engaged' by another part of the vertically integrated company. Moreover, the draft of the Commission's Interpretative Note specified that the personnel 'shall be employed by the ITO',[33] which assumes that the contract of employment is signed by the ITO.

3.71 The Interpretative Note also clarifies that the ITO must employ a sufficient number of qualified employees:[34]

> As regards corporate services, including legal services, accountancy and IT services, which are considered to constitute part of the activity of electricity or gas transmission as defined in Articles 12 and 17(2) Electricity Directive and Articles 13 and 17(2) Gas Directive, the ITO must employ a sufficient number of qualified staff members to handle day-to-day core activities. Only if the ITO has employed a sufficient number of staff members for day-to-day handling of these activities may it, in specific circumstances and by way of exception, conclude contracts with third-party service providers for legal, IT, or accountancy services. The same applies to specific services relating to, for example, the development and repair of the network. The ITO should employ a sufficient number of qualified staff members to handle day-to-day activities in this area, in order to be autonomous. Only if this condition is fulfilled can it, by way of exception, conclude contracts for services in this area with third-party service providers.[35]

3.72 The Interpretative Note also addresses in more detail the question of the leasing of personnel by the vertically integrated undertaking:

> A specific regime concerns the leasing of personnel and contracting of services between any part of the vertically integrated undertaking and the ITO. As the ITO should be autonomous and not dependent on other parts of the vertically integrated undertaking, leasing of personnel and contracting of services to the ITO by other parts of the vertically integrated undertaking, including by the DSO, are categorically prohibited (Article 17(1)(c) Electricity and Gas Directives) . . .
>
> Furthermore, the ITO is not allowed to share IT systems or equipment, physical premises and security access systems with any other part of the vertically integrated undertaking. The ITO is also not allowed to use the same consultants or external

[33] Draft of the Interpretative Note, 11.
[34] Interpretive Note: Unbundling, 16.
[35] Interpretive Note: Unbundling, 16.

contractors for IT systems or equipment, security access systems or auditing, in accordance with Article 17(5) and (6) Electricity and Gas Directives.[36]

3.73 The Interpretative Note thus suggests that the Directives prohibit categorically the loan of personnel. Because the ITO must not be dependent upon the vertically integrated undertaking, leasing of personnel and subcontracting of services are fully prohibited from the vertically integrated undertaking or from any part of it.

3.74 The Interpretative Note specifies that it is the Supervisory Body of the ITO which is in charge of the appointment and of the renewal of the work contracts of the members of the management and the persons responsible for the management:

> The Supervisory Body of the ITO is in charge of taking all decisions regarding the appointment and renewal, working conditions including remuneration, and termination of the term of the management of the ITO.[37]

3.75 The Interpretative Note also makes clear that the employees cannot hold interests or receive financial benefits, directly or indirectly, from the vertically integrated undertaking, any part of it or an undertaking other than the ITO:

> The management and the employees of the ITO cannot hold an interest in or receive any financial benefit, directly or indirectly, from any part of the vertically integrated undertaking other than the ITO. In addition, remuneration of the management and employees cannot depend on activities or results of any part of the vertically integrated undertaking other than the ITO. This last rule prevents for example the granting to the management of stock options based on the shares of the vertically integrated undertaking.[38]

3.76 In conclusion, taking into account the above-mentioned provisions of the new Directives and the Commission's Interpretative Note, the members of the management, the persons responsible for the management, and/or the members of the administrative bodies of an ITO must be appointed by the Supervisory Body of the TSO.

3.77 With regard to the other members of the ITO's personnel, taking into account the various provisions of the Directive, the requirement of the independence of the TSO and owing to the fact that they must be 'employed' by the ITO, a 'recruitment' or 'appointment' by the holding company or the vertically integrated company will not be compatible with the requirements of the Directives.

3.78 *(iii) Common services:* The question can be asked whether the TSO carrying on the network activity independently of the vertically integrated undertaking may, on basis of contracts, within some limits and with some controls and constraints, benefit from the support of the IT, legal, and accounting departments of the vertically

[36] Interpretive Note: Unbundling, 16.
[37] Interpretive Note: Unbundling, 18.
[38] Interpretive Note: Unbundling, 19.

integrated company. In short, will the ITO be able to benefit, subject to safeguards, from the support of such 'group services'?

3.79 On this subject, each of the Directives provides that 'the transmission system operator shall not share IT systems or equipment, physical premises and security access systems with any part of the vertically integrated undertaking nor use the same consultants or external contractors for IT systems or equipment, and security access systems'.[39] The Commission's Interpretative Note underlines that the Directives are clear and that the ITO must employ all human and physical resources necessary to fulfil its obligations and to continue its activity of transmission of gas and electricity. These rules of appointment do not relate to cleaning and safety services, however:[40]

> This requirement concerning autonomy of the ITO does not relate to activities that do not directly concern the activity of electricity or gas transmission, such as office cleaning services or office security services. As regards these ancillary activities personnel does not necessarily have to be employed by the ITO and contracts for services can be concluded with third-party service providers whenever this is considered appropriate.[41]

3.80 As discussed at para 3.71, the Interpretative Note clarifies that, concerning personnel, the ITO should employ a sufficient number of qualified staff members, and only if these are sufficient to cover its day-to-day activities may it, exceptionally, enter into contracts with third-party service providers for legal, IT, or accountancy services, or for network development and repair.[42] Similarly, the Interpretative Note makes it clear that the TSO may not call upon the vertically integrated undertaking for its services (including the sharing or leasing of IT systems or equipment, physical premises, and security access systems), as this would endanger the ITO's autonomous and independent operation.[43]

3.81 With regard to the services which could be rendered by the ITO to the vertically integrated undertaking, this is allowed in specific circumstances in accordance with Article 17(1)(c) of the Third Directives:

> leasing of personnel and rendering of services, to and from any other parts of the vertically integrated undertaking shall be prohibited. A transmission system operator may, however, render services to the vertically integrated undertaking as long as:
>
> (i) the provision of those services does not discriminate between system users, is available to all system users on the same terms and conditions and does not restrict, distort or prevent competition in generation or supply; and

[39] Art 17(5) of the Third Electricity and Third Gas IEM Directives.
[40] Interpretive Note: Unbundling, 15.
[41] Interpretive Note: Unbundling, 15 and 16.
[42] Interpretive Note: Unbundling, 15.
[43] Interpretive Note: Unbundling, 16.

(ii) the terms and conditions of the provision of those services are approved by the regulatory authority.[44]

3.82 *(iv) 'Supervisory Body' and 'compliance officer':* First, according to Articles 20 and 21 of each of the Third Directives, the TSO under the ITO model should have a 'Supervisory Body' and 'compliance officer'. Article 20 in both of the Third Directives provides that:

> [t]he transmission system operator shall have a Supervisory Body which shall be in charge of taking decisions which may have a significant impact on the value of the assets of the shareholders within the transmission system operator, in particular decisions regarding the approval of the annual and longer-term financial plans, the level of indebtedness of the transmission system operator and the amount of dividends distributed to shareholders. The decisions falling under the remit of the Supervisory Body shall exclude those that are related to the day-to-day activities of the transmission system operator and management of the network, and in relation to activities necessary for the preparation of the ten-year network development plan developed pursuant to Article 22.
>
> The Supervisory Body shall be composed of members representing the vertically integrated undertaking, members representing third party shareholders and, where the relevant legislation of a Member State so provides, members representing other interested parties such as employees of the transmission system operator.

3.83 The establishment of a Supervisory Body is a key element of the ITO option. The Supervisory Body will be in charge of the decisions concerning the appointment of the management (including remuneration, term of office, renewal, etc) and all decisions which may influence the value of the assets of the ITO. But the Supervisory Body shall not intervene in decisions falling under the remit of the day-to-day activities of the TSO and the management of the network. Such decisions by the Supervisory Body must be notified to the NRA and can only become effective where the NRA raises no objections to them within three weeks.

3.84 The Supervisory Body, once established, will then designate a 'compliance officer' or an officer charged with ensuring that the obligations of the ITO are respected. Article 21 of each of the Third Directives provides:

> (1) Member States shall ensure that transmission system operators establish and implement a compliance program which sets out the measures taken in order to ensure that discriminatory conduct is excluded, and ensure that the compliance with that program is adequately monitored. The compliance program shall set out the specific obligations of employees to meet those objectives. It shall be subject to approval by the regulatory authority. Without prejudice to the powers of the national regulator, compliance with the program shall be independently monitored by a compliance officer.

[44] Art 17(1)(c) of the Third Electricity and Third Gas IEM Directives.

> (2) The compliance officer shall be appointed by the Supervisory Body, subject to the approval by the regulatory authority. The regulatory authority may refuse the approval of the compliance officer only for reasons of lack of independence or professional capacity. The compliance officer may be a natural or legal person. Article 19(2) to (8) shall apply to the compliance officer.
>
> (3) The compliance officer shall be in charge of:
>
> (a) monitoring the implementation of the compliance program;
>
> (b) elaborating an annual report, setting out the measures taken in order to implement the compliance program and submitting it to the regulatory authority;
>
> (c) reporting to the Supervisory Body and issuing recommendations on the compliance program and its implementation;
>
> (d) notifying the regulatory authority on any substantial breaches with regard to the implementation of the compliance program; and
>
> (e) reporting to the regulatory authority on any commercial and financial relations between the vertically integrated undertaking and the transmission system operator.
>
> (4) The compliance officer shall submit the proposed decisions on the investment plan or on individual investments in the network to the regulatory authority.[45]

3.85 A compliance programme against discriminatory conduct should be established, and the compliance programme and the compliance officer are subject to the detailed rules of Article 21 of the Third Electricity and Gas IEM Directives.

3.86 The Interpretative Note does not clarify whether, in the case of a cross-border grid system, it is necessary to appoint a compliance officer for each of the two countries nor, indeed, whether this could be the same person. Insofar as the compliance officer is the privileged bond between the TSO and his regulator, it seems preferable to appoint two compliance officers, each one in charge of the relationships with its NRA. This structure would have to be validated and approved by the European Commission but it seems that, precisely within the framework of a cross-border merger and a combined TSO, this solution would be at the same time advisable and pragmatic. Indeed, it could be less easy for an operator to develop and maintain optimal and privileged relations with the NRA of another Member State, with whose regulation the TSO is likely to be far less familiar, and vice versa. The approach suggested here would also allow us to avoid questioning the TSO's knowledge and competence vis-à-vis another Member State's regulatory regime.

3.87 *(v) The management of combined grids:* Articles 29 and 26(2) of each of the Third Directives[46] refer to the possibility of a combined operator: ie an operator for the

[45] Art 21 of the Third Electricity and Third Gas IEM Directives.
[46] See also Art 28 of the Third Gas IEM Directive.

transmission and for the distribution networks. The ITO model allows this formula of combined grid operators.[47] Article 29 of the Third Directives, indeed, provides that:

> Article 26(1) shall not prevent the operation of a combined transmission and distribution system operator provided that operator complies with Articles 9(1), or 13 and 14, or Chapter V or falls under Article 44(2).

3.88 However, the combined reading of Articles 26 and 29 and, in particular, the requirement in Article 26 that DSO management must be independent of the management of the TSO[48] raises certain difficulties.[49] Article 26 in each of the Third Directives provides:

> In addition to the requirements under paragraph 1, where the distribution system operator is part of a vertically integrated undertaking, it shall be independent in terms of its organization and decision-making from the other activities not related to distribution. In order to achieve this, the following minimum criteria shall apply:
>
> (a) those persons responsible for the management of the distribution system operator must not participate in company structures of the integrated electricity undertaking responsible, directly or indirectly, for the day-to-day operation of the generation, transmission or supply of electricity.[50]

3.89 There is uncertainty concerning the interaction between Articles 26 and 29 of the Third Directives. Article 26 provides that the distribution system operator shall be independent in terms of its organization and decision-making from the other activities not related to distribution. Article 26 also provides that the persons responsible for the management of the distribution system operator may not belong to the structures of the integrated undertaking which are directly or indirectly in charge of the daily management of the production activities, transmission or supply of electricity. Article 29, on the other hand, provides the possibility of creating a combined transmission and distribution system operator, and thus the exploitation of a combined network of transmission and distribution by the same operator.

3.90 An interesting point is that, on this issue, the draft of the Commission's Interpretative Note referred only to the activities of supply and generation, and not to the activities of transmission. The draft recalled several times the requirement of 'management separation . . . [:] the management of the network company do not work at the same time for the supply or production company of the vertically integrated company'.[51]

[47] See Art 29 of the Third Electricity and Third Gas IEM Directives.
[48] Viz: 'as a consequence, a manager of the DSO cannot at the same time be a director of the related transmission, supply or production company, or vice versa'.
[49] Interpretive Note: Unbundling, 24.
[50] Art 26(2) of the Third Electricity and Third Gas IEM Directives.
[51] Interpretive Note: Unbundling, 19.

3.91 In the same way, the Interpretative Note refers to the activities of 'production or supply':

> [the i]ndependence of the persons responsible for the network management may be put into jeopardy by their salary structure, notably if their salary is based on the performance of the holding company or of the production or supply company, as this may create conflicts of interest. Also the transfer of managers from the DSO to other parts of the company and vice versa may entail a risk of conflicts of interest and requires rules and measures safeguarding independence. Conflicts of interest for the network management may also arise if the DSO directly or indirectly holds shares in the related supply or production company and obtains a financial interest in its performance.[52]

3.92 On the question as to whether a combined network operator may manage the transmission and the distribution network, and use common services for these two activities, the Interpretative Note answers as follows:

> An important question in the context of separation of management is to what extent it is permissible to have common services, i.e. services which are shared between transmission/distribution, supply and perhaps other businesses within the vertically integrated company. Such services could include personnel and finance, IT services, accommodation and transport. It might be argued that a requirement to systematically duplicate such common services would significantly increase costs without bringing corresponding additional benefits.
>
> However, it is appropriate to look at this issue carefully on a case-by-case basis, requiring in any event that conditions are fulfilled to reduce competition concerns and to exclude conflicts of interests.[53]

3.93 The discussion in the Interpretative Note concerning the use of common services suggests, in principle, that the use of combined services by a combined TSO and DSO may be possible, subject to evaluation on a case-by-case basis.

3.94 Avoiding the creation of a completely new undertaking and instead using the possibility of a combined grid operator (TSO and DSO) would make it possible to avoid problems which might arise from the transfer of licences or agreements. It is indeed much easier, if there are regroupings of concessions or licences within the same company, to make transfers rather than to lodge a new request for licences or concessions in order to have the right, in the relevant Member State, to act as a TSO or a DSO. Thus, maintaining the same legal personality while still respecting the conditions related to the designation and the granting of the concessions must make it possible to maintain the rights acquired by concessions, licences, or agreements. Indeed, financial contracts, public obligations, and other concessions are linked with the nomination of a TSO or a DSO. In such regroupings, therefore, it will be necessary to take care not to call into question the designation or the certification of the TSO or the DSO (on certification, see paras 3.99 ff).

[52] Interpretive Note: Unbundling, 24.
[53] Interpretive Note: Unbundling, 20.

(5) Conclusion

3.95 The three unbundling options apply in the same manner to both the electricity and the gas sectors. In principle, subject to the caveat about pre-existing vertically integrated undertakings, any of the three options can be chosen by the Member States.

3.96 From a legal standpoint, both the ISO and ITO models are therefore derogations from the principle of ownership unbundling: this is clear from the wording of Article 9 in each Directive. This could, in particular, justify a restrictive interpretation of their scope of application.

3.97 Second, it is not possible to revert from ownership unbundling back to an ITO: the ISO and ITO options can only be chosen for a TSO in a system which currently still involves a measure of vertical ownership integration.

3.98 The implementation, in due time, of the Third Energy Package is also important. The Third Package Directives and Regulations lay down a deadline of implementation into Member State law of 11 March 2011, but it should be noted that the provisions under Article 9 concerning ownership unbundling have been applicable only from 3 March 2012.

C. Certification of the Transmission System Operator

3.99 The Third Energy Package has introduced an innovation with regard to the designation and appointment of a TSO: henceforth, a TSO is to be subject to prior certification by its NRA. Such certification aims to guarantee that the TSO respects its obligations to unbundle its activities from production and/or supply of electricity and/or natural gas. The certification process applies to each of the unbundling models analysed above.

3.100 Two types of procedure are provided by the Third Electricity and Gas IEM Directives.

(1) Certification for the designation and appointment of TSOs: general

3.101 Article 10 of each Directive lays down a procedure which intends to ensure that no supply or production undertaking or, in the case of a vertically integrated undertaking (under the ISO or ITO models), no supply or production subsidiary anywhere in the EU, can own or operate a transmission system in any Member State of the EU, except in accordance with the unbundling provisions laid out above.

3.102 The NRA's approval is only to be granted where the Article 9 unbundling requirements have been satisfied (Article 10(2)), and TSOs must notify the NRA of any planned transaction which may require reassessment of compliance with Article 9 (see Article 10(3)). An NRA's certification decision must be notified to the

Commission: the latter is empowered by Article 3 of the Electricity[54] and Gas[55] Regulations to assess whether that certification does indeed comply with the rules laid down in Articles 9 and 10 of the Directives. Further, NRAs are to continue to monitor a TSO's respect for the OU conditions and have the power to open a new certification procedure if a new decision should be required (Article 10(4)).

(2) Certification for TSOs controlled by a person from a non-EU Member State

3.103 According to Article 11 in each Directive, any third country undertaking which wishes to acquire a substantial participation in, or control over, a transmission grid located within the EU will be subject to the same unbundling requirements as EU-based undertakings. The Commission's original proposal for the Third Package Directives emphasized that:

> it is imperative—without prejudice to the international obligations of the [EU]—to ensure that all economic operators active on European energy markets respect and act in accordance with market investor principles . . . The aim is to guarantee that companies from third countries respect the same rules that apply to EU-based undertakings in both letter and spirit—not to discriminate against them.[56]

3.104 While the far-reaching nature of the original proposal was watered down somewhat, Article 11(1) requires the NRA to notify the Commission of any request for TSO certification by a non-EU applicant or any change in circumstances that might lead to such an applicant securing control of an EU TSO. Under Article 11(3), the NRA has four months in which to adopt a draft decision on such certification and notify it to the Commission (Article 11(4)). The NRA is required to refuse if it has not been demonstrated that:

(a) the entity concerned complies with the requirements of Article 9; and
(b) to the regulatory authority or to another competent authority[57] designated by the Member State that granting certification will not put at risk the security of energy supply of the Member State and the [EU].[58]

The Commission has two months to deliver its opinion (unless an extension of two months is sought to elicit the views of ACER, the notifying Member States, and interested parties) on the notification from the NRA (Article 11(6)) and then the NRA has a further two months within which to deliver its final certification decision (Article 11(8)).

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[54] Regulation 714/2009/EC [2009] OJ L211/15.
[55] Regulation 715/2009/EC [2009] OJ L211/36.
[56] COM(2007) 528 and 529 final (containing COD (2007) 195 and 196) (19 September 2007), 7–8.
[57] On security of supply and the competent authority, see paras 10.44 ff.
[58] In answering the question under Art 11(3)(b), the relevant national authority must consider: '(i) the rights and obligations of the [EU] with respect to that third country arising under international

(3) Re-certification for current TSOs?

3.105 One practical issue which may arise in this regard is whether, on the entry into force of the Third Package Directives, the NRA is required (or indeed even empowered) to take all such certification decisions again, or whether the previous certification of TSO undertakings may subsist (provided, of course, that they continue to respect the conditions of the new Directives). It is submitted that such a fresh decision is not necessary as a matter of course. The purpose of the certification provisions is to apply the unbundling rules to new TSOs and to monitor whether a breach of the unbundling rules has been committed by those entities already properly designated and appointed as TSOs prior to the Third Package. Accordingly, the latter category of TSOs should continue to be treated as validly certified, unless one of the triggers for reassessment (i.e. failure to respect unbundling or control by a third-country entity) is met. This approach respects the acquired rights of those TSOs already validly designated and appointed in accordance with Article 1 of the First Protocol to the European Convention for the protection of Human Rights and Fundamental Freedoms (ECHR): uncertainty in this regard is to be avoided if at all possible. The Commission's Interpretative Note on the unbundling regime mentions nothing about any need to take such approval decisions again and would thus seem to accept the position taken here.[59]

D. Unbundling Derogations

(1) Specific derogations

3.106 **(a) Derogations requested by acceding Member States:** The development and adoption of the Second Package took place at the same time as negotiations for the accession of a number of new EU Member States. As part of that accession, some of the new Member States requested derogations from particular provisions of the legislation. The Slovenian derogation[60] from the old Electricity Regulation 1228/03/EC expired in 2007 and need no longer concern us. Estonia, meanwhile,

law, including any agreement concluded with one or more third countries to which the [EU] is party and which addresses the issues of security of energy supply; (ii) the rights and obligations of the Member Sate with respect to that third country arising under agreements concluded with it, insofar as they are in compliance with [EU] law; and (iii) other specific facts and circumstances of the case and the third country concerned'.

[59] Viz: 'The regulatory authorities are under the obligation to open a certification procedure upon notification by a potential TSO, or upon reasoned request from the Commission. Apart from that, regulatory authorities must monitor compliance of TSOs with the rules on unbundling on a continuous basis, and must open a new certification procedure on their own initiative where according to their knowledge a planned change in rights or influence over transmission system owners or TSOs made lead to an infringement of unbundling rules, or when they have reason to believe that such infringement may have occurred' (Interpretive Note: Unbundling, 22).

[60] Regulation 1223/2004/EC [2004] OJ L233/3.

under Directive 2004/85/EC, secured a temporary derogation from the application of what is now Article 33(1)(b) and (c) of the Third Electricity IEM Directive, thus delaying full market opening until 1 January 2013, and this remains applicable in the Third Directive.[61]

Slovakia's application to derogate from the requirement for unbundling of TSOs under Article 9(1) of Directive 2003/55, meanwhile, was rejected by the Commission.[62] **3.107**

(b) Small isolated systems or markets: Article 44(1) of the Third Electricity Directive and Article 49(1) of the Gas Directive provide the possibility of derogation for small isolated systems or markets. Thus: **3.108**

> Member States which can demonstrate, after this Directive has been brought into force, that there are substantial problems for the operation of their small isolated systems, may apply for derogations from the relevant provisions of Chapters IV, VI, VII, and VIII, as well as Chapter III, in the case of micro isolated systems, as far as refurbishing, upgrading and expanding existing capacity are concerned, which may be granted to them by the Commission. The Commission shall inform the Member States of those applications before taking a decision, taking into account respect for confidentiality. That decision shall be published in the Official Journal of the European Union.[63]

Small isolated systems are defined in Article 2(26) of the Third Electricity Directive as 'any system with consumption of less than 3000 GWh in the year 1996, where less than 5 per cent of annual consumption is obtained through interconnection with other systems'. Micro isolated systems, meanwhile, are defined in Article 2(27) as 'any system with consumption less than 500 GWh in the year 1996, where there is no connection with other systems'. **3.109**

An exemption for small isolated systems was included in the First Electricity IEM Directive.[64] As stated by one group of commentators: **3.110**

> [i]n a small isolated system, which in fact means an island not connected to the main grid of a country, the economies of scale of electricity production at present means no meaningful competition is possible. It is likely that, in such system, the level of demand means that there is room for very few generation facilities, and possibly no more than one. In such circumstances the creation of a competitive market is not possible and to 'liberalise' it would do more harm than good . . . This would most likely lead to higher prices than a regulated monopoly.[65]

[61] C Jones (gen ed), *EU Energy Law—Volume I: The Internal Energy Market—The Third Liberalisation Package* (3rd edn, Leuven: Claeys & Casteels, 2010), 444.

[62] Decision C/2004/3148.

[63] Art 44(1) of the Third Electricity IEM Directive.

[64] Art 24(3) of Directive 96/92/EC [1997] OJ L27/20.

[65] C Jones (gen ed), *EU Energy Law—Volume I: The Internal Energy Market—The Third Liberalisation Package* (3rd edn, Leuven: Claeys & Casteels, 2010), 446.

3.111 Member States must apply to the Commission for such a derogation: they do not apply automatically under the Directives. If it agrees, the Commission will make such a grant in a formal decision and publish it in the Official Journal.

3.112 A number of applications for derogations for small isolated electricity systems such as the Azores, Cyprus, Malta, Corsica, and Madeira have already been made and considered by the Commission. The Azores was granted an extensive derogation, effectively resulting in the non-application of the electricity Directive on that territory.[66] In the case of Cyprus, certain derogations were requested and granted under the Second Package.[67] In 2006, Malta applied for and was granted a full derogation from market opening[68] because, due to the size and structure of its electricity market it was not feasible that effective competition could develop. These are now enshrined as an automatic derogation in Article 44(2) of the Third Electricity IEM Directive,[69] by virtue of which Article 9 shall not apply to Cyprus, Luxembourg, and/or Malta. In addition, Articles 26, 32, and 33 shall not apply to Malta.

3.113 In the field of gas, Article 7(3) of the Third Gas Directive deals with 'isolated systems forming gas islands'. With a view to creating an internal market in natural gas, Member States should foster the integration of their national markets and the cooperation of system operators at EU and regional level, also incorporating the isolated systems forming gas islands that persist in the EU. Article 49 of the Third Gas IEM Directive, meanwhile, addresses isolated and emergent[70] gas markets in more detail. For our purposes here, it contains certain derogations from (inter alia) the unbundling provisions. First, Cyprus, as an isolated (Article 49(1)) and an emergent (Article 49(2)) gas market, has now been granted the express power to derogate from the requirements of Articles 4, 9, 37, and/or 38 (under Article 49(1)) and Articles 4, 9, 13(1) and (3), 14, 24, 25(5), 26, 31, 32, 37(1), and/or 38. The derogation does not require notification to and approval by the Commission, and any such derogation(s) are to end from the moment when Cyprus no longer qualifies as an isolated and/or (as the case may be) emergent market. Second, the special position of natural gas in Estonia, Latvia, and Finland is acknowledged under

[66] Decision 2004/920/EC of 20 December 2004 concerning the derogation from certain dispositions of Directive 2003/54/CE to the Azores archipelago [2004] OJ L389/31.

[67] C Jones (gen ed), *EU Energy Law—Volume I: The Internal Energy Market—The Third Liberalisation Package* (3rd edn, Leuven: Claeys & Casteels, 2010), 449.

[68] Decision 2006/859/EC [2006] OJ L332/32 (30 November 2006).

[69] Note the second paragraph of Art 44(2) clarifies that: '[f]or the purposes of Article 9(1)(b), the notion "undertaking performing any of the functions of generation or supply" shall not include final customers who perform any of the functions of generation and/or supply of electricity, either directly or via undertakings over which they exercise control, either individually or jointly, provided that the final customers including their shares of the electricity produced in controlled undertakings are, on an annual average, net consumers of electricity and provided that the economic value of the electricity they sell to third parties is insignificant in proportion to their other business operations.'

[70] Which means, 'a Member State in which the first commercial supply of its first long-term natural gas supply contract was made not more than 10 years earlier' (Art 2(31) of the Third Gas IEM Directive).

Article 49(1), third sub-paragraph, according to which Articles 4, 9, 37, and/or 38 shall not apply to those Member States until any of them is directly connected to the interconnected system of any other Member State apart from each other and Lithuania.

3.114 These specific provisions reflect the more general statement in Article 49(1) of the Third Gas IEM Directive, under which any Member State not directly connected to the interconnected system of any other Member State and having only one external supplier may derogate from Articles 4, 9, 37, and/or 38: at present, the particular cases listed in the later paragraphs of Article 49 cover all of those Member States which might otherwise fall under the first paragraph, although future acceding Member States might yet wish to take advantage of Article 49(1).

3.115 **(c) Extension of time for implementation:** Article 9(4) of the Third Electricity Directive provides that 'Member States may allow for derogations from points (b) and (c) of paragraph 1 until 3 March 2013, provided that transmission system operators are not part of a vertically integrated undertaking'.[71]

(2) 'Closed systems' under Article 28

3.116 The specific provisions concerning 'closed distribution systems' may be understood as derogations from the standard rules on unbundling and third party access. This area has become topical after the ECJ's judgment in the *citiworks* case, and the issue is given full discussion in the chapter on third party access (Chapter 4).

E. Towards Full Ownership Unbundling?[72]

(1) Why pursue full ownership unbundling?

3.117 It might be asked, given the far-reaching unbundling provisions already contained in the Second Package (requiring legal, accounting, and functional separation of the key stages in the value chain): why does the Commission continue to pursue full OU?[73] Eminent authors have argued that, before gathering experience on the operation over time of the legal unbundling regime, to move further to full OU would be premature and a breach of subsidiarity and/or proportionality principles, whether under EU or national (constitutional) law.[74] It is thus worth exploring

[71] Art 9(4) Third Electricity IEM Directive.

[72] See, generally, E Ehlers, *Electricity and Gas Supply Network Unbundling in Germany, Great Britain and The Netherlands and the Law of the European Union: A Comparison* (Antwerp: Intersentia, 2009) and A Johnston, 'Ownership Unbundling: Prolegomenon to a Legal Analysis' (n 9).

[73] Both in its proposals for the Third Package (as discussed at para 3.18) and its use of EU competition law (see the discussion at paras 3.125 ff).

[74] See, eg, Pielow, Brunekreeft, and Ehlers (n 9) for detailed argument in this vein.

what might be gained from full OU. Pollitt has summarized the key arguments in favour of OU:[75]

(i) increased *promotion of competition*, by reducing discrimination against non-vertically integrated undertakings across a range of areas (prices, terms and conditions, access to information). This should encourage new market entry, by removing the fear that incumbents' power in their home markets may be exploited to the detriment of new competitors;[76]
(ii) improving the ability of NRAs to perform their tasks effectively, by encouraging greater (cost) transparency in network and commercial businesses;
(iii) allowing a better focus on, and increase in, *investment in transmission networks*, especially with regard to interconnections and the concomitant benefits to inter-Member State trade and market integration. This aims: to address currently distorted incentives, which are not to invest in the interests of the system as a whole but rather in the overall interests of the vertically integrated undertaking; and to *reduce* the future *risks of* (arbitrary) *government intervention* in the market and its structure, ensuring a stability regulatory regime going forward.

3.118 It should be noted that, at national level, there may be other policies and priorities influencing such decisions to pursue OU: some countries may be keen to pave the way to the privatization of the unbundled assets (eg DSO ownership unbundling in the Netherlands); others may be committed to retaining a clear 'public utility' role for TSOs and/or DSOs, leading them to delay or oppose such unbundling and privatization. Further, there may be fears that full OU will facilitate foreign takeovers of domestic energy businesses. Various devices in national law, such as 'Golden Shares', have been employed in attempts to prevent such foreign acquisitions, largely unsuccessfully when used vis-à-vis undertakings established in other EU Member States due to the TFEU's rules concerning free movement of capital.[77] The *Commission v Belgium* case provides a framework for analysing possible

[75] M Pollitt, 'The Arguments For and Against Ownership Unbundling of Energy Transmission Networks' (2008) 36 *Energy Policy* 704; see also H Cremer, J Cremer, and P de Donder, 'Legal vs. Ownership Unbundling in Network Industries' (CEPR, Discussion Paper No 5767, August 2006; available at <http://www.cepr.org/pubs/dps/DP5767.asp.asp> and <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=931500>).

[76] See also Commission, 'Proposal for a Directive amending Directive 2003/54/EC concerning common rules for the internal market in electricity', COM(2007) 528 (19 September 2007), 4.

[77] See Cases C-367/98 *Commission v Portugal* [2002] ECR I-4731, C-483/99 *Commission v France* [2002] ECR I-4781, C-503/99 *Commission v Belgium* [2002] ECR I-4809, discussed by H Fleischer, 'Annotation' (2003) 40 CMLRev 493; more recent cases include Cases C-174/04 *Commission v Italy* [2005] ECR I-4933, C-274/06 *Commission v Spain* [2008] ECR I-165, and C-326/07 *Commission v Italy* [2009] ECR I-2291. See, further, M Hunt, 'Ownership Unbundling: The Main Legal Issue in a Controversial Debate', in B Delvaux, M Hunt, and K Talus (eds), *EU Energy Law and Policy Issues: the ELRF Collection* (Rixensart (Belgium): Euroconfidentiel, 2008), sec 2, ch 2 and K Talus, *Vertical Natural Gas Transportation Capacity, Upstream Commodity Contracts and EU Competition Law* (Alphen aan den Rijn: Kluwer Law International, 2011), 55–58.

justifications for such national law golden shares on the basis of security of supply (discussed further at paras 9.30 ff), emphasizing the limited extent to which this justification could be invoked. Further, Article 11 of both the Third Electricity and Gas IEM Directives responds to the concern that undertakings from non-EU Member States might acquire TSOs in the EU, undermining the impact of the unbundling provisions and/or threatening security of supply (on which see Recitals 25 (Electricity) and 22 (Gas)). This provision requires a foreign TSO to follow a special certification procedure (in place of the ordinary one applied to EU-based TSO owners under Article 10 of each Directive), and NRAs must refuse to certify such a TSO if either the relevant Directive's unbundling rules are not met by that TSO (even if the other assets in the value chain are located outside the territory of the EU) or if EU security of supply would be threatened (Article 11(3)).[78]

3.119 In practice, of course, such goals may only partly be achieved by OU, and criticisms have been made that some of these goals may positively be hindered by OU: eg raising the vast amounts of capital necessary to invest in upgrading and expanding transmission networks may prove more difficult where the TSO undertaking lacks the deeper range of assets held by a vertically integrated undertaking and where it does not have the opportunity to develop revenues from other related businesses (like generation or supply) which will be generated by such transmission investments. Also, the costs of replacing relations within a vertically integrated undertaking with a series of arm's length contracts under a regulated regime are argued by some to outweigh the benefits listed above of moving to full OU.[79]

(2) 'Constitutional' dimensions of ownership unbundling

3.120 Alongside these economic arguments concerning the costs and benefits of OU, a range of legal arguments has also been raised to challenge OU measures.[80]

3.121 **(a) Free movement law:** The rules of the TFEU concerning free movement have been raised as a potential objection to national measures pursuing full OU. They are treated here under the loose heading of 'constitutional dimensions' due to the directly effective and hierarchically superior nature of such Treaty rules under EU

[78] For discussion of the Commission's original, and more far-reaching, proposal and the potential implications of WTO law for such EU measures, see V van Hoorn, '"Unbundling", "Reciprocity" and the European Internal Energy Market: WTO Consistency and Broader Implications for Europe' [2009] *European Energy and Environmental Law Review* 51. For the Russian context, see S de Jong and J Wouters, 'European Energy Security Governance: Key Challenges and Opportunities in EU-Russia Energy Relations' (Leuven Centre for Global Governance, Working Paper No 65, June 2011) (available at <http://ssrn.com/abstract=1898676>), esp. at 23–29.

[79] See, eg, M Mulder, V Shestalova, and M Lijesen, 'Vertical separation of the energy-distribution industry' (CPB No 84, 2005) and B Baarsma et al, 'Divide and Rule. The Economic and Legal Implications of the Proposed Ownership Unbundling of Distribution and Supply Companies in the Dutch Electricity Sector' (2007) 35 *Energy Policy* 1785.

[80] For a pre-Third Package discussion, see PD Cameron, *Competition in Energy Markets: Law and Regulation in the European Union* (2nd edn, Oxford: OUP, 2007), 126.

law. In the Netherlands, objections have been raised at various stages to OU proposals on the basis of their restrictive effect upon the free movement of capital protected by Article 63 TFEU.[81] The measures adopted to secure full OU of DSOs were eventually challenged in court by three Dutch generating companies, and in June 2010 the Court of Appeal in The Hague ruled that the Dutch legislation amounted to a potentially justifiable, but ultimately disproportionate restriction upon the free movement of capital within the EU.[82] Prima facie, full OU for DSOs does indeed restrict capital movement because those engaged in generation, trade, or supply activities would be prevented from acquiring a significant interest in a distribution company. The Appeal Court refused to allow the promotion of pure economic interests[83] as a justification for such a restriction, in part because the ECJ's case law does not allow this (see, eg, the *Campus Oil* judgment)[84] and in part because the pre-existing EU-level legislation in the Third Package had already addressed such concerns in a manner less restrictive than the Dutch rules (ie to go further was, in the circumstances, disproportionate). Clearly, full OU for TSOs is also a prima facie restriction upon the free movement of capital for similar reasons, but justifying that such a restriction is necessary and proportionate is more straightforward, given the existence of the rules in the Third Package on the subject (as has previously been discussed in detail) and the relatively wide discretion likely to be afforded to the EU legislator by the ECJ in any challenge to those rules.

3.122 **(b) EU fundamental rights law:** At the EU level, the fundamental rights and principles developed under the European Convention for the protection of Human Rights and Fundamental Freedoms (ECHR) by the European Court of Human Rights (ECtHR) in Strasbourg are of significance. This is for two reasons. First, the ECJ has developed its jurisprudence on this question over the years (arguably largely in response to concerns at national level that the process of scrutiny and judicial review of the legislative competence of the EC did not take sufficient care in respect of fundamental rights arguments). It has created a linkage between the ECHR and its case law, on the one hand, and the EC legal order, on the other, by the device of 'general principles of EU law', drawn from and inspired by the

[81] Although it should be noted that the freedom of establishment under Art 49 TFEU may also be engaged: for discussion on the interaction between the capital and establishment rules, see Hunt (n 77), 73–89.

[82] *Essent, Delta and Eneco v Dutch State* (22 June 2010). For discussion, see HHB Vedder, 'Een streep door de splitsingswet? Het Hof Den Haag over de Won' (2010) 9(3/4) *Nederlands Tijdschrift voor Energierecht* 177 (the 'Won' being the 'Wet onafhankelijk netbeheer' or Dutch Unbundling Act). An appeal against this judgment is pending before the Dutch Supreme Court; meanwhile, uncertainty reigns, especially given that Nuon and Essent had already sold all of their non-DSOs assets to other undertakings, raising the prospect of possible damages claims against the Dutch Government should the Appeal Court's judgment be confirmed.

[83] Specifically, (i) preventing cross-subsidies between regulated distribution activities and other competitive parts of the business; (ii) securing greater transparency, so as to protect customers of DSOs; and (iii) to guarantee security of supply.

[84] Case 72/83 *Campus Oil v Minister for Industry and Energy* [1984] ECR 2727; see our discussion of security of supply as a justification for restrictions upon free movement at paras 9.24 ff.

common constitutional traditions of the EU's Member States.[85] One of the few clearly consistent elements in those traditions is the membership of the Council of Europe and its ECHR: as a result, the case law developed by the ECtHR has become an important source of inspiration for the ECJ and the General Court (formerly the Court of First Instance (CFI)) in their development of fundamental rights protection within the EU. Second, all EU Member States are also signatory to the ECHR and thus are also responsible for ensuring that its provisions are respected within their national legal order.

For our purposes, the key fundamental right in question is likely to be the right **3.123** to property laid down in Article 1 of the First Protocol to the ECHR (and the corresponding terms of Article 17 of the EU Charter of Fundamental Rights). A fuller discussion of the structure of reasoning required by the ECtHR case law in this area can be found elsewhere:[86] in short, provided that the transmission assets are sold off, thus ensuring that their current owners receive some compensation in return for their inability any longer to own such assets, it seems that this should amply satisfy the proportionality requirements imposed by the ECHR under this provision.[87]

(c) National constitutional law: Various authors and stakeholders have also raised **3.124** arguments under national constitutional law, suggesting that EU legislation or decisions which would positively require full ownership unbundling would not be enforced with their national legal order. While strictly a matter of national law, it is important to highlight that such arguments exist and have been strongly supported by a number of governments and eminent commentators. They tend to raise arguments very similar to those which might arise under the ECHR and/or the EU's Charter of Fundamental Rights with regard to property rights; as with those

[85] The foundational cases are Case 11/70 *Internationale Handelsgesellschaft v Einfuhr und Vorratsstelle für Getreide und Futtermittel* [1970] ECR 1125, esp. paras. 3 and 4; Case 4/73, *Nold v Commission* [1974] ECR 491, esp para 13; Case 44/79, *Hauer v Land Rheinland-Pfalz* [1979] ECR 3727, esp. paras. 14 and 15 and subsequent discussion, with clear references to the right to property under Art 1 of the First Protocol to the ECHR. The right to property was also of importance in the ECJ's judgment in Case C-84/95 *Bosphorus v Minister of Transport* [1996] ECR I-3953.

[86] See A Johnston, 'Take-or-pay Contracts for Renewables: An Analysis of European Legal Issues', sec. 4, ch. 4 in B Delvaux, M Hunt, and K Talus (eds), *EU Energy Law and Policy Issues—The Energy Law Research Forum Collection* (Rixensart (Belgium): Euroconfidentiel, 2008), at sec B.1 for discussion; see also S Praduroux and K Talus, 'The Third Legislative Package and Ownership Unbundling in the Light of the European Fundamental Rights Discourse' (2008) 9 *Competition and Regulation in Network Industries* 3.

[87] It can be noted that the rationale underlying the fundamental rights analysis under the ECHR (mirrored in many national systems) is very similar to the basis upon which claims to recover stranded costs have been developed and subsequently analysed under EC law in the State aids field. See Commission Communication relating to the methodology for analysing State aid linked to stranded costs (26 July 2001), which is available at <http://ec.europa.eu/competition/state_aid/legislation/stranded_costs_en.pdf>. See further the brief article by B Allibert in the Commission's Competition Policy Newsletter, No 3, October 2001, 25–27, discussing the Decisions taken by the Commission on the applications by Austria, Spain, and the Netherlands.

European fundamental rights instruments, in practice the success of such arguments will turn on questions of the proportionality of any such prima facie restrictions upon those protected rights. It may be the case at national level that courts may grant rather less leeway to the national legislator than might be available under the ECHR and the EU Charter, although this remains to be seen in practice. Even if the proportionality test were more tightly operated, however, the Constitutional Courts of some EU Member States would still not refuse to enforce such EU law rules unless they found that the EU's activities showed systemic and persistent disregard for the need to safeguard such fundamental rights on the EU level.[88]

(3) Competition law and ownership unbundling

3.125 It has long been clear that, as a general matter, merger law could make a significant contribution to such market structure questions. Where it is thought that allowing a merger involving such an undertaking might lead to competition difficulties, it is open to the Commission to prohibit it from being implemented under the EU's Merger Control Regulation 139/2004/EC (MCR).[89] Instead of prohibition, conditions may be attached to the Commission's approval of such mergers, including requiring the merging parties to divest themselves of certain assets. A good illustration of this phenomenon is the Electricité de France (EDF)/Energie Baden-Württemburg (EnBW) merger,[90] in which the Commission required that EDF sell off Compagnie Nationale de Rhône (including its electricity generation assets on the Rhône river barrage system) as a condition of EDF being allowed to acquire the stake in EnBW.

3.126 National merger control law may also be relevant, particularly where the relevant merger control thresholds for the application of the MCR are not met, or where the Commission refers a merger down to the national merger control authorities (Article 9 MCR). This point is underlined by national merger laws which contain provisions allowing intervention on public interest grounds: while such provisions in the UK have rarely been used,[91] if important infrastructural questions are

[88] See, inter alia, *Brunner v European Union Treaty* [1994] 1 CMLR 57 and, most recently, *The Lisbon Treaty Judgment*, BVerfG, 2 BvE 2/08, 30 June 2009 (available in English at <http://www.bverfg.de/entscheidungen/es20090630_2bve000208en.html>). From a voluminous literature, see the following useful discussions in English of the developing German position: M Herdegen, 'Maastricht and the German Constitutional Court: Constitutional Restraints for an "Ever Closer Union"' (1994) 31 CMLRev 235, U Everling, 'Will Europe Slip on Bananas? The *Bananas Judgment* of the Court of Justice and National Courts' (1996) 33 CML Rev 401, and A Steinbach, 'The *Lisbon Judgment* of the German Federal Constitutional Court—New Guidance on the Limits of European Integration?' (2010) 11 *German Law Journal* 367 (available at <http://www.germanlawjournal.com/index.php?pageID=11&artID=1246>).

[89] [2004] OJ L24/1.

[90] Case No COMP/M.1853, *EDF/EnBW* (7 February 2001).

[91] Indeed, even when the formal test referred to the 'public interest', successive Secretaries of State instead took a firm and consistent policy line that this was to be interpreted as a test based solely upon competition criteria: see, eg, B Rodger, 'Reinforcing the Scottish "Ring-Fence": A Critique of UK Merger Policy vis-à-vis the Scottish Economy' [1996] ECLR 104, who criticized UK merger policy (under the previous regime of the Fair Trading Act 1973) for its failure to take into account important regional economic considerations, instead subsuming them in the overall competition-based analysis.

involved in a merger, this might be one of those rare occasions where such powers were called into action.[92] Similarly, these questions may be sufficient to encourage the national authorities to request that the Commission should refer a case 'down' (under Article 22(3) MCR) to the national merger control body, even where the merger's size has ensured that it had met the thresholds for the application of the EU regime.

Lately, however, the other provisions of EU competition law have come to the fore **3.127** in the energy sector in general, and with particular force when applied to network assets. Most recently, the Commission has accepted commitments from E.ON,[93] RWE,[94] and ENI[95] to sell (some of) their transmission networks as part of the settlement of proceedings for breach of the EU competition rules. These undertakings had been guilty of various practices in breach of what is now Article 102 TFEU.

This strategy of the parallel usage by Commission of *ex post* competition law en- **3.128** forcement and legislative proposals in Third Package to achieve ownership unbundling goals is interesting, and it is perhaps ironic that more 'progress' was achieved by the Commission vis-à-vis the German transmission grids using competition law than in the EU's legislative process, where the German Government put up a staunch defence of the legal status of German TSOs, only to see the sale of E.ON and RWE's grids agreed in a deal to avoid (even heftier) competition law fines. This strategy is not uncontroversial: some commentators[96] see this as a reflection of the weakness of *ex ante* regulatory tools and processes, but also as the development of a strange '*quasi-ex ante* regulatory approach through antitrust', leading to negotiations between the Commission and energy companies in an ongoing and iterative process, rather than the traditional *ex post* application of antitrust law. Achieving structural remedies through only partly public decision-making processes leading to commitments[97] by energy undertakings creates unpredictability and may

[92] In the current UK regime, the Secretary of State can add to the range of relevant public interest considerations by making an Order (approved by both Houses of Parliament), while the legislature can also add to the list of public interest matters by statute. Just such an exception currently seems to be planned to deal with the current financial instability, with the intention of allowing Lloyds TSB plc to acquire Halifax–Bank of Scotland: for discussion see, eg, <http://news.bbc.co.uk/1/hi/business/7622380.stm>.

[93] [2009] OJ C36/8 (13 February 2009): the Dutch TSO, TenneT duly acquired E.ON's TSO business on 10 November 2009.

[94] [2008] OJ C310/23 (5 December 2008).

[95] [2010] OJ C55/13 (5 March 2010).

[96] L Hancher and A de Hauteclocque, 'Manufacturing the EU Energy Markets: The Current Dynamics of Regulatory Practice' (TILEC Discussion Paper 2010-003, January 2010).

[97] The ECJ has recently (Case C-441/07 P, *Alrosa v Commission* [2010] ECR I-5949) overturned the CFI's judgment (Case T-170/06, [2007] ECR II-2601) in the *Alrosa* case: the CFI had required the Commission more clearly to explain the competition problem involved and to justify

damage the legitimacy of both the application of competition law and, indeed, of the EU's legislative processes which led to the Third Package (by creating the impression that such finely balanced legislative compromises can simply be upset by the Commission's application of the EU's competition rules).

the proportionality of the commitments required, as well as to protect the procedural rights of the defendants and third parties. But the ECJ found that the Commission's discretion under the commitments procedure (Art 9 of Regulation 1/2003/EC, [2003] OJ L1/1) was broad: no positive finding of infringement is required of the Commission and 'judicial review . . . relates solely to whether the Commission's assessment is manifestly incorrect' (at para 42).

4

THIRD PARTY ACCESS

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A. Introduction

Third party access (TPA) is the cornerstone of the liberalization of the electricity and energy market in Europe. This was recently addressed by the ECJ in Case C-439/06 *citiworks AG* (22 May 2008).[1] The ECJ underlined that 'for competition to function, non-discriminatory, transparent and fairly priced network access is of paramount importance in bringing about the internal electricity market'[2] and that 'open third-party access to transmission and distribution systems constitutes one of the essential measures which the Member States are required to implement in order to bring about the internal market in electricity'.[3] **4.01**

The starting point of third party access to the EU energy markets was the access to grids for the transit of electricity and gas. The Transit Directives—ie for electricity, Council Directive 90/547/EEC of 29 October 1990 on the transit of electricity **4.02**

[1] Case C-439/06 *citiworks AG v Flughafen Leipzig/Halle GmbH* [2008] ECR 2008 I-3913, hereafter, '*citiworks* case'. This case is further analysed in the present chapter, in the context of 'closed distribution systems': see paras 4.125 ff.

[2] *citiworks* case, para 40.

[3] *citiworks* case, para 44.

through transmission grids[4] and, for gas, Council Directive 91/296/EEC of 31 May 1991 of the transit of natural gas through grids[5]—organized negotiated access to grids for transit purposes on the basis of non-discriminatory conditions, fair for all the parties concerned, exclusive of unfair clauses or unjustified restrictions, and respecting security of supply and quality of services.[6]

4.03 Third party access was then extended to the electricity and natural gas transmission and distribution systems by the First Energy Package. Member States had the choice between negotiated and regulated access. While the former was based on voluntary commercial agreements between suppliers and eligible customers,[7] the latter was based on published tariffs (and/or published terms and conditions for the gas market) for the use of transmission and distribution systems.[8] On the electricity market, Member States could also opt for a 'single buyer' responsible for the purchase of the electricity contracted by an eligible customer from a producer 'at a price equal to the sale price offered by the single buyer to eligible customer minus the price of published tariffs'.[9] In practice, this procedure has not been implemented.

4.04 In the Second Energy Package, only the model of regulated access to electricity and natural gas transmission and distribution was retained. This system was also extended to include access to liquefied natural gas (LNG) facilities.[10] On the gas market, access to storage facilities, linepack, and ancillary services as well as to upstream pipeline networks was also addressed. For the former, it could be negotiated or regulated[11] while, for the latter, Member States had to take the necessary measures to allow negotiations.[12]

4.05 Third party access to the EU energy markets evolved further in the Third Energy Package. The application of regulated tariffs to balancing services besides transmission and distribution tariffs was clarified.[13] The access to storage facilities and linepack was also reinforced.[14] This chapter analyses the law concerning third party access, as it stands after the entry into force of the Third Energy Package. The

[4] [1990] OJ L313/30, 13 November 1990, hereafter 'Electricity Transit Directive'.
[5] [1991] OJ L147/37, 12 June 1991, hereafter 'Gas Transit Directive'.
[6] Art 3(1) and (2) of the Electricity and Gas Transit Directives.
[7] Art 17(1) to (3) of the First Electricity Directive and Art 15 of the First Gas Directive.
[8] Art 17(4) of the First Electricity Directive and Art 16 of the First Gas Directive.
[9] Art 18 of the First Electricity Directive.
[10] Art 20(1) of the Second Electricity IEM Directive and Art 18(1) of the Second Gas Directive.
[11] Art 19 of the Second Gas Directive.
[12] Art 20 of the Second Gas Directive.
[13] Art 37(6) of the Third Electricity IEM Directive and Art 41(6) of the Third Gas IEM Directive.
[14] Art 33(1) of the Third Gas IEM Directive.

provisions guaranteeing third party access are examined first (paras 4.06 ff) before turning to the derogations and specific cases (paras 4.56 ff).

B. Third Party Access in EU Energy Legislation

4.06 Third party access in the Third Energy Package is based on regulated access (paras 4.07 ff). However, negotiated access still may apply for specific facilities (paras 4.31 ff).

(1) Regulated third party access

4.07 Regulated tariffs are the cornerstone of regulated third party access (paras 4.08 ff). Transmission system operators (TSOs) and distribution system operators (DSOs), as well as national regulatory authorities (NRAs), are guarantors of this third party access (paras 4.26 ff).

4.08 **(a) Regulated tariffs:** In accordance with Article 32(1) of the Third Electricity and Gas Directives, access to the transmission and distribution systems as well as LNG facilities has to be 'based on published tariffs, applicable to all eligible customers, including supply undertakings and applied objectively and without discrimination between system users'.

4.09 The articulation of regulated third party access on such tariffs was underlined by the ECJ in its recent judgment in *Julius Sabatauskas*.[15] The ECJ underlined in this judgment that the concept of access was generally used in the context of regulated tariffs, independent of the connection modalities to the grid.[16]

[15] Case C-239/07 *Julius Sabatauskas* [2008] ECR I-7523, hereafter '*Sabatauskas*'.
[16] The ECJ was questioned about the possibility of interpreting the third party access provisions of the Second Electricity IEM Directive as 'obliging Member States to establish legal rules whereby any third party has the right, at his discretion, provided that the electricity system has "the necessary capacity", to choose the system—electricity transmission system or electricity distribution system—to which he wishes to be connected and the operator of that system has an obligation to grant access to the network'. It decided that:

> 40. The terms "access" and "connection" appear in the Directive [2003/54/EC] with different meanings. The term "access" is linked to the supply of electricity, including *inter alia* the quality, regularity and cost of the service. It is often used in the context of guaranteeing non-discriminatory tariffs. Thus, it is stated in recitals 2 and 13 of the preamble to the Directive [2003/54/EC] that access to the network on the basis of tariffs published prior to their entry into force guarantees non-discriminatory transmission and distribution tariffs, in recital 6 that access must be non-discriminatory, transparent and fairly priced, in recital 15 that the intervention of regulatory authorities guarantees non-discriminatory access to the network and in recital 17 that non-discriminatory and cost-reflective balancing mechanisms are necessary in order to ensure effective market access for all market players.
> 41. The term "connection" is used, in particular, in a technical context and relates to physical connection to the system . . .
> 46. It is one of the objectives of the Directive [2003/54/EC] that access to the system should be open—which . . . constitutes an essential measure for bringing about the completion of the internal market in electricity—and that it should be based on objective, non-discriminatory

4.10 The scope and criteria of regulated tariffs are analysed (paras 4.11 ff), before turning to the procedure applicable for the adoption and publication of those tariffs (paras 4.20 ff).

4.11 *(i) Scope and Criteria of Regulated Tariffs:* Regulated tariffs cover three components:

(1) the connection and access to national transmission and distribution system as well as the access to LNG facilities;
(2) balancing services; and
(3) the access to cross-border infrastructures.

4.12 Regarding the connection and access to national transmission and distribution systems as well as LNG facilities, several criteria have to be met by those tariffs. First of all, they have to be objective and non-discriminatory.[17] This does not imply standardized tariffs; differentiated tariffs may be applied for different services, quantities, requirements, nominations, etc, as long as they are adopted in line with the procedure hereafter examined.[18]

4.13 The second criterion is the one of 'cost-reflectivity':[19] the tariffs or their methodologies 'shall allow the necessary investments in the networks to be carried out in a manner allowing those investments to ensure the viability of the networks'.[20] For the internal natural gas market, it is furthermore specified that tariffs applied by TSOs should 'take into account the need for system integrity and its improvement and reflect the actual costs incurred, insofar as such costs correspond to those of an efficient and structurally comparable network operator and are transparent, whilst including an appropriate return on investment, and, where appropriate, taking account of the benchmarking of tariffs by the regulatory authorities'.[21]

4.14 A third criterion for access and connection tariffs to transmission and distribution systems, as well as for access to LNG facilities, is the existence of incentives, over

and transparent criteria and on tariffs published prior to their entry into force, and not that it should be at the customer's discretion.

47. It follows from this that Member States retain a certain flexibility in steering system users towards one or another type of system, provided, however, that they do so for non-discriminatory reasons and in accordance with objective considerations. System users thus have a right of access to the electricity system but Member States may decide that the connection is to be made on one or another type of system.' (ECJ, *Sabatauskas*, paras 41, 42, 46, and 47.)

[17] Recital (36) and Art 32(1) of the Third Electricity IEM Directive and Recital (32) and Art 32(1) of the Third Gas IEM Directive.

[18] See paras 4.20 ff. Differentiated tariffs are expressly envisaged for the natural gas sector by Regulation 715/2009 for the distinction between firm and interruptible capacity.

[19] Recital (36) and Art 37(6)(a) of the Third Electricity IEM Directive and Recital (32) and Art 41(6)(a) of the Third Gas IEM Directive.

[20] Article 37(6)(a) of the Third Electricity IEM Directive and Art 41(6)(a) of the Third Gas IEM Directive.

[21] Art 13(1), para 1 of Regulation 715/2009.

both short and long term, 'to increase efficiencies, foster market integration and security of supply and support the related research activities'.[22]

4.15 For the natural gas market, a further criterion applies for interruptible capacity: the probability of interruption has to be reflected in the price.[23]

4.16 Finally, and still only for the natural gas market, 'third party access services may be granted subject to appropriate guarantees from network users with respect to the creditworthiness of such users. Such guarantees shall not constitute undue market-entry barriers and shall be non-discriminatory, transparent and proportionate'.[24]

4.17 Turning to balancing services, this component fell within the scope of regulated tariffs following the adoption of the Third Energy Package. Indeed, it has been clarified that the terms and conditions of balancing services, 'including the rules and tariffs, for the provisions of such services' by TSO and DSOs shall be adopted according to the same methodology as for regulated tariffs for the connection and access to transmission and distribution networks.[25] As for tariffs for access and connection to transmission and distribution systems as well as for access to LNG facilities, balancing services tariffs should be non-discriminatory and cost-reflective.[26] This criterion has been clarified for the gas market in Regulation 715/2009: 'imbalance charges shall be cost-reflective to the extent possible, whilst providing appropriate incentives on network users to balance their input and off-take of gas. They shall avoid cross-subsidisation between network users and shall not hamper the entry of new entrants'.[27] Such tariffs should also provide incentives to network users 'to balance their input and off-takes'[28] as well as, both over the short and long term, 'to increase efficiencies, foster market integration and security of supply and support the related research activities'.[29]

4.18 The last component of regulated tariffs—access to cross-border infrastructures—was also added by the Third Energy Package Directives. The Third Directives are, however, silent regarding the scope and criteria of this component. Some clarifications may be found for the electricity market in Regulation 714/2009, which

[22] Art 37(8) of the Third Electricity IEM Directive and Art 41(8) of the Third Gas IEM Directive.

[23] Art 14(1) para 2 of Regulation 715/2005.

[24] Arts 14(3) and 15(4) of Regulation 1775/2009.

[25] Arts 15(7), 25(6), and 37(6) of the Third Electricity IEM Directive and Arts 13(3), 25(5), and 41(6) of the Third Gas IEM Directive. The need to address balancing tariffs was addressed in Recital (35) of the Third Electricity IEM Directive and in Recital (31) of the Third Gas IEM Directive.

[26] Arts 15(7), 25(6), and 37(6) of the Third Electricity IEM Directive and Arts 13(3), 25(5), and 41(6) of the Third Gas IEM Directive. The need to address balancing tariffs was addressed in Recital (35) of the Third Electricity IEM Directive and in Recital (31) of the Third Gas IEM Directive.

[27] Art 21(3) of Regulation 715/2009.

[28] Art 37(6)(b) of the Third Electricity IEM Directive and Art 41(6)(b) of the Third Gas IEM Directive.

[29] Art 37(8) of the Third Electricity IEM Directive and Art 41(8) of the Third Gas IEM Directive.

aims at 'setting fair rules for cross-border exchange in electricity' and providing 'for mechanisms to harmonise the rules for cross-border exchanges in electricity'.[30] Article 14 of Regulation 714/2009 provides guidelines regarding 'charges for access to networks'. Such charges shall be 'transparent, take into account the need for network security and reflect actual costs incurred insofar as they correspond to those of an efficient and structurally comparable network operator and are applied in a non-discriminatory manner. Those charges shall not be distance-related'.[31] If possible, tariffs applied to producers and/or consumers should 'provide locational signals at [EU] level, and take into account the amount of network losses and congestion caused, and investment caused for infrastructure'.[32] The following elements should also be taken into account: 'payments and receipts resulting from the inter-transmission system operator compensation mechanism' and 'actual payments made and received as well as payments expected for future period of time, estimated on the basis of past periods'.[33] Finally, no specific charges may be set up for individual transactions for declared transits of electricity.[34]

4.19 As for the natural gas market, Regulation 715/2009 provides that tariffs for network users have to be set separately for each point of entry or exit of the transmission system. A transitional period was granted until 3 September 2011, with network charges having to be calculated irrespective of the contractual paths but on the basis of different entry and exit points.[35]

4.20 *(ii) Procedure for adoption of regulated tariffs:* The adoption of regulated tariffs is one of the core duties of national regulatory authorities (NRAs). It is cited as their first duty by Article 37(1)(a) of the Third Electricity IEM Directive and Article 41(1)(a) of the Third Gas IEM Directive: 'the regulatory authority shall have the following duties: (a) fixing or approving, in accordance with transparent criteria, transmission or distribution tariffs or their methodologies …'. It follows from Article 37(6) of the Third Electricity IEM Directive and from Article 41(6) of the Third Gas IEM Directive that 'the regulatory authorities shall be responsible for fixing or approving sufficiently in advance of their entry into force at least the methodologies used to calculate or establish' those tariffs or methodologies.

4.21 As underlined by the Commission in its Interpretative Note of 22 January 2010 concerning regulatory authorities,[36] those dispositions leave Member States with

[30] Art 1(a) and (b) of Regulation 714/2009.
[31] Art 14(1) of Regulation 714/2009.
[32] Art 14(2) of Regulation 714/2009.
[33] Art 14(3) of Regulation 714/2009.
[34] Art 14(5) of Regulation 714/2009.
[35] Art 13(1) para 4 of Regulation 1775/2009.
[36] Commission Staff Working Paper, Interpretative Note on Directive 2009/72/EC Concerning Common Rules for the Internal Market in Electricity and Directive 2009/73/EC Concerning Common Rules for the Internal Market in Natural Gas: The Regulatory Authorities, 22 January 2010 (hereafter, 'Interpretative Note: Regulatory Authorities').

four options for the intervention of national regulatory authorities in the adoption of regulated tariffs. The NRAs may:[37]

(1) fix the tariffs;
(2) fix the methodology for the adoption of the tariffs;
(3) approve the tariffs; or
(4) approve the methodology.

4.22 The scope of the competences of NRAs in the adoption of regulated tariffs has been recently analysed by the ECJ in *Commission v Belgium*.[38] In this case, the methodology applicable to depreciations and equitable margin in the case of extensions of existing installations or new installations recognized as of national or European interest was fixed by the Belgian Government, after receiving an opinion from the NRA (the Commission de Régulation de l'Electricité et du Gaz (CREG)). The procedure for the adoption of this methodology differed from the other methodologies applicable to the access and connection to the Belgian electricity and natural gas transmission and distribution systems: there, the methodologies were adopted by the Belgian Government following a proposal from the CREG. The ECJ considered that a procedure where the CREG was only given the opportunity to provide an 'opinion' on the methodology infringed the competences of NRAs regarding regulated tariffs.[39] The ECJ also underlined that the intervention of the CREG at a later stage in the approval of the tariffs proposed by system operators for certain types of investment (for the extension of existing installations or in new installations recognized as having a Belgian or European interest) was not relevant in curing this defect of the Belgian rules, since the grant of the relevant competences to the Belgian Government had the effect of reducing the competences granted to the CREG, so that the CREG was accordingly bound by specific rules in its approval of the tariffs.[40]

4.23 Besides this judgment, it worth underlining that, contrary to the Second Package Directives, Member States may no longer make the decision of the NRA regarding tariffs (setting or approval of tariffs, or setting or approval of the methodologies) conditional upon the formal approval of another relevant designated body of a Member State.[41] Following the adoption of the Third Energy Package, decisions of NRAs regarding tariffs are to be autonomous and directly binding; Member States may, however, still intervene through 'general policy guidelines'. As the

[37] Interpretative Note: Regulatory Authorities (n 36), 14.
[38] Case C-474/08 *Commission v Belgium* [2009] ECR I-175* (summary publication only, judgment of 19 December 2009).
[39] *Commission v Belgium* (n 38), paras 27–29.
[40] *Commission v Belgium* (n 38), para 30.
[41] Such a possibility was provided by Art 23(3) of the Second Electricity IEM Directive and by Art 25(3) of the Second Gas Directive, and could result in referral to another regulatory body such as the national competition office (eg in Germany, the Bundeskartellamt) or to a government office, such as the Ministry of Economic Affairs.

Commission's Interpretive Note on regulatory authorities under the Third Package states:

> The core duties of the NRA as regards network tariffs do not deprive the Member State of the possibility to issue general policy guidelines which ultimately will have to be translated by the NRA into the tariff structure and methodology. However, these guidelines should not encroach on the NRA's competences or infringe any of the requirements of the Electricity and Gas Directives and Regulations. Although a Member State could eg issue a general policy guideline with regard to attracting investments in renewables, the Commission's services would consider a rule setting the profit margin in the cost-plus tariff as a prohibited direct instruction to the NRA.[42]

4.24 The position taken by France in transposing the Third Energy Package into national law is worthy of note here: while entrusting the NRA, the Commission de Régulation de l'Energie (CRE), with the competence to fix the relevant tariff methodologies, various guidelines were laid down in the Decree n°2011/504 of 9 May 2011.[43] Notably, it is provided that tariffs have to be calculated in a transparent and non-discriminatory way, in order to cover the whole of the costs borne by the system operators, to the extent that such costs correspond to those of an efficient system operator.[44] It is also provided that the costs borne by the system operators and to be covered in the tariffs should, in particular, include the costs resulting from the execution of public service obligations, the costs linked to the necessary research and development for the increase of the grid capacities (especially interconnections with neighbouring countries), and the costs for connection to the grids and the services operated exclusively by system operators.[45]

4.25 A final step to be analysed in the procedure of adoption of regulated tariffs is their publication: regulated tariffs have to be published prior to their entry into force. In case a national regulatory authority is entrusted with the mere task of fixing or approving a methodology, the tariffs adopted on its basis should also be published.

[42] Interpretative Note: Regulatory Authorities (n 36), 14.

[43] Ordonnance n°2011/504 du 9 mai 2011 portant codification de la partie législative du Code de l'Energie.

[44] Art L 341–2, first subsection of the French Energy Code: 'Les tarifs d'utilisation du réseau public de transport et des réseaux publics de distribution sont calculés de manière transparente et non discriminatoire, afin de couvrir l'ensemble des coûts supportés par les gestionnaires de ces réseaux dans la mesure où ces coûts correspondent à ceux d'un gestionnaire de réseau efficace'.

[45] Art L 341–2, first subsection of the French Energy Code: '1° Les coûts résultant de l'exécution des missions et des contrats de service public; 2° Les surcoûts de recherche et de développement nécessaires à l'accroissement des capacités de transport des lignes électriques, en particulier de celles destinées à l'interconnexion avec les pays voisins et à l'amélioration de leur insertion esthétique dans l'environnement; 3° Une partie des coûts de raccordement à ces réseaux et une partie des coûts des prestations annexes réalisées à titre exclusif par les gestionnaires de ces réseaux, l'autre partie pouvant faire l'objet d'une contribution dans les conditions fixées aux articles L. 342-6 et suivants'.

(b) TSOs/DSOs and national regulatory authorities: guarantor of the third party access: Several duties and responsibilities are entrusted to TSOs and DSOs as well as to NRAs to ensure third party access to the transmission systems, distribution systems, and LNG facilities. Those tasks are examined briefly in the following paragraphs. **4.26**

(i) Duties and responsibilities of TSOs and DSOs in third party access: TSOs and DSOs have the responsibility to provide third party access to the system and facilities they manage.[46] Besides this general responsibility, several duties of TSOs and DSOs are relevant for third party access: **4.27**

- an information and transparency duty: TSOs and DSOs have to 'provide system users with the information they need for efficient access to [including use of] the system'.[47] Such information notably relates to the availability of the capacities, in relation to capacity-allocation mechanisms and congestion management procedures;[48]
- while providing information, TSOs and DSOs should be careful to preserve the confidentiality of the commercially sensitive information obtained in the course of their business.[49] TSOs should particularly not misuse to the advantage of related undertakings the information obtained from third parties in the context of their access to the system;[50]
- a non-discrimination duty: TSOs and DSOs have to ensure that no discrimination occurs 'between system users or classes of system users, particularly in favour of [their] related undertakings';[51]
- a duty to operate, maintain, and develop, under economic conditions and with due regard to the environment, secure, reliable, and efficient systems and/or facilities (such as LNG facilities).[52] TSOs on the electricity market are entrusted in this context with the task to ensure the 'availability of all necessary ancillary services, including those provided by demand response';[53]

[46] Art 12(h) of the Third Electricity IEM Directive and Art 14(1)(a)–(b) and 15(1)(a) of Regulation 715/2009.

[47] Art 12(g) and 25(3) of the Third Electricity IEM Directive and Art 13(d) and 25(3) of the Third Gas IEM Directive.

[48] Art 15(3) and (4) and Annex 1, Guidelines on the management and allocation of available transfer capacity of interconnections between national systems, point 5, Transparency of Regulation 714/2009 and Art 14 to 17 of Regulation 715/2009. Those provisions are examined further at paras 4.57 ff.

[49] Arts 16(1) and (3) and 27 of the Third Electricity IEM Directive and Arts 16(1) and (3) and 27 of the Third Gas IEM Directive as well as Arts 14 and 15 of Regulation 715/2009.

[50] Art 16(2) of the Third Electricity IEM Directive and Art 16(2) of the Third Gas IEM Directive.

[51] Arts 12(f) and 25(2) of the Third Electricity IEM Directive and Arts 13(1)(b) and 25(2) of the Third Gas IEM Directive.

[52] Arts 12(a) and (d) and 25(1) of the Third Electricity IEM Directive and Arts 13(1)(a) and 25(1) of the Third Gas IEM Directive.

[53] Art 12(d) of the Third Electricity IEM Directive.

- a duty to procure the energy used for their activities on the basis of transparent, non-discriminatory, and market-based procedures;[54] and
- a duty to complete balancing tasks on the basis of objective, transparent, and non-discriminatory rules.[55]

4.28 TSOs and DSOs on the electricity market also have specific duties regarding access to, and dispatching of electricity on, their systems. TSOs are responsible for dispatching the generating installation in their areas and for determining the use of interconnectors with others systems.[56] In this frame, TSOs have to respect certain priority criteria. They first have to give priority to generating installations using renewable energy sources or generating installations producing combined heat and power. Such priority relates both to access to, and the dispatching of the electricity on, the transmission system.[57] TSOs may also, if allowed by Member States for reasons for security of supply, give priority in the dispatching to generating installations using indigenous primary energy fuel sources. Such priority is capped at, in a calendar year, 15 per cent of the overall primary energy necessary to produce the electricity consumed in the Member States concerned.[58]

4.29 As for DSOs, they are required to dispatch generating installations with a priority to installation using renewable energy sources or waste or producing combined heat and power.[59]

4.30 *(ii) Duties and responsibilities of national regulatory authorities in third party access:* Besides their core duties in the adoption of regulated tariffs, as examined in the preceding paragraphs, the following responsibilities and duties of NRAs are also relevant for third party access:

- NRAs are required to promote, in close cooperation with the Agency for the Co-operation of Energy Regulators (ACER), other regulatory authorities and the Commission, a competitive, secure, and environmentally sustainable internal market in electricity and natural gas within the EU, and effective market opening for all customers and suppliers in the EU;[60]
- NRAs have to facilitate the access to the network for new generation capacity, in particular removing barriers that could prevent access for new market entrants and of electricity/gas for renewable energy sources;[61]

[54] Arts 15(6) and 25(5) of the Third Electricity IEM Directive and Art 13(5) of the Third Gas IEM Directive.

[55] Arts 15(7) and 25(6) of the Third Electricity IEM Directive and Arts 13(3) and 25(5) of the Third Gas IEM Directive as well as Art 21 of Regulation 715/2009.

[56] Art 15(1) of the Third of Electricity Directive.

[57] Art 15(3) of the Third Electricity IEM Directive and Art 16(2)(b) and (c) of Directive 2009/28/EC, this later Directive is hereafter examined in Ch 12 on Renewable Energy Sources.

[58] Art 15(4) of the Third Electricity IEM Directive.

[59] Art 25(4) of the Third Electricity IEM Directive.

[60] Art 36(a) of the Third Electricity IEM Directive and Art 40(1) of the Third Gas IEM Directive.

[61] Art 36(e) of the Third Electricity IEM Directive and Art 40(e) of the Third Gas IEM Directive.

- NRAs must monitor the level and effectiveness of market opening and competition at both wholesale and retail levels. Any relevant case or information is to be brought by the national regulatory authorities to the competent competition authorities;[62]
- NRAs also have to monitor 'the occurrence of restrictive contractual practices, including exclusivity clauses which may prevent large non-household customers from contracting simultaneously with more than one supplier or restrict their choice to do so'. Where appropriate, national regulatory authorities have to inform the national competition authorities of such practices;[63] and
- NRAs must ensure access to customer consumption data, on the basis of an easily understandable harmonized format, and are to guarantee a prompt access for all customers to such data in order to allow them to exercise third party access.[64]

(2) Possibility of negotiated third party access to certain specified facilities

4.31 As has already been underlined, access to certain, specified facilities may be granted on a negotiated basis. The facilities concerned are: storage facilities, linepack, and ancillary services, as well as upstream pipelines.

4.32 **(a) Gas storage facilities and linepack:** The regime applicable for the access to storage facilities and linepack has been reinforced by the Third Energy Package.[65] To analyse this regime and reinforcement, we will: (i) first recall the scope of storage facilities and linepack (paras 4.33 ff); then (ii) examine the designation, unbundling and tasks of storage system operators (paras 4.38 ff); before finally (iii) reviewing the possible access regimes (paras 4.40 ff).

[62] Art 37(j) of the Third Electricity IEM Directive and Art 41(j) of the Third Gas IEM Directive.

[63] Art 37(k) of the Third Electricity IEM Directive and Art 41(k) of the Third Gas IEM Directive.

[64] Art 37(p) of the Third Electricity IEM Directive and Art 41(q) of the Third Gas IEM Directive.

[65] Such reinforcements were highlighted by Recital 24 of the Third Gas IEM Directive, according to which: '[i]t is necessary to ensure the independence of storage system operators in order to improve third-party access to storage facilities that are technically and/or economically necessary for providing efficient access to the system for the supply of customers. It is therefore appropriate that storage facilities are operated through legally separate entities that have effective decision-making rights with respect to assets necessary to maintain, operate and develop storage facilities. It is also necessary to increase transparency in respect of the storage capacity that is offered to third parties, by obliging Member States to define and publish a non-discriminatory, clear framework that determines the appropriate regulatory regime applicable to storage facilities. That obligation should not require a new decision on access regimes but should improve the transparency regarding the access regime to storage. Confidentiality requirements for commercially sensitive information are particularly important where data of strategic nature are concerned or where there is only a single user of a storage facility'.

4.33 *(i) Scope of the regime applicable to gas storage facilities and linepack:* A storage facility is defined by Article 2(9) of the Third Gas IEM Directive as 'a facility used for the stocking of natural gas and owned and/or operated by a natural gas undertaking, including the part of LNG facilities used for storage but excluding the portion used for production operations, and excluding facilities reserved exclusively for transmission system operators in carrying out their functions'.

4.34 It follows from this definition that the portions of storage used for production operations are excluded. Such exclusion is justified by the need to allow producers exclusive use of some of the storage portions to smooth any production irregularities.[66]

4.35 Storage for the use of TSOs is also excluded from the definition of 'storage facilities'. Unlike the exception for production purposes, it follows from the word 'exclusively' in the definition of storage facilities of Article 2(9) of the Third Gas IEM Directive that part of a storage facility may not be reserved by TSOs.[67]

4.36 The inclusion of LNG facilities in the definition of 'storage facilities' is clarified by Article 33(2) of the Third Gas IEM Directive. This Article states that the third party access regime applicable to storage facilities 'shall not apply to . . . temporary storage that are related to LNG facilities and are necessary for the re-gasification process and subsequent delivery to the transmission system'.

4.37 As to linepack, this is defined by Article 2(15) of the Third Gas IEM Directive as 'the storage of gas by compression in gas transmission and distribution systems, but not including facilities reserved for transmission system operators carrying out their functions'.

4.38 *(ii) Designation, unbundling, and tasks of storage system operators:* In the application of Article 12 of the Third Gas IEM Directive, Member States have to designate storage system operators.[68] Such operators are bound by the rule of legal and functional unbundling. Where an independent system operator is appointed or a storage system operator is part of a vertically integrated undertaking, the transmission system owner has to be independent—at least in terms of its legal form,

[66] Commission Staff Working Paper, Interpretative Note on Directive 2009/73/EC Concerning Common Rules for the Internal Market in Natural Gas: Third-Party Access to Storage Facilities (22 January 2010), 4 (hereafter, 'Interpretive Note: TPA to Storage Facilities'): '[i]n light of the EU's general policy goal of stimulating domestic production, such exclusive use of storage for production operations is therefore justified if it enables or improves the production process. It is the responsibility of the Member State in which the production is located to ensure that the use of storage for production operations is not abused by producers, through the creation of de facto priority access to storages'.

[67] Interpretive Note: TPA to Storage Facilities, 4.

[68] Art 12 of the Third Gas IEM Directive: 'Member States shall designate, or shall require natural gas undertakings which own storage facilities to designate, for a period of time to be determined by Member states, having regard to considerations or efficiency and economic balance, one or more storage . . . system operators'.

organization, and decision-making—from other activities not relating to transmission, distribution, and storage. This unbundling obligation only applies 'to storage facilities that are technically and/or economically necessary for providing efficient access to the system for the supply of customers'.[69]

4.39 The tasks of storage system operators are identical to those of transmission system operators. The reader is accordingly referred to the above analysis of the relevant duties and responsibilities of gas TSOs regarding third party access.[70]

4.40 *(iii) Access to storage facilities and linepack:* Access to storage facilities and linepack is organized by Article 33 of the Third Gas IEM Directive. Such access is limited to the cases where it is 'technically and/or economically necessary for providing efficient access to the system for supply of customers'.[71] Several criteria have been provided by the Commission to assess the technical and/or economical necessity of access to storage facilities and linepack:[72]

- according to the type of storage, it should be analysed whether other instruments are 'available for suppliers to obtain the same level of technical and economic flexibility as through a storage facility'. Elements to take into account relate to: the availability and price of transport capacity, the liquidity of hubs and other traded markets, as well as any need for short-term or seasonal storage;
- depending upon the storage facility, it could be considered that access is required for only a part of the storage facilities. Such a consideration should be analysed regularly in the light of any market development that may render a bigger portion of the storage facilities necessary;
- the technical and/or economic necessity of the access to a storage facility or linepack should not be assessed on the basis of the portfolio of customers; and
- equally, the possibility of investing in new storage facilities as well as geological potentials should not be taken into account. The technical and/or economic necessity to provide access to storage facilities and linepack is to be assessed on the basis of existing installations. However, should new facilities be constructed, the applicable regime would need to be reassessed.

4.41 Once the technical and/or economic necessity to grant access to a storage facilities and linepack is recognized, Member States have the choice between negotiated and regulated access.

4.42 In the case of negotiated access, Member States or, if so provided, the national regulatory authorities, have to take necessary measures to allow natural gas undertakings and eligible customers either inside or outside the territory covered by the

[69] Art 15(1) of the Third Gas IEM Directive. The criteria in respect of these unbundling obligations are analysed above in Ch 3.

[70] Art 13(1) of the Third Gas IEM Directive: see paras 4.27 ff.

[71] Art 33(1) of the Third Gas IEM Directive.

[72] Interpretive Note: TPA to Storage Facilities, 10.

interconnected system to negotiate access to storage facilities and linepack. The parties shall be obliged to negotiate access in good faith. The contracts are to be negotiated with either the relevant storage system operator or natural gas undertaking. Storage system operators and natural gas undertakings had to publish the main commercial conditions for the use of storage facilities and linepack by 1 January 2005[73] and must continue to do so on an annual basis every year thereafter. System users shall be consulted in the frame of the development of the main commercial conditions.[74]

4.43 Regarding regulated access to storage facilities and linepack, this is to be based on published tariffs and/or other terms and obligations for use of those storage facilities and linepack. When developing such tariffs (or the methodologies for their calculation), Member States or, if so provided, the regulatory authorities, shall consult system users. This access may also cover supply contracts with competing natural gas undertakings other than the owner and/or operator of the system or a related undertaking.[75]

4.44 Several guidelines for Member States were provided by the Commission, to assist in making the choice between negotiated and regulated access to storage facilities and linepack. The following indicative principles may be taken into account:

- the existence of a flexibility market: it should be questioned whether there is effective competition between facilities or between facilities and other flexibility services in the market. It should also be questioned whether there is competitive pressure between storage facilities or between facilities and other flexibility services, which will allow the market mechanism to ensure efficient tariffs, products, product variety, and access to the services offered;
- effective access to storage: it should be determined whether a high proportion of the storage capacity has already been booked on a long-term basis, leaving only a small proportion of the storage capacity on the market each year; and
- the degree of dispersal of storage clients: it should be assessed whether most of the capacity is booked by one or only a few large undertakings, and the effects of such concentration on the storage pricing and the efficiency of the use of the storage facilities should be examined.[76]

4.45 Whichever access system is chosen (negotiated or regulated), it must be objective, transparent and non-discriminatory. 'Objective' implies that the access system has to correspond to the factual characteristics of the storage facilities and linepack. 'Transparent' means that, as for regulated access to transmission and distribution

[73] This date corresponds to the six months following the entry into force of the Second Gas Directive, in accordance with the regime previously provided by Art 19(3) of this Directive.
[74] Art 33(3) of the Third Gas IEM Directive.
[75] Art 33(4) of the Third Gas IEM Directive.
[76] Interpretive Note: TPA to Storage Facilities, 12.

services as well as LNG facilities, all criteria have to be published prior to the entry into force. They have to be easily understandable for any third party and must be technically justified. Finally, 'non-discriminatory' access means that system users must be treated according to the same objectives and according to equal terms regarding, in particular, pricing and other access conditions.

Finally, it should be highlighted that the provisions of Regulation 715/2009/EC apply to both negotiated and regulated access.[77] **4.46**

(b) Ancillary services: Ancillary services are defined by Article 2(14) of the Third Gas IEM Directive as 'all services necessary for access to and the operation of transmission networks, distribution networks, LNG facilities, and/or storage facilities, including load balancing, blending and injection of inert gases, but not including facilities reserved exclusively for transmission system operators carrying out their functions'. **4.47**

Access to ancillary services on the natural gas market, except for those related LNG facilities and necessary for the re-gasification process and subsequent delivery to the transmission system,[78] is organized according to the same rules as for the access to storage facilities and linepack, examined above, with two exceptions. **4.48**

The first exception is that access to ancillary services is not bound by the need to demonstrate a technical and/or economic necessity to provide efficient access to the system for the supply of customers.[79] The second exception is that no criteria have to be defined and published to determine which regime (negotiated or regulated) is applicable to ancillary services.[80] **4.49**

(c) Upstream gas pipelines: An upstream pipeline network is defined by Article 2(2) of the Third Gas IEM Directive as 'any pipeline or network of pipelines operated and/or constructed as part of an oil or gas production project, or used to convey natural gas from one or more such projects to a processing plant or terminal or final coastal landing terminal'. **4.50**

Access to such networks is governed by Article 34 of the Third Gas IEM Directive. According to this provision, Member States must 'take the necessary measures to ensure that natural gas undertakings and eligible customers, wherever they are located, are able to obtain access to upstream pipeline networks, including facilities supplying technical services incidental to such access . . . except for the parts for such networks and facilities which are used for local production operations at the site of a field where the gas is produced'.[81] **4.51**

[77] Art 1(4), of Regulation 715/2009/EC: 'This regulation, with the exception of Article 19(4), shall apply only to storage facilities falling under Article 33(3) or (4) of Directive 2009/73/EC.'
[78] Art 33(2) of the Third Gas IEM Directive.
[79] Art 33(1) of the Third Gas IEM Directive.
[80] Art 33(1) of the Third Gas IEM Directive.
[81] Art 34(1) of the Third Gas IEM Directive.

4.52 Measures adopted by Member States for the access to upstream pipeline network have to be notified to the Commission.[82]

4.53 The modalities of the access to upstream pipeline networks are left to subsidiarity and thus are for Member States to decide. Such modalities should, however, be in accordance with the relevant legal instruments. The objectives of 'fair and open access, achieving a competitive market in natural gas and avoiding any abuse of a dominant position, taking into account security and regularity of supplies, capacity which is or can reasonably be made available, and environmental protection' should be applied.[83]

4.54 Some guidelines are given in the Third Gas IEM Directive regarding various matters which could be taken into account by Member States when adopting upstream access regimes:

(a) the need to refuse access where there is a incompatibility of technical specifications which cannot reasonably be overcome;
(b) the need to avoid difficulties which cannot reasonably be overcome and could prejudice the efficient, current and planned future production of hydrocarbons, including that from fields of marginal economic viability;
(c) the need to respect the duly substantiated reasonable needs of the owner or operator of the upstream pipeline network for the transport and processing of gas and the interests of all other users of the upstream pipeline network or relevant processing or handling facilities who may be affected; and
(d) the need to apply their laws and administrative procedures, in conformity with [EU] law, for the grant of authorization for production or upstream development.[84]

4.55 Settlement arrangements have to be set up to address disputes relating to access to upstream pipeline networks. The authorities which have competence to deal with such disputes have to be independent of the parties, and must be given access to all relevant information. Disputes have to be settled expeditiously and the relevant settlement authority is required take into account the above-mentioned criteria as well as the number of parties which may be involved in negotiating access to the relevant upstream gas pipeline.[85] Cross-border disputes shall be settled by the dispute settlement arrangement of the Member State having jurisdiction over the upstream pipeline network which refuses access. Should more than one Member State cover the network concerned, both Member States shall consult each other to ensure a consistent application of the access regime to upstream pipeline networks provided by Article 34 of the Third Gas IEM Directive.[86]

[82] Art 34(1) of the Third Gas IEM Directive.
[83] Art 34(2) of the Third Gas IEM Directive.
[84] Art 34(2)(a)–(d) of the Third Gas IEM Directive.
[85] Art 34(3) of the Third Gas IEM Directive.
[86] Art 34(4) of the Third Gas IEM Directive.

C. Derogations and Specific Cases

4.56 There are several grounds on the basis of which third party access may be either refused or adjusted. The following derogations and specific cases may be highlighted: lack of capacity (paras 4.57 ff); small isolated systems and markets (paras 4.65 ff); emergent markets and regimes (paras 4.71 ff); gas take-or-pay contracts (paras 4.82 ff); new interconnectors/infrastructures and significant increases of existing interconnectors/infrastructures (paras 4.98 ff); direct lines (paras 4.113 ff); public service obligations (paras 4.121 ff); closed distribution systems (paras 4.125 ff); and long-term contracts concluded prior to the liberalization of the energy markets (paras 4.136 ff).

(1) Lack of capacity

4.57 According to Article 32(2) of the Third Electricity IEM Directive and Article 35(1) of the Third Gas IEM Directive, access to the system may be refused where there is a lack of capacity.

4.58 Duly substantiated reasons have to be provided for such refusals. In the final report of its Energy Sector Inquiry, the Commission underlined the insufficiency of the data relating to network availability:[87]

> [n]etwork users require more transparency going beyond the current minimum requirements set by EU legislation. Of particular importance is data relating to network availability, especially for electricity interconnections and gas transit pipelines. Data on the operation of generation capacity and gas storage also needs to be more widely available. For electricity, in particular, it was noted that rules on proper market conduct and supervision differ significantly between Member States, as there is little harmonization at EU level of the transparency requirements.

4.59 Paragraph 26 of its Final Report thus recommended that:[88]

> [t]o ensure a level playing field, all market participants require information to be made available on an equal footing and in a timely manner. At present there is an information asymmetry between the vertically integrated incumbents and their competitors. Improved transparency would minimise risks for new market players and so reduce entry barriers and improve trust in the wholesale markets and confidence in price signals. Obviously it needs to be ensured that no collusion takes place on the basis of the published information and, although commercial confidentiality is important, this should not be allowed to undermine effective transparency by being given too wide an interpretation.

[87] Communication from the Commission, Inquiry pursuant to Art 17 of Regulation (EC) No 1/2003 into the European Gas and Electricity Sectors (final report), COM(2006) 851 final (10 January 2007), 7, para 25 (hereafter, 'Energy Sector Inquiry: Final Report').
[88] Energy Sector Inquiry: Final Report, 7, para 26.

4.60 Beyond the general obligation of TSOs and DSOs to provide system users with the information they need for efficient access to the system,[89] several provisions aiming at the transparency of network availability were reinforced or added by the Third Energy Package.

4.61 For the electricity market, Article 15(2) of the Third Electricity IEM Directive provides that 'the dispatching of generating installations and the use of interconnectors shall be determined on the basis of criteria which shall be approved by national regulatory authorities where competent and which must be objective, published and applied in a non-discriminatory manner, ensuring the proper functioning of the internal market in electricity'.[90] The level of information to be provided by TSOs was reinforced by Regulation 714/2009:

- TSOs have to publish an 'estimate of available transfer capacity for each day, indicating any available transfer capacity already reserved'. Such publications have to cover at least week ahead and month ahead estimates. Quantitative indications of the expected reliability of the available capacity must also be provided;[91]
- TSOs must also publish 'relevant data on aggregated forecast and actual demand, on availability and actual use of generation and load assets, on availability and use of the networks and interconnections, and on balancing power and reserve capacity';[92] and
- the guidelines on the management and allocation of available transfer capacity of interconnections between national systems annexed to Regulation 714/2009 was completed by a point entitled 'Transparency', which specifies the duties of TSOs regarding the publication of 'all relevant data related to network availability, network access and network use, including a report on where and why congestion exists, the methods applied for managing the congestion and the plans for its future management'.[93]

4.62 Regarding the gas market, the transparency requirements were reinforced by Regulation 715/2009. TSOs, LNG and storage system operators have to publish information on the technical contracted and available capacities on a numerical, regular, and rolling basis, as well as in a user-friendly, standardized manner.[94] For the capacity on the transmission system, information has to be provided for all relevant points including entry and exit points. Beside this obligation, TSOs have

[89] Arts 12(g) and 25(3) of the Third Electricity IEM Directive and Arts 13(1)(d) and 25(4) of the Third Gas IEM Directive.
[90] Art 15(2) of the Third Electricity IEM Directive.
[91] Art 15(3) of Regulation 714/2009/EC.
[92] Art 15(4) of Regulation 714/2009/EC.
[93] Annex 1 of Regulation 714/2009, Guidelines on the management and allocations of available transfer capacity of interconnections between national systems, para 5, 'Transparency'.
[94] Arts 18(3) and 19(2) of Regulation 715/2009/EC.

to publish *ex ante* and *ex post* 'supply and demand information, based on nominations, forecasts and realised flow in and out of the system'.[95] As to LNG and storage system operators, they have to publish 'the amount of gas in each storage or LNG facility, or group of storage facilities if that corresponds to the way in which the access is offered to system users, inflows and outflows, and the available storage and LNG facility capacities, including those facilities exempted from third-party access'.[96] Such information must also be communicated to the TSOs for publication on an aggregated level per system or subsystem defined by the relevant points. This type of information is to be updated at least on a daily basis.[97]

4.63 The incidence of an access refusal on the basis of a lack of capacity is handled differently in the Third Electricity IEM Directive and in the Third Gas IEM Directive. On the electricity market, the Member State or their NRA (if so provided by the national implementing rules) must ensure that the system user who has been refused access can bring his claim to a dispute settlement procedure. The NRA shall also ensure that relevant information on the measures that would be necessary to reinforce the network is provided by the TSO or DSO concerned.[98]

4.64 For the gas market, Member States are empowered by the Third Gas IEM Directive to take the necessary measures to ensure that a natural gas undertaking which refuses access because of a lack of capacity must make the necessary enhancements, as long as it is economic to make them or a potential customer is willing to pay for them. In this case, a natural gas undertaking could not refuse access on the ground of lack of capacity.[99]

(2) Small isolated systems/markets

4.65 Member States may apply for derogation to third party access on the electricity market in case of substantial problems for the operation of the small or micro-isolated systems.[100]

4.66 Small isolated systems are defined by the Third Electricity IEM Directive as 'any system with consumption of less than 3,000 GWh in the year 1996, where less

[95] Art 18(6) of Regulation 715/2009/EC.
[96] Art 19(4) of Regulation 715/2009/EC.
[97] Art 19(4) of Regulation 715/2009/EC.
[98] Art 32(2) of the Third Electricity IEM Directive.
[99] Art 35(2) of the Third Gas IEM Directive. See also Commission Staff Working Paper, Interpretative Note on Directive 2009/33/EC Concerning Common Rules for the Internal Market in Natural Gas: Third-Party Access to Storage Facilities (22 January 2010), 15.
[100] Art 44(1) of the Third Electricity IEM Directive. Small isolated systems and micro-isolated systems may also apply for derogations to the relevant provisions related to transmission system operation (Ch IV), to distribution system operation (Ch VI), and to unbundling and transparency of accounts (Ch VII). Micro-isolated systems may also seek to derogate from the relevant provisions related to generation (Ch III) 'as far as refurbishing, upgrading and expanding existing capacity are concerned'.

than 5 per cent of annual consumption is obtained through interconnection with other systems'.[101]

4.67 A micro-isolated system is defined as 'any system with consumption less than 500 GWh in the year 1996, where there is no connection with other systems'.[102]

4.68 The reference to 1996 in the eligibility threshold is justified by the fact that the derogation for small isolated systems was already granted by the First Electricity IEM Directive.[103] The derogation for micro-isolated systems was introduced by the Second Electricity Directive and it logically also adopted 1996 as the reference year for eligibility.[104]

4.69 Any small and micro-isolated system derogations are subject to a decision from the Commission. Member States have to apply to the Commission for a derogation, demonstrating that, after the Third Electricity IEM Directive has been brought into force, there would be substantial problems for the operation of their small/micro-isolated systems. Before taking its decision, the Commission has to inform every Member State so as to allow all of them to submit any remarks that they may have. Once the decision is taken it is published in the Official Journal of the European Union.[105] An automatic derogation from third party access has, however, been granted to Malta.[106]

4.70 No similar derogation from third party access is provided on the gas market. Where an isolated gas market is permitted to derogate from certain provisions of the Third Gas IEM Directive, the provisions related to third party access are not involved.[107]

(3) Emergent markets/regions

4.71 On the gas market, Member States may derogate from third party access in case of emergent markets. According to Article 49(2) of the Third Gas IEM Directive,[108]

[101] Art 2(26) of the Third Electricity IEM Directive.
[102] Art 2(27) of the Third Electricity IEM Directive.
[103] Art 24(3) of the First Electricity Directive and Art 2(23) of this Directive for the definition of 'small isolated system'.
[104] Art 26(1) of the Second Electricity IEM Directive for the derogation regime and Art 2(27) of this Directive for the definition of micro-isolated systems.
[105] Art 44(1) of the Third Electricity IEM Directive.
[106] Art 44(2) of the Third Electricity IEM Directive.
[107] Art 49(1) of the Third Gas IEM Directive: 'Member States not directly connected to the interconnected system of any other Member State and having only one main external supplier may derogate from Articles 4 [authorization procedure], 9 [unbundling of transmission systems and transmission system operators], 37 [market opening and reciprocity] and/or 38 [direct lines]. A supply undertaking having a market share of more than 75 per cent shall be considered to be a main supplier. Any such derogation shall automatically expire where at least one of the conditions referred to in this paragraph no longer applies. Any such derogation shall be notified to the Commission.'
[108] This Article reiterates without modifications the derogation already provided in Art 28(2) of the Second Gas Directive.

'a Member State, qualifying as an emergent market, which, because of the implementation of this Directive, would experience substantial problems may derogate from [Article] . . . 32 . . . Such derogation shall automatically expire from the moment when the Member State no longer qualifies as an emergent market'.[109]

4.72 An emergent market is understood as 'a Member State in which the first commercial supply of its first long-term natural gas supply contract was made not more than 10 years earlier'.[110]

4.73 The purpose of the derogation for emergent markets is to support the transition from emergent market to a normal market in which competition will function. Such derogation is to expire as soon as a Member State no longer qualifies as an emergent market in the light of the definition of 'emergent market', which leaves Member States with a maximum of a ten-year derogation period. Ten years after the 'first commercial supply of the first long-term natural gas supply contract',[111] the market of the Member State concerned shall be opened to competition. A gradual market opening is provided by Article 49(3) of the Third Gas IEM Directive. After the expiry of the ten-year delay, the market has to be opened to eligible customers corresponding to at least 33 per cent of the total annual gas consumption of the national gas market. During this time, the Member State may decide not to apply third party access to: ancillary services; and temporary storage for the degasification process, and its subsequent delivery to the transmission system.

4.74 Two years after the expiry of the ten-year delay, all non-household customers have to be eligible and third party access must be extended to both ancillary services and temporary storage for the degasification process and its subsequent delivery to the transmission system. Three years thereafter, all customers have to be eligible.

4.75 The application of this derogation is not subject to any decision of the Commission: this derogation merely has to be notified. The possibility for Cyprus to apply this derogation from third party access to its market was expressly provided in the Third Gas IEM Directive.[112] Any derogation for an emergent market has to be published in the Official Journal of the European Union.[113]

[109] Member States qualifying as emergent markets may also derogate from the requirements of the Third Gas IEM Directive regarding: the authorization procedure (Art 4), the unbundling of transmission systems and TSO (Art 9), some of the tasks of transmission, storage, and/or LNG system operators (Art 13(1) and (3)), from independent system operators (Art 14), from the designation of DSOs (Art 24), from some of the tasks of DSOs (Art 25(1)), from the unbundling of DSOs (Art 26), from the unbundling of accounts (Art 31), from market opening and reciprocity (Art 37(1)), and/or from direct lines (Art 38).
[110] Art 2(31) of the Third Gas IEM Directive.
[111] Art 2(31) of the Third Gas IEM Directive.
[112] Art 49(2), para 2 of the Third Gas IEM Directive.
[113] Art 49(7) of the Third Gas IEM Directive.

4.76 Besides emergent markets, a possibility to derogate from third party access is also provided for emergent regions. Such a derogation is governed by Article 49(4) and (5) of the Third Gas IEM Directive, which are unchanged from the previous regime of Article 28(4) and (5) of the Second Gas IEM Directive.

4.77 The derogation for emergent regions is temporary and may be granted where the implementation of the Third Gas IEM Directive would cause 'substantial problems in geographically limited area of a Member State, in particular concerning the development of the transmission and major distribution infrastructure, and with a view to encouraging investment'.[114] The scope of the derogations that may be granted is similar to that available for an emergent market, as examined above. However, in this case, contrary to emergent markets, Member States have to apply to the Commission.

4.78 In its assessment of the application, the Commission has to take into account the following criteria:

- the need for infrastructure investments, which would not be economic to operate in a competitive market environment;
- the level and payback prospects of investment required;
- the size and maturity of the gas system in the area concerned;
- the prospects for the gas market concerned; and
- the geographical size and characteristics of the area or region concerned, and socio-economic and demographic factors.[115]

4.79 The scope of any derogation for gas infrastructure other than distribution infrastructures is limited. A derogation may only be granted where no other gas infrastructure has been established in the area or has been established for less than a ten-year period. The derogation cannot exceed ten years from the first supply of gas in the area.[116]

4.80 Derogations for distribution infrastructure are limited only in their possible duration. They cannot be granted for a period longer than 20 years from the first supply of gas via the relevant infrastructure in the area.[117]

4.81 Before taking any decision on the application for derogation, the Commission must inform all Member States so as to allow them to submit their remarks and comments. Once the decision is taken, it has to be published in the Official Journal of the European Union. Greece has an express derogation for its existing distribution

[114] Art 49(4) of the Third Gas IEM Directive.
[115] Art 49(5), para 1 of the Third Gas IEM Directive.
[116] Art 49(5), para 2 of the Third Gas IEM Directive.
[117] Art 49(5), para 3 of the Third Gas IEM Directive.

concessions in the Third Gas IEM Directive. This derogation was also already granted by the Second Gas IEM Directive.[118]

(4) Gas take-or-pay contracts

4.82 Prior to the liberalization of the gas market, most of the EU's gas supply was contracted under long-term take-or-pay (TOP) contracts,[119] aimed at sharing the price and volume risks between producers and buyers, given the long lead times in investment planning and capital intensive operations.[120] At the time of the adoption of the First Gas IEM Directive, it was considered that incumbent operators bound by TOP contracts might have an excess of gas following loss of market share and no acquisition of new clients.[121] The opportunity to derogate from third party access in case of TOP clauses was accordingly provided in Article 25 of Directive 98/30/EC.

4.83 This possibility was retained in the Second[122] and Third[123] Gas IEM Directives, TOP clauses being recognized as 'funding instruments for exploiting gas fields and constructing pipelines'.[124] No similar possibility is provided for the electricity sector.

4.84 The possibility to derogate from third party access in case of TOP clauses in the internal market for natural gas is to remain the exception, rather than the rule. It may apply where a natural gas undertaking 'encounters, or considers it would encounter serious economic and financial difficulties because of its take-or-pay commitments accepted in one or more gas-purchase contracts'.[125]

4.85 To benefit from a temporary derogation, a natural gas undertaking has to apply to the Member State concerned or the designated regulatory authority. Depending upon the option chosen by the Member State, the application may be presented

[118] Art 49(8) of the Third Gas IEM Directive (which is unchanged from Art 28(8) of the Second Gas Directive) states that: 'Greece may derogate from Art 4 [authorization procedure], 24 [designation of distribution system operators], 25 [tasks of distribution system operator], 26 [unbundling of distribution system operators], 32 [third party access], 37 [market opening and reciprocity] and/or 38 [direct lines] of this Directive for the geographical areas and time periods specified in the licences issued by it, prior to 15 March 2002 and in accordance with Directive 98/30/EC, for the development and exclusive exploitation of distribution networks in certain geographical areas.'
[119] The characteristics of such TOP contracts are examined at paras 8.159 ff.
[120] DGXVII/A3/B3, Directive 98/30/EC, 'Meeting of Follow-up Group, Take-or-Pay Contracts' (22 October 1998), 3.
[121] C Jones (gen ed), *EU Energy Law—Volume I: The Internal Energy Market—The Third Liberalisation Package* (3rd edn, Leuven: Claeys & Casteels, 2010), 459.
[122] Arts 21(1) and 27 of Directive 2003/55/EC.
[123] Arts 32(1) and 48 of Directive 2009/73/EC.
[124] Report of the European Parliament of 1 March 2002 on the Proposal for a Directive of the European Parliament and of the Council amending Directives 96/92/EC and 98/30/EC concerning common rules for the internal market in electricity and natural gas—Committee on Industry, External Trade, Research and Energy (2001/0077/(COD)), 78.
[125] Art 48(1) of Directive 2009/73/EC.

before or after the refusal of access. In the latter case, the application is to be presented without delay. Duly substantiated reasons regarding the nature and extent of the difficulties, as well as efforts undertaken to solve them, have to be provided.

4.86 In the absence of reasonable alternative solutions, the Member State concerned or the designated regulatory authority may grant a derogation from third party access. Such a decision must be notified without delay to the Commission, which decides in the last resort whether to approve, amend or withdraw the derogation.

4.87 Several criteria have to be taken into account by the relevant Member State or its designated regulatory authority and the Commission when deciding whether to grant a derogation from third party access in the case of TOP clauses. The scope of those criteria was outlined by the Follow-up Group devoted to TOP contracts which met on 22 October 1998, pursuant to the adoption of Directive 98/30/EC.[126]

4.88 **(a) The objective of the Directive:** Clearly, the goal is to achieve a competitive gas market. From the Follow-up Group's work, it is clear that this criterion should be considered as having primacy. It highlighted that 'any decision on refusing access should . . . be balanced and justified against the main objective of the directive which is the opposite, namely providing access to the system'.

4.89 **(b) The constraints over public service obligations (PSOs) and security of supply:** As highlighted by the Follow-up Group, PSOs—including those related to security of supply—are to be respected where a derogation is to be granted.

4.90 **(c) The position of the natural gas undertaking on the gas market and the level of competition on that market:** The notion of 'position of the natural gas undertaking on the gas market' was clarified by the Follow-up Group as follows:

> [t]he position of the gas company would include aspects such as size of the company (area of operation; balance sheet; assets; market share; turnover; etc); the role of the company in international gas trade; the supply and sales portfolio of the company; the extent of the gas infrastructure owned by the company including storage; ownership in other gas/energy companies (up-stream and down-stream); rights and obligations of the company (including public service obligations, if any), etc.
>
> As to the level of competition on the gas market, reference was made to 'the market in which the company operates, which could be regional, national or wider'. It was also highlighted that the competitive analyses should not be limited to the natural gas market but could 'also assess the general level of competition in the market'.

4.91 **(d) The seriousness of the difficulties encountered:** The Follow-up Group also insisted on the need to consider the financial and economical implications for customers whose access may be denied if the derogation were granted. It also

[126] DGXVII/A3/B3, 'Directive 98/30/EC, Meeting of Follow-up Group, Take-or-Pay Contracts', 22 October 1998, 6–8.

outlined the fact that the derogation should be proportionate to the difficulties encountered: 'depending on the seriousness of the problem, the duration and scope of the derogation and access refusal (0–100 per cent of the requested TPA volumes) should be tailored'. The Follow-up Group did not specify any threshold for the grant of a derogation, considering that it was not precisely quantified and a case-by-case analysis was necessary. The triggering threshold should be one that 'renders a derogation indispensable for the continued activity of a given gas company'.

4.92 **(e) The date of signature and the terms of the concerned contracts:** This criterion allows a distinction to be drawn between existing and future contracts. As highlighted by the Follow-up Group, this criterion requires that market operators should 'take account of the changing market circumstances and ensure that future contractual terms would better allow for changes resulting from a more competitive gas market'. In the application of this criterion, derogations for TOP contracts concluded after the entry into force of Directive 2009/73/EC are less likely to be accepted. This was already highlighted at the time of Directive 98/30/EC by the Follow-up Group:

> in any case, for contracts entered into after the entry into force of the gas directive (ie 10 August 1998), the Commission will scrutinise with particular thoroughness the impact on competition and market developments of a take-or-pay contracts in difficulties including possible alternative contractual options available at the time of signature of the contract and the reasonableness and necessity of a derogation.

4.93 **(f) The efforts undertaken to address the difficulties:** As highlighted by the Follow-up Group, the grant of a derogation from TPA in the case of a TOP clause should be the last available solution after the exhaustion and failure of all alternative solutions. Accordingly, efforts to find alternative solutions must be assessed. Such efforts, as highlighted by the Follow-up Group, may include 'attempts to sell the gas elsewhere; attempts to renegotiate the contract; efforts to increase company efficiency, etc'.

4.94 **(g) The extent to which difficulties were foreseeable at the time of signing the TOP clause:** This criterion reiterates the prudence necessary in the conclusion of TOP contracts after the entry into force of Directive 2009/73/EC.

4.95 **(h) The level of connection of the system with other systems and their degree of interoperability:** The scope of this criterion was clarified by the Follow-up Group as follows:

> not all regional and national gas networks are equally well integrated into the European gas grid. There may also be technical aspects which hamper interoperability with other systems . . . These issues may hamper the possibilities of gas companies in such areas to sell gas outside their traditional supply area in case of serious take-or-pay problems.

4.96 The last criterion covers the effects of the possible derogation upon the correct application of Directive 2009/73/EC regarding the smooth functioning of the internal market in natural gas. As highlighted by the Follow-up Group, this criterion recalls that the derogation should be applied in a restrictive manner considering its negative effect on the smooth functioning of the internal market in natural gas.

4.97 The derogation regime is less strict for contracts concluded before the entry into force of the Second Gas IEM Directive, ie before 4 August 2003. For such contracts, the decision on an application for derogation should ensure economically viable outlets.

(5) New interconnectors/infrastructure and significant increases of capacities of existing interconnectors/infrastructures

4.98 Third party access may be waived in favour of major new interconnectors/infrastructures or significant increases in the capacity of the existing interconnectors/infrastructures. Such derogation is provided for the electricity market by Article 17 of Regulation 714/2009 and for the gas market by Article 48 of the Third Gas IEM Directive. Those Articles reiterate (with only minor modifications) the regime already provided respectively by Article 7 of Regulation 1228/2003 and Article 22 of the Second Gas IEM Directive, a regime which had been clarified by the Commission in a couple of interpretative notes.[127]

4.99 The rationale behind the third party access derogation in cases of new interconnectors/infrastructure or significant increases in the capacity of existing interconnectors/infrastructures is the need to ensure the realization of such investments. Those investments are, by their nature, highly expensive and risky. The reconciliation of such costs and risks in regulated tariff may be difficult; while operators would require a guarantee regarding the return on their investments, NRAs may be reluctant to include highly expensive and risky projects in the general regulated tariffs.[128] In the absence of the socialization of the costs of new major interconnectors/infrastructure or the significant increases of capacities of existing interconnectors/infrastructures, it appears justified, in respect of several of the conditions examined hereafter, to derogate from third party access.

[127] Namely: the Note of DG TREN on Directive 2003/55/EC and Regulation 1228/2003 in the Electricity and Gas Internal Market Concerning Exemptions from Certain Provisions of the Third Party Access Regime (30 January 2004); and Commission Staff Working Document on Article 22 of Directive 2003/55/EC Concerning Common Rules for the Internal Market in Natural Gas and Article 7 of Regulation (EC) No 1223/2003 on Conditions for Access to the Network for Cross-border Exchanges in Electricity, New Infrastructure Exemptions, SEC(2009) 642 (6 May 2009) (hereafter, 'Working Document: New Infrastructure Exemptions').

[128] C Jones (gen ed), *EU Energy Law—Volume I: The Internal Energy Market—The Third Liberalisation Package* (3rd edn, Leuven: Claeys & Casteels, 2010), 466, paras 11.70–11.72.

4.100 For the electricity market, the new infrastructures potentially covered by the derogation are 'new direct current interconnectors'. Alternating current interconnectors may also be granted a derogation in exceptional cases, provided 'that the costs and risks of the investments in question are particularly high when compared with the costs and risks normally incurred when connecting two neighbouring national transmission systems by an alternating current interconnector'.[129] Significant increases of capacity in existing interconnectors may also be granted a derogation.[130]

4.101 For the gas market, the derogation is limited to 'major new gas infrastructure, ie interconnectors, LNG and storage facilities'. Projects employing significant increases of capacity in existing infrastructures, and modifications of such infrastructures enabling the development of new sources of gas supply, may also be eligible for a third party access derogation.[131]

4.102 Several conditions have to be met for the grant of the derogation.[132] A first condition relates to the enhancement of competition. The investment must enhance competition in electricity/gas supply[133] and, should a derogation be granted, this should not be detrimental to competition.[134] These two requirements 'imply that the project must be pro-competitive and thus create benefits for consumers'.[135] In assessing this condition, the Commission is particularly attentive to the market power of the operators applying for the derogation.[136] Where a dominant undertaking would be a direct or indirect beneficiary of a derogation, conditions would have to be attached to the derogation to address competition concerns. The investment has to increase the opportunities for non-dominant competitors to enter the concerned market or to expand their market position. Capacity caps[137] may accordingly be imposed upon the beneficiary of the derogation in the allocation of its new infrastructures capacity.

[129] Art 17(1) and (2) of Regulation 714/2009/EC.

[130] Art 17(3) of Regulation 714/2009/EC.

[131] Art 36(1) and (2) of the Third Gas IEM Directive.

[132] Those conditions are identical for the electricity and gas sectors, except for two conditions.

[133] Art 17(1)(a) of Regulation 714/2009/EC and Art 36(1)(a) of the Third Gas IEM Directive.

[134] Art 17(1)(f) of Regulation 714/2009/EC and Art 36(1)(e) of the Third Gas IEM Directive.

[135] Working Document: New Infrastructure Exemptions (n 127), para 30.

[136] Working Document: New Infrastructure Exemptions (n 127), para 33: 'Exemption requests by dominant undertakings in markets served by the new infrastructure are likely to have the greatest potential for harming competition and therefore require particularly careful scrutiny. However, exemption requests introduced by non-dominant undertakings may also in certain circumstances have a negative effect on competition. This may be the case, in particular, where the undertakings requesting the exemption—individually or collectively—have a significant degree of market power or where the exemption might favour the market position of third parties that are either dominant or have a significant degree of market power. This could be the case, for example, where the exemption is requested by a company that has no supply interests, but capacity in the exempted infrastructure is or could be contracted on a long term basis by dominant suppliers.'

[137] Working Document: New Infrastructure Exemptions (n 127), para 34.

4.103 A second condition to be assessed for the grant of a TPA derogation in such cases is the level of risks: '[is] the level of risks attached to the investments . . . such that the investment would not take place unless an exemption is granted[?]'.[138] Two risks may be taken into account: the first is the risk that the investment is not used. This may be caused by the absence of capacity users for the upstream supply or for the downstream demand. A risk of non-use could also be caused by a change in flows following other changes in the system. A second risk is the risk that costs and/or revenues will change in the future. This may occur following a non-use or a change in the market situation or in contract or access terms and conditions.[139] The conclusion of long-term contracts is often considered to mitigate those risks.[140] Where the investment in the new infrastructure is likely to lead to a monopoly situation, the second type of risk would then be considerably reduced, as well as making it necessary to derogate from third party access (albeit raising questions about whether the first or the fifth conditions, concerning competition, could be met).

4.104 A third condition for third party access derogation in cases of new infrastructure or significant increase of the capacity of an existing infrastructure relates to the ownership structure: 'the interconnector/infrastructure must be owned by a natural or legal person which is separate at least in terms of its legal form from the system operators in whose systems that interconnector/infrastructure would be built'.[141] This condition aims to ensure that the costs of infrastructure falling outside of the scope of regulated tariffs are not underwritten through such tariffs, so as to guarantee the ring-fencing of the non-regulated activities of TSOs.[142]

4.105 A fourth condition relates to the levying of charges: 'charges must be levied on users of that interconnector/infrastructure'.[143] This condition also aims at ring-fencing the non-regulated activities of TSOs.

4.106 A fifth condition is the fact that the exemption should not be detrimental to competition or the effective functioning of the internal market or the efficient functioning of the regulated system to which the infrastructure is connected.[144] Contrary to the condition related to the enhancement of competition, this condition focuses on the possible negative effects of the exemption itself. It implies the assessment of the repercussions of the exemption on other projects.[145]

[138] Art 17(1)(b) of Regulation 714/2009/EC and Art 36(1)(b) of the Third Gas IEM Directive.
[139] Working Document: New Infrastructure Exemptions (n 127), para 41.
[140] Such long-term contracts are examined further, first, at paras 4.136 ff, with attention to those concluded prior to the liberalization of the energy market and then, at paras 8.121–8.171, with regard to the conclusion of new long-term contracts.
[141] Art 17(1)(c) of Regulation 174/2009 and Art 36(1)(c) of the Third Gas IEM Directive.
[142] Working Document: New Infrastructure Exemptions (n 127), paras 53 and 54.
[143] Art 17(1)(d) of Regulation 714/2009/EC and Art 36(d) of the Third Gas IEM Directive.
[144] Art 17(1)(f) of Regulation 714/2009/EC and Art 36(i) of the Third Gas IEM Directive.
[145] Working Document: New Infrastructure Exemptions (n 127), paras 60–63.

4.107 For the electricity sector, an additional condition relates to the absence of coverage of the costs from transmission or distribution charges since the partial opening of the electricity market following the adoption of the First Electricity Directive: no part of the capital or operating cost of the interconnector applying for the derogation must have been 'recovered from any component of charges made for the use of transmission or distribution systems linked by the interconnector'.[146] The effect of this condition is to prevent the granting of any derogation to existing interconnectors.[147]

4.108 Finally, for the gas market only, an additional condition relates to the enhancement of security of supply.[148] Several criteria are considered to assess whether a new infrastructure or an increase of capacity in an existing infrastructure enhances the security of supply:

- the contribution to a diversification of supply to the relevant market through, for instance, new sources of supply or new routes of supply from an existing source of supply;
- the contribution to the achievement of security of supply standards for household customers in the supply markets in accordance with the legislation concerning measures to safeguard security of natural gas supply;[149]
- the flexibility of supply of the infrastructure project;[150] and
- the size of the planned project.[151]

4.109 As to the procedure for the grant of a derogation to third party access to a new infrastructure or to the significant increases of the capacity of an existing infrastructure, it is the following. The exemption is decided in a first stage by the relevant NRA on a case-by-case basis. Such exemption may cover all or part of the capacity of the new interconnector or infrastructure, or of the existing infrastructure or interconnector whose capacity is significantly increased.[152] When deciding to grant an exemption, consideration must be given to the necessity of imposing conditions on the duration of the exemption and the issue of non-discriminatory access to the interconnector/infrastructure. The NRA must also decide upon the rules and mechanisms for management and allocation of capacity of the infrastructure or

[146] Art 17(1)(e) of Regulation 714/2009/EC.
[147] Working Document: New Infrastructure Exemptions (n 127), para 59.
[148] Art 36(1)(a) of the Third Gas IEM Directive.
[149] The most recent instrument is Regulation 994/2010/EU [2010] OJ L295/1: see the discussion in Ch 10 on Security of Supply (paras 10.31 ff).
[150] Working Document: New Infrastructure Exemptions (n 127), para 26. Amongst the elements of flexibility, the contribution to LNG terminals may be favoured compared to contribution in gas pipelines since LNG terminals allow a wider choice of location for the import of gas. Another element of flexibility could be related to the existence of an anti-hoarding mechanism.
[151] Working Document: New Infrastructure Exemptions (n 127), paras 25–27.
[152] Art 17(4) of Regulation 714/2009/EC and Art 36(3) and (6) of the Third Gas IEM Directive.

interconnector in question. Congestion management rules must notably include the obligation to offer unused capacity on the secondary market.[153]

4.110 ACER is competent to provide an advisory opinion prior to the decision of the relevant NRA. This possibility is automatic for new interconnectors or significant increases of the capacity of existing interconnectors on the electricity market. On the gas market, ACER may provide an advisory opinion in cases where the infrastructure in question is located in the territory of more than one Member State. Moreover, on the gas market the Agency can exercise the decision-making task conferred upon the relevant NRAs in cases where the NRA(s) were unable to reach an agreement within a certain period of time or upon a joint request from the NRAs concerned.[154]

4.111 Once a decision has been reached, the NRA(s) must transmit it to the Agency and to the Commission, and the Commission takes the final decision.[155]

4.112 Contrary to the regime previously provided in the Second Gas IEM Directive and in the First Electricity Regulation, under the new regime the decision of the Commission to grant a third party access derogation is limited in time: the Commission's approval shall lose its effect two years after its adoption in the event that the construction of the interconnector/infrastructure has not yet started, and five years from its adoption in the event that the interconnector/infrastructure has not become operational. A time extension may be granted by the Commission where the delay is due to major obstacles beyond the control of the person to whom the exemption has been granted.[156] The Commission is also competent to adopt guidelines for the application of the conditions attached to such derogations.[157]

(6) Direct lines

4.113 A specific case of third party access may occur where there are direct lines. This case is governed by Article 34 of the Third Electricity IEM Directive and Article 38 of the Third Gas IEM Directive. Both Articles are unchanged from the previous Second IEM Directives.[158]

4.114 Direct lines on the electricity market are defined as 'either an electricity line linking an isolated generation site with an isolated customer or an electricity line linking an electricity producer and an electricity supply undertaking to supply directly

[153] Art 17(4) paras 3 and 4 of Regulation 714/2009/EC and Art 36(6) paras 2 and 3 of the Third Gas IEM Directive.
[154] Art 17(4) para 2 of Regulation 714/2009/EC and Art 36(4) of the Third Gas IEM Directive.
[155] Art 17(7) and (8) of Regulation 714/2009/EC and Art 36(8) and (9) of the Third Gas IEM Directive.
[156] Art 17(8) para 5 of Regulation 714/2009/EC and Art 36(9) para 5 of the Third Gas IEM Directive.
[157] Art 17(9) of Regulation 714/2009/EC and Art 36(10) of the Third Gas IEM Directive.
[158] Art 22 of the Second Electricity IEM Directive and Art 24 of the Second Gas Directive.

their own premises, subsidiaries and eligible customers'.[159] For the gas market, direct lines are understood as 'a natural gas pipeline complementary to the interconnected system'.[160]

4.115 While not clear from the definition in the Third Electricity IEM Directive, it appears from the Third Gas IEM Directive that direct lines are part of the distribution or transmission network, depending upon the network to which they are interconnected.

4.116 Member States have to enable the supply of electricity through direct lines. Two cases are targeted for the electricity market: the supply of electricity by electricity producers and electricity supply undertakings established within the territory of the concerned Member State to their own premises, subsidiaries, and eligible customers. The second case is the possibility of all eligible customers within the territory of the concerned Member State to be supplied through a direct line by a producer and supply undertakings. Two cases are also targeted for the gas market. Natural gas undertakings established within the territory of a concerned Member State have to be able to supply the eligible customer through a direct line. Any such eligible customer within the territory of the concerned Member State has to be able to be supplied through a direct line by natural gas undertakings.[161]

4.117 The criteria for granting authorization for the construction of direct lines have to be laid down by the Member States. They should be objective, transparent, and non-discriminatory.[162]

4.118 The impact of such direct lines upon third party access is clarified in the Third Electricity IEM Directive. According to its Article 34(3), 'the possibility of supplying electricity through a direct line . . . shall not affect the possibility of contracting electricity in accordance with Article 32'. It follows from this provision that direct lines must comply with TPA on the basis of regulated and published tariffs. Although no similar provision is provided in the Third Gas IEM Directive, the application of third party access to gas direct lines should, as a matter of consistency and logic, be identical.

4.119 Besides, it should be highlighted that Member States may make any authorization to construct a direct line conditional upon either the refusal of system access on the basis of the aforementioned Article 32 related to third party access or upon the opening of a dispute settlement procedure regarding access to the network.[163]

[159] Art 2(15) of the Third Electricity IEM Directive.
[160] Art 2(18) of the Third Gas IEM Directive.
[161] Art 34(1) of the Third Electricity IEM Directive and Art 38(1) of the Third Gas IEM Directive.
[162] Art 34(2) of the Third Electricity IEM Directive and Art 38(2) of the Third Gas IEM Directive.
[163] Art 34(4) of the Third Electricity IEM Directive and Art 38(3) of the Third Gas IEM Directive.

4.120 Finally, a Member State, at least with regard to the electricity market, could refuse to authorize a direct line if it would obstruct the provisions of the Third Electricity IEM Directive relating to public service obligations.[164]

(7) Public service obligations

4.121 To ensure the reconciliation of market opening and competition with minimum standards to customers, Member States are entitled to impose public service obligations (PSOs) upon electricity and natural gas undertakings.[165]

4.122 Member States may decide in the electricity sector to derogate from third party access 'in so far as [its] application would obstruct the performance, in law or in fact, of the obligations imposed on electricity undertakings in the general economic interest and in so far as the development of trade would not be affected to such an extent as would be contrary to the interest of the [Union]. The interest of the [Union] includes, *inter alia*, competition with regard to eligible customers . . . and Article [106] of the Treaty'.[166]

4.123 A similar possibility of derogation from third party access is provided by the Third Gas IEM Directive but at the option of natural gas undertakings. It follows from Article 35(1) of the Third Gas IEM Directive, related to refusal of access, that 'natural gas undertakings may refuse access to the system where the access to the system would prevent them from carrying out the public service obligations referred to in Article 3(2) which are assigned to them'.

4.124 The possible impact of any PSO-based derogation from third party access should be proportionate. There should be no other alternative for fulfilling those PSOs which is less restrictive to competition and trade.[167]

(8) Closed distribution systems

4.125 The Third Energy Package introduced the concept of 'closed distribution systems'. The introduction of this concept followed the ECJ's *citiworks* judgment.[168] This judgment related to a dispute between a supplier of electricity (citiworks) and the operator of the airport of Leipzig/Halle, also operator of the electricity grid of that airport (Flughafen Leipzig/Halle). That grid had been qualified as a private grid by the German Regulatory Authority, the Bundesnetzagentur. According to the German

[164] Art 34(5) of the Third Electricity IEM Directive.
[165] Art 3(2) of the Third Electricity IEM Directive and Art 3(2) of the Third Gas IEM Directive. Such public service obligations (PSO) are examined in Ch 7.
[166] Art 3(14) of the Third Electricity IEM Directive.
[167] See the *citiworks* case, para 60.
[168] See the *citiworks* case, para 60.

law, the provisions concerning third party access were not applicable to such private grids.[169] The dispute was brought before the national court, which decided to question the ECJ about the compatibility of the German law with the provisions of the Second Electricity IEM Directive related to third party access.[170] The ECJ considered that the exclusion of third party access could not be justified by the fact that the system to which access was sought constituted a private internal system with no effect on competition because of the low consumption of electricity and which was an accessory to the principal activity related to the operation of an airport. The ECJ accordingly decided that 'a provision . . . which exempts certain operators of energy supply systems from the obligation to provide third parties with open access to those systems on the ground that they are located on a geographically connected operation zone and that they predominantly serve to supply the energy needs of the undertaking itself and of connected undertakings' does not respect the principle of third party access and is accordingly incompatible with EU energy law.[171]

4.126 Following this judgment, concern grew that the application of the system operators' obligations to private systems was likely to lead to unnecessary administrative burdens, irreconcilable with such private systems outside the public transmission or distribution grid.[172] The Third Energy Package accordingly introduced the concept of 'closed distribution systems', which could be eligible, on certain conditions, for some exemptions from the distribution system operators' obligations.

4.127 Closed distribution systems are governed by Article 28 of both the Third Electricity IEM Directive and the Third Gas IEM Directive. A closed distribution system is defined as a 'system which distributes [electricity/gas] within a geographically confined industrial, commercial or shared services site and does not . . . supply household customers . . . if:

(a) for specific, technical or safety reasons, the operations or the production process of the users of that system are integrated; or
(b) that system distributes [electricity/gas] primarily to the owner or operator of the system or to their related undertakings'.[173]

[169] Art 110 of the German Law of 7 July 2005 related to the supply in electricity and gas, at the time of the dispute.
[170] See the *citiworks* case, para 22: 'By its question, the national court is asking, in essence, whether Article 20(1) of Directive 2003/54 is to be interpreted as precluding a provision, such as the first point of Paragraph 110(1) of the EnWG, which exempts certain operators of energy supply systems from the obligation to provide third parties with open access to those systems on the ground that they are located on a geographically connected operation zone and predominantly serve to supply the energy needs of the undertaking itself or of connected undertakings, where it is not established that open third-party access to those systems would impose an unreasonable burden.'
[171] See the *citiworks* case, para 65.
[172] Commission Staff Working Paper, Interpretative Note on Directive 2009/72/EC Concerning Common Rules for the Internal Market in Electricity and Directive 2009/73/EC Concerning Common Rules for the Internal Market in Natural Gas: Retail Markets (22 January 2010), 10.
[173] Art 28(1) of both the Third Electricity and Third Gas IEM Directives.

4.128 The scope of this definition of closed distribution systems is clarified by Recital (13) of the Third Electricity IEM Directive and Recital (28) of the Third Gas IEM Directive:

> Industrial, commercial or shared services sites such as train station buildings, airports, hospitals, large camping sites with integrated facilities or chemical industry sites can include closed distribution systems because of the specialized nature of their operations.

4.129 A closed distribution system should not in principle supply household customers, except on an incidental basis.[174]

4.130 Closed distribution systems are distinct from 'public networks'[175] for the supply of electricity and natural gas. They result, most of the time, from historic situations implied by the localization of certain end users, usually industrial, from the public system. In certain cases, an end user is downstream from another end user. In order to provide access for the downstream end user to the public electricity or natural gas system, the upstream client allows the downstream client to pass through its installations, potentially subject to services or valuable considerations. Before the adoption of the Third Energy Package, such situations were governed by 'wheeling agreements', also known as 'pass-through contracts'.

4.131 In the light of those characteristics and to guarantee the legal security of pre-existing situations, the Third Energy IEM Directives allow Member States to implement a derogation regime for closed distribution systems. The possibility to exempt closed distribution systems from the adoption of regulated tariffs and their publication prior to the entry into force is expressly provided.[176] Should this exemption be applied, Member States have to provide the possibility for end-users connected to a closed distribution system to bring the applicable tariffs or methodologies before the NRA for their review and approval a posteriori.[177] There is accordingly no derogation from third party access: such access is to be applied to closed distribution systems, but it may be applied, for instance, on the basis of contractually negotiated tariffs. It should be highlighted that in its first reading of the proposals for the Third Electricity and Gas Directives, the European Parliament had recommended leaving the possibility to Member States to exempt industrial sites

[174] Art 24(4) of both the Third Electricity and the Third Gas IEM Directives: '[i]ncidental use by a small number of households with employment or similar associations with the owner of the distribution system are located within the area served by a closed distribution system shall not preclude an exemption . . . being granted'.

[175] Commission Staff Working Document, Interpretative Note on Directive 2009/72/EC Concerning Common Rules for the Internal Market in Electricity and Directive 2009/73/EC Concerning Common Rules for the Internal Market in Natural Gas: Retail Markets (22 January 2010), 10 (hereafter, 'Interpretive Note: Retail Markets'): 'the closed distribution system must be located on a geographically confined site. This distinguishes it from the general public network'.

[176] Art 28(2) of both the Third Electricity and the Third Gas IEM Directives.

[177] Art 28(3) of both the Third Electricity and the Third Gas IEM Directives.

from third party access.[178] The European Parliament defined an industrial site as 'a privately-owned geographical area with a power grid which is primarily designed to supply industrial consumers in that area'. The proposed regime to derogate from third party access in case of such industrial sites was justified by the European Parliament as follows:

> [o]perators of energy grids on industrial sites do not have to comply with obligations on the operation of the grid in all EU Member States. This has no legal basis. EU legislation should enable Member States to provide derogations for industrial sites to ensure legal certainty. The differentiated treatment of industrial grids ensures proportionate efforts while not compromising the aims of liberalisation. This amendment does not compromise the rights of end consumers on industrial sites. Typically, there are few independent end consumers supplied from industrial sites.[179]

4.132 Another exemption from system operators' obligations is expressly provided for the electricity sector. Member States may provide for NRAs to exempt the operator of a closed distribution system from the requirement to procure the energy used to cover energy losses and reserved capacity in the system according to transparent, non-discriminatory, and market-based procedures.[180]

4.133 Besides the express exemptions laid down in the Directives, Member States may decide on other exemptions, as underlined by the Commission in its Interpretative Note:

> Where there is an obligation on Member States to develop rules applying to DSOs they may design targeted and proportionate rules for closed DSOs that take into account their particular circumstances.
>
> This is particularly important as the precise nature of many obligations on system operators is set by Member States and not directly laid down in the Electricity or Gas Directive.[181]

4.134 In the absence of the application of derogations to closed distribution systems, such systems are subject to the obligations of system operators regarding tariffs, PSOs, grid management, etc.

[178] European Parliament Legislative Resolution of 18 June 2008 on the Proposal for a Directive of the European Parliament and of the Council Amending Directive 2003/54/EC Concerning Common Rules for the Internal Market in Electricity, A6-0191/2008, 22, and European Parliament Legislative Resolution of 9 July 2008 on the Proposal for a Directive of the European Parliament and of the Council Amending Directive 2003/55/EC Concerning Common Rules for the Internal Market in Natural Gas, A6-257/2008, 27.

[179] Report of the European Parliament on the Proposal for a Directive of the European Parliament and of the Council amending Directive 2003/54/EC Concerning Common Rules for the Internal Market In Electricity, 19 May 2008, A6-0191/2008, 22.

[180] Art 28(2)(a) of the Third Electricity IEM Directive.

[181] Interpretive Note: Retail Markets (n 175), 11.

4.135 Closed distribution systems provide a legal basis for wheeling agreements and are accordingly likely to be based upon similar contractual clauses. The following common contractual clauses may be of particular relevance:

- the determination of an access point to the transport or distribution grid. Such a clause might read: 'taking due account of the physical constraints of the site for the access of the downstream end-user to the grid, the upstream end-user grants to the downstream end-user a long-term, reliable and secure access to the grid through the connection point up to a capacity of . . .';
- the point where the property and risks are transferred. This point is usually the point where the electricity is put at the disposal of the downstream end-user. This clause might be drafted as follows: 'the property and the risks attached to the wheeled electricity shall pass from the upstream end-user to the downstream end-user at the point of putting at disposal';
- the interruption of supply of the downstream end-user. The upstream end-user is usually not responsible for such interruptions since it is not part of the contract but merely makes its installations available to facilitate the supply. For instance: 'since the upstream end-user has no incidence on the grid and the connection, it cannot be responsible to the downstream user for incidences on the grid or the connection';
- the maintenance of the installations necessary to the wheeling of the electricity and/or natural gas. For instance: 'each party commits to maintain its installations in good state and secure and reliable conditions for the entire duration of the wheeling contract and having regard to the physical constraints of the site towards the grid';
- the allocation procedures of the downstream end-user in order to avoid unbalance on the grid. The allocation procedures of the system operator or of the access responsible party may be imposed. For example: 'the downstream end-user shall apply the allocation procedures imposed by the TSO/DSO or, should the case be, the Access Responsible Party, and shall have in any event the same Access Responsible Party as the upstream end-user, in conformity with the applicable legislation';
- the allocation of the costs for the use of the transport and/or distribution grid. This might read: 'unless otherwise agreed, the downstream end-user shall pay its share, or the equivalent, in the costs for the access and connection incurred by the upstream end-user for the site'.

(9) Position of long-term contracts: pre-liberalization long-term contracts

4.136 Third party access may be hindered by long-term contracts booking most of the capacity of, *inter alia*, transmission or distribution grids, interconnectors or storage facilities. Restrictions to third party access are particularly to be found in long-term contracts concluded prior to the liberalization of the energy markets, usually in the

context of energy transit. During its Energy Sector Inquiry, DG COMP underlined that 'pre-liberalisation contracts are the main reason why primary capacity is booked long-term by historical incumbents'.[182] It also underlined that:

> most capacity on crucial transit lines—which are vital for market integration—is in the hands of historic players. The transit contracts signed by these historic players before liberalisation will not expire, on average, before 2022. As a consequence, new entrants have little access to most of the transit pipelines, which in practice means that shipping gas over distances covering several pipelines is hardly possible.[183]

4.137 This subsection accordingly focuses on pre-liberalization long-term contracts. The possibility to adopt new long-term contracts following the opening of the electricity and gas markets is examined later in the chapter devoted to Energy Contracts.[184]

4.138 First, the evolution of EU energy legislation regarding pre-liberalization long-term contracts is analysed (at paras 4.139 ff), before turning to the question of the sanctity of such contracts (at paras 4.156 ff).

(a) Evolution of EU Energy Legislation Regarding Pre-liberalization Long-term Contracts

4.139 *(i) First Energy Package, the Commission Communication on 'Stranded Costs' and the ECJ's judgment in* Vereniging voor Energie, Milieu en Water*:* Long-term contracts which pre-dated liberalization were addressed in the First Electricity IEM Directive. Article 24 provided a transitional regime allowing for derogations from certain provisions of the liberalized electricity market, including third party access, where respect for prior commitments or guarantees of operations would be endangered:

> (1) Those Member States in which commitments or guarantees of operation given before the entry into force of this Directive may not be honoured on account of the provisions of this Directive, may apply for a transitional regime which may be granted by the Commission, taking into account, amongst other things, the size of the system concerned, the level of interconnection of the system and the structure of its electricity industry. The Commission shall inform the Member States of those applications before it takes a decision, taking into account respect for confidentiality. This decision shall be published in the Official Journal of the European Communities.
> (2) The transitional regime shall be of limited duration and shall be linked to expiry of the commitments or guarantees referred to in paragraph 1. The transitional regime may cover derogations from Chapters IV, VI and VII of this Directive.

[182] Commission, *DG Competition, Energy Sector Inquiry—Issues Paper* (15 November 2005), 18, para 45.
[183] Commission, *DG Competition, Energy Sector Inquiry—Issues Paper* (15 November 2005), 24.
[184] Ch 8, at paras 8.119 ff.

Applications for a transitional regime must be notified to the Commission no later than one year after the entry into force of this Directive.

4.140 No similar transitional regime was provided in the First Gas IEM Directive, which only considered the possibility of derogation from third party access in cases of serious economic and financial difficulties.

4.141 Following the adoption of the First Electricity IEM Directive, several Member States expressed, alongside the use of the transitional regime provided in Article 24 of Directive 96/92/EC, their wish to introduce State aid mechanisms to support the adaptation of their electricity companies to the introduction of competition under favourable conditions. Such mechanisms were accepted, as long as they were limited to the historical costs of commitments or guarantees that could no longer be honoured following the liberalization of the electricity market, generally referred to as 'stranded costs'.[185]

4.142 In July 2001, the Commission published the Communication on the Methodology for Analysing State Aid Linked to Stranded Costs.[186] This Communication determined the eligible stranded costs and the extent to which aid for such costs would be compatible with the EU's State aid rules. Long-term purchase contracts were explicitly cited amongst possible stranded costs. To be eligible, the following conditions had to be fulfilled:

(1) the 'commitments or guarantees of operation' had to be anterior to the entry into force of the First Electricity Directive, ie 19 February 1997;
(2) such 'commitments or guarantees of operation' must have presented the risk of not being honoured following the adoption of the First Electricity Directive, ie they should become non-economical and affect the competitiveness of the concerned undertaking;
(3) the 'commitments or guarantees of operation' had to be irrevocable; and
(4) stranded costs are economic costs corresponding to the actual sums invested, paid, or payable in application of the 'commitments or guarantees of operation'.

4.143 The scope of the transitional regime provided by Article 24 of Directive 96/92/EC was clarified by the ECJ's judgment in *Vereniging voor Energie, Milieu en Water* (commonly know as the '*VEMW* case') of 7 June 2005.[187] The ECJ considered that contracts concluded prior to the liberalization of the electricity markets were

[185] For a deeper analysis of this point, see PD Cameron, *Competition in Energy Markets, Law and Regulation in the European Union* (2nd edn, Oxford: OUP, 2007), 432–446.
[186] Commission Communication relating to the Methodology for Analysing State Aid Linked to Stranded Costs (25 July 2001); see Commission Press Release IP/01/1077: 'Commission adopts document on "Methodology for analyzing State aid linked to stranded costs" in the electricity sector.'
[187] Case C-17/03 *Vereniging voor Energie, Milieu en Water, Amsterdam Power Exchange Spotmarket BV, Eneco NV v Directeur van de Dienst uitvoering en toezicht energie, Nederlands*

not *per se* exempted from, inter alia, third party access. To benefit from such an exemption, the procedure provided in Article 24 of Directive 96/92/EC had to be followed. Should that not be the case, any advantage to an undertaking previously in a monopoly situation would be incompatible with the principle of access to the system, the cornerstone of the liberalization of the electricity markets:

> Equal treatment of this kind could be compromised if it were accepted that each Member State could, outside of the procedure and conditions laid down in Article 24 of the Directive, confer an advantage on the undertaking previously holding its monopoly in order to safeguard performance of the long-term contracts which that undertaking concluded prior to the liberalisation of the electricity market. That would run counter to the objective of the Directive set out in recital (12) in its preamble, according to which 'whatever the nature of the prevailing market organisation, access to the system must be open in accordance with this Directive and must lead to equivalent economic results in the States and hence to a directly comparable level of opening-up of markets and to a directly comparable degree of access to electricity markets.[188]

4.144 The ECJ accordingly decided that priority access granted on the basis of commitments contracted prior to the liberalization of the electricity market but without compliance with the procedure provided in Article 24 of Directive 96/92/EC led to the grant of a discriminatory access and was accordingly incompatible with Directive 96/92/EC.[189]

4.145 The ECJ furthermore rejected the argument based upon the protection of legitimate expectations and of legal certainty. It considered that no elements indicated the maintenance of the situation applicable at the time the concerned contracts were concluded:

> 75. In the present case, the [EU] institutions did not adopt any measure or assume any form of conduct which could have pointed to the maintenance of the legislative situation in force in 1989 and 1990, under which the international contracts of the SEP were concluded . . .
>
> 78. It cannot therefore be argued that the [EU] institutions created well-founded expectations on the part of the SEP that a monopoly for the importation of electricity into the Netherlands would be maintained or that the SEP would be allowed to enjoy a preferential right to use the network for the cross-border transmission of

Elektriciteit Administratiekantoor BV [2005] ECR I-4983 (hereinafter, '*VEMW*'). For discussion, see the Opinion of Advocate General Jääskinen in Case C-264/09 *Commission v Slovakia*, Opinion of 15 March 2011, paras 46–54; in its judgment of 15 September, the ECJ relied upon the relevant Investment Protection Agreement which bound Slovakia prior to its accession to the EU.

[188] *VEMW*, para 63.
[189] *VEMW*, para 71: '[i]t follows that priority access to a portion of the capacity for the cross-border transmission of electricity conferred on an operator by reason of commitments assumed before the Directive entered into force, but without compliance with the procedure set out in Article 24 of the Directive, must be regarded as being discriminatory within the terms of Articles 7(5) and 16 of the Directive and as therefore being contrary to those articles'.

electricity until the expiry of the international contracts which had been entered into.

4.146 *(ii) Second Energy Package:* The Second Energy Package mostly focused upon pre-liberalization long-term term contracts in the natural gas sector. Directive 2003/55/EC expressly maintained, in its Article 32(1), the validity of long-term gas contracts concluded before the liberalization of the internal natural gas market in accordance with the Transit Directive:[190]

> Directive 91/296/EEC shall be repealed with effect from 1 July 2004, without prejudice to contracts concluded pursuant to Article 3(1) of Directive 91/296/EEC, which shall continue to be valid and to be implemented under the terms of the said Directive.

4.147 Existing gas contracts were also addressed in Regulation 1775/2005/EC, in order to specify that such contracts are subject to congestion management procedures.[191] It followed from Articles 5(3) and (4) of that Regulation that:

> (3) When transmission system operators conclude new transportation contracts or renegotiate existing transportation contracts, these contracts shall take into account the following principles:
> (a) in the event of contractual congestion, the transmission system operator shall offer unused capacity on the primary market at least on a day-ahead and interruptible basis;
> (b) network users who wish to re-sell or sublet their unused contracted capacity on the secondary market shall be entitled to do so. Member States may require notification or information of the transmission system operator by network users.
>
> (4) When capacity contracted under existing transportation contracts remains unused and contractual congestion occurs, transmission system operators shall apply paragraph 3 unless this would infringe the requirements of the existing transportation contracts. Where this would infringe the existing transportation contracts, transmission system operators shall, following consultation with the competent authorities, submit a request to the network user for the use on the secondary market of unused capacity in accordance with paragraph 3.

4.148 The scope of application of congestion management procedures to pre-liberalization long-term contracts was clarified in the guidelines drafted by the Commission for Article 5 of Regulation 1775/2005. The draft guidelines, presented at the 11th Madrid Forum on 18–19 May 2006, are particularly relevant here:

> **2.6 Requirements of existing transportation contracts (Art 5(4))**
>
> (63) Article 5(4) of the Regulation stipulates that, as a general rule, the provisions of Article 5(3) also apply to existing contracts . . . unless this would infringe the requirements of the existing contracts.

[190] Council Directive 91/296/EEC of 31 May 1991 on the transit of natural gas through grids [1991] OJ L147/37.

[191] On such congestion management procedures, see Ch 8, at paras 8.121–8.142.

> (64) DG TREN services take the view that the requirements of the existing contracts would only be infringed if:
> - the contract in question could not be properly executed anymore by applying the interruptible UIOLI [ie Use-It-Or-Lose-It] approach as required by Article 5(3)(a), or
> - explicit provisions in existing transportation contracts concluded before 1 July 2006 forbid the application of Article 5(3) of the Regulation.
>
> (65) DG TREN services tend to consider the former case a reinforcement of the interruptible UIOLI principle meaning that the initial capacity holder would not finally lose the capacity contracted, but can dispose of it by nominating the gas flows meant to serve his customers.
>
> (66) As for the latter case, the contractual provisions in question would have to comply with the general competition rules. Where this is not the case provisions would be void and thus could not infringe the requirements of an existing contract.
>
> (67) In the event, however, that such provisions comply with the general competition rules, Article 5(4) establishes an obligation for the TSO to call on the capacity holder for offering his unused capacity on the secondary market in line with the provisions laid down in Article 5(3)(b).[192]

4.149 The final version of those guidelines, dated 12 June 2007, provides that:

> **4.14. Requirements of existing transportation contracts (Art. 5(4))**
>
> 38. Article 5(4) of the Regulation stipulates that, as a general rule, the provisions of Article 5(3) also apply to existing contracts, unless this infringes the requirements of the existing contracts.
>
> 39. The principle of selling unused capacity on an interruptible basis as required by Article 5(3)(a) need not constitute an infringement of the requirements of the existing contracts. As the capacity is sold on an interruptible basis, the initial capacity holder would not lose the capacity contracted, but could dispose of it by nominating the gas flows meant to serve his customers . . .
>
> 41. In the event that the network user or TSO could successfully prove that the requirements of his transportation contract have been infringed, Article 5(4) establishes an obligation for the TSO to call on the capacity holder to offer his unused capacity on the secondary market in line with the provisions laid down in Article 5(3)(b). This means that, in such a case, either the TSO would exceptionally take part in the secondary market with the network user's capacity on that network user's behalf or the network user would be able to use the capacity on the secondary market.[193]

[192] Congestion Management Procedures, Draft Explanatory Note of DG Energy & Transport on Article 5 'Principles of Capacity Allocation Mechanism and Congestion Management Procedures', paras 3, 4, and 5, as well as para 2(2) of the Annex to 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, paras 63–67, p 16.

[193] Commission, Staff Working Document on Capacity Allocation and Congestion Management for Access to the Natural Gas Transmission Networks Regulated under Article 5 of Regulation (EC) No 1775/2005 on Conditions for Access to the Natural Gas Transmission Networks, SEC(2007) 822 (12 June 2007), paras 38–40.

4.150 What about the position of long-term gas contracts, which had been concluded before the liberalization of the internal natural gas market and were in accordance with the Transit Directive, *following* the adoption of Regulation 1775/2005/EC? The question of whether the derogation regime for such contracts would be maintained was at issue in a case brought before the ECJ by the Belgian gas TSO Fluxys against the Commission de Régulation de l'Electricité et du Gaz ((CREG), the NRA for the federal Belgian level). The ECJ was deprived of the opportunity to settle the question in its judgment of 9 December 2010, after Fluxys withdrew from the procedure.[194] However, the position taken by Advocate General Trstenjak in her Opinion of 28 September 2010 does provide some guidance. CREG considered that the absence of any explicit derogation in the 2005 Regulation for such pre-liberalization long-term gas contracts led to the implicit removal of the derogation provided by Article 32(1) of Directive 2003/55/EC. The Advocate General, however, considered that the mere failure of the Regulation to mention any derogation for such contracts could not lead to its implicit abrogation, particularly given the important economic consequences of the removal of that derogation.[195] The Advocate General also considered that the derogation provided for such pre-liberalization long-term gas contracts was justified by the need to respect the 'legitimate expectation' of shippers which held such contracts. The derogation, therefore, did not discriminate when compared with other types of gas contracts which are fully subject to the rules of the liberalized natural gas market.[196]

4.151 With regard to the electricity sector, Directive 2003/54/EC did not retain the transitional regime provided in Article 24 of Directive 96/92/EC and did not invoke in any of its provisions the question of pre-liberalization long-term contracts. Such contracts are only mentioned in the Annex to Regulation 1228/2003/EC, which provided guidelines on the management and allocation of available transfer capacities of interconnections between national systems. According to this Annex, 'existing long-term contracts shall have no pre-emption rights when they come up for renewal'.[197]

4.152 *(iii) Commission Staff Working Document:* The question of pre-liberalization long-term contracts was assessed in 2006 by the Commission in a Staff Working Document,[198] in the light of both the Second Energy Package, adopted in 2003,

[194] Case C-241/09 *Fluxys v Commission de Régulation de l'Electricité et du Gaz (CREG)*, judgment of 9 December 2010.

[195] Case C-241/09 *Fluxys v Commission de Régulation de l'Electricité et du Gaz (CREG)*, Opinion of Advocate General Trstenjak (28 September 2010), paras 68–72.

[196] Case C-241/09 *Fluxys v Commission de Régulation de l'Electricité et du Gaz (CREG)*, Opinion of Advocate General Trstenjak (28 September 2010), paras 73–75.

[197] Regulation 1228/2003, Annex, para 2: Guidelines on the Management and Allocation of Available Transfer Capacity of Interconnections between National Systems, Position of Long-term Contracts.

[198] Commission, Staff Working Document on the Decision C-17/03 of 7 June 2005 of the Court of Justice of the European Communities, Preferential Access to Transport Networks under

and the ECJ's 2005 judgment in the *VEMW* case. Considering the electricity market, the Commission recalled that 'Directive 2003/54/EC . . . [no] longer provide for any specific derogations in relation to the application of non-discriminatory rules to historical long-term supply and capacity reservation contracts'.[199] It did, however, highlight that existing long-term contracts are not outlawed following the judgment of the ECJ in *VEMW*. They merely cannot benefit from priority allocation[200] of capacities: '[u]nder the Directive and the Regulation, only the priority allocation of transmission or distribution capacities is incompatible with [EU] rules. Long-term supply contracts are not *per se* invalid under the Court judgment, although they cannot be subject to preferential treatment'.[201]

4.153 The Commission adopted a similar position with regard to the gas market, with the exception of 'transit gas contracts that were concluded and implemented under the terms of Directive 91/296/EEC', in line with Article 32(1) of Directive 2003/55/EC. The possible exemption of TOP contracts in cases of serious economic and financial difficulties was also recalled by the Commission.

4.154 *(iv) Third Energy Package:* The Third Energy Package gives much less attention to pre-liberalization long-term contracts. For the electricity market, neither Directive 2009/72/EC nor Regulation 714/2009/EC specifically mentions such contracts. For the gas market, Directive 2009/73/EC does not retain the substance of Article 32(1) of Directive 2003/55/EC, but simply repeals the 2003 Directive entirely. As to the application of congestion management procedures to pre-liberalization long-term contracts, it is reinforced in the new Regulation 715/2009, Recital 21 which insists upon the application of congestion management and capacity-allocation principles to existing contracts.[202] Furthermore, provisions related to congestion

the Electricity and Gas Internal Market Directives, SEC(2006) 547 (26 April 2006) (hereafter, 'Working Document: Preferential Access').

[199] Working Document: Preferential Access (n 198), 3, para 6.

[200] The issues of priority access, discrimination, and derogations (under the Second Electricity IEM Directive 2003/54/EC and the Electricity Cross-border Exchanges Regulation 1228/2003/EC) were in issue in Case C-264/09 *Commission v Slovakia* (judgment of 15 September 2011). In his Opinion, AG Jääskinen advised that such priority access rights (granted for 16 years in return for investment in the construction of a transmission line) were discriminatory under Art 20 of Directive 2003/54/EC and would thus require justification (since they had not been granted pursuant to a derogation under Art 7 of the Regulation 1228/2003/EC). He found such justification via what is now Art 351 TFEU, under which pre-existing international obligations concluded before Slovakia's membership of the EU could not be affected by the EU Treaties (paras 68–110). The ECJ did not examine the arguments under the Directive in any detail, but essentially agreed with the approach of its Advocate General with regard to the Investment Protection Agreement which applied to Swiss investments in Slovakia and which had been entered into prior to Slovak accession to the EU. Thus, the preferential access agreement counted as an 'investment' protected by that Agreement and was therefore covered by Art 351 TFEU (paras 29–53).

[201] Working Document: Preferential Access (n 198), 3, para 7.

[202] According to Recital (21) of Regulation 715/2009: '[t]here is substantial contractual congestion in the gas networks. The congestion-management and capacity-allocation principles for new or newly negotiated contracts are therefore based on the freeing-up of unused capacity by enabling

management rules no longer distinguish (as they did under the old Article 5(3) and (4) of the 2005 Regulation) between existing contracts, on the one hand, and renegotiation of such contracts and conclusion of new contracts, on the other.[203]

4.155 It thus appears that, from the expiry of the transposition period (ie 3 March 2011), the Third Energy Package's provisions shall apply in full to pre-liberalization long-term contracts.

4.156 **(b) Sanctity of pre-liberalization long-term contracts:** In the light of the evolution of the provisions applicable to pre-liberalization long-term contracts in EU energy legislation, one should question the extent to which the sanctity of such pre-liberalization long-term contracts is affected. In the energy sector, the sanctity of such contracts covers the highly significant issues of contractual capacities, contractual tariffs, and the allocation of those capacities.

4.157 To address this question, it should first be examined whether pre-liberalization long-term contracts remain valid following the adoption of the Third Energy Package. Some elements of an answer to this question may be found in the impact assessment of the Commission accompanying the preparatory work of the Third Energy Package:[204]

> **4.1.5. Modifying the treatment of pre-liberalisation long term contracts for gas transmission**
>
> Article 32(1) of Directive 2003/55/EC exempts long-term contracts for gas transmission concluded pursuant to Article 3(1) of Directive 91/296/EEC. A possibility would be to delete or change this provision in order to clarify that the legislation also applies to such contracts.

4.158 In the end, this option was not retained:

> **6.5. Actions to regulate long-term contracts in gas**
>
> Article 32(1) of Directive 2003/55/EC exempts long-term contracts for gas transmission concluded pursuant to Article 3(1) of Directive 91/296/EEC. However, at

network users to sublet or resell their contracted capacities and the obligation of transmission system operators to offer unused capacity to the market, at least on a day-ahead and interruptible basis. Given the large proportion of existing contracts and the need to create a true level playing field between users of new and existing capacity, those principles should be applied to all contracted capacity, including existing contracts'.

[203] Art 16 of Regulation 715/2009 accordingly states that: '[t]he transmission system operator shall implement and publish non-discriminatory and transparent congestion-management procedures which facilitate cross-border exchanges in natural gas on a non-discriminatory basis and which shall be based on the following principles: (a) in the event of contractual congestion, the transmission system operator shall offer unused capacity on the primary market at least on a day-ahead and interruptible basis; and (b) network users who wish to re-sell or sublet their unused contracted capacity on the secondary market shall be entitled to do so.'

[204] Commission, Staff Working Document—Accompanying the Legislative Package on the Internal Market for Electricity and Gas, Impact Assessment, SEC(2007) 1179 (19 September 2007).

this stage, further legislative measures concerning long-term contracts in gas do not appear to be proportionate.

4.159 This choice was confirmed in the impact assessment summary:

> *Policy options and analysis of impacts*: . . .
>
> – Pre-liberalisation long-term contracts
>
> The current framework has created some confusion. One possibility would be to delete or change the provisions to make it clear that the legislation also applies to such contracts, but this may question the validity of pre-liberalisation contracts for import of gas into the EU.
>
> The Commission has concluded that the Directive should not be amended on this issue. It is clear that all contracts concluded before the entry into force of Directive 2003/55/EC continue to be valid insofar as they comply with [EU] competition law and that these contracts are equally subject to the provisions of the of the current framework . . .
>
> Conclusions: comparing the options
>
> – Action to regulate long-term contracts in gas: the cost-benefit analysis of further legislative measures on long-term contracts in gas was not conclusive.

4.160 In the face of those elements, it could reasonably be advanced that pre-liberalization long-term contracts remain in force on aspects which are not contrary to the EU competition rules and to the rules of the internal electricity and natural gas markets. This position was supported by Advocate General Trstenjak in her Opinion in the *Fluxys* case: the 'legitimate expectation' of shippers having such contracts justified the derogation provided for such pre-liberalization long-term gas contracts.[205]

4.161 Accordingly, assuming that such contracts respect the competition rules,[206] they should be enforceable subject to the regulatory rules laid down by the Third Energy Package and as specified by each Member States following the transposition of

[205] Case C-241/09 *Fluxys v Commission de Régulation de l'Electricité et du Gaz (CREG)*, Opinion of Advocate General Trstenjak (28 September 2010), paras 73–75; the withdrawal of Fluxys from the case meant that the ECJ did not rule on the substance of the matter: see judgment of 9 December 2010. See, also, the Opinion of AG Jääskinen (15 March 2011) in Case C-264/09 *Commission v Slovakia* (judgment of 15 September 2011), paras 32–37.

[206] Which includes both EU antitrust and State aid rules. The Commission has recently, and not uncontroversially, applied what is now Art 107 TFEU to long-term power purchase agreements in both Poland and Hungary: Commission Decision of 25 September 2007 on State aid awarded by Poland as part of power purchase agreements (etc) [2009] OJ L83/1 and Commission Decision C41/05 of 4 June 2008 on the State aid awarded by Hungary through power purchase agreements [2009] OJ L225/53; the Hungarian Decision was upheld by the General Court of Joined Cases T-80/06 and T-182/09 *Budapest: Erömü v Commission* (judgment of 13 February 2012). EU State aid law was applied because the State-owned single buyer in each country was the purchaser and because State legislation made provision for generating the revenue used to pay the costs under the power purchase agreements (PPAs). For discussion, see L Hancher, 'Long-term Contracts and State Aid: A New Application of the EU State Aid Regime or a Special Case?', in J-M Glachant, D Finon, and A de Hauteclocque (eds), *Competition, Contracts and Electricity Markets: A New Perspective* (Cheltenham (UK): Edward Elgar, 2011), Ch 10.

this package into their national legal orders. Pre-liberalization long-term contracts would therefore be subject to regulated congestion management procedures, regulated tariffs and regulated capacity allocation procedures.

4.162 Such regulated allocation procedures should be unlikely to interfere with the sanctity of pre-liberalization long-term contracts; such procedures are mostly operational. The application of regulated tariffs and regulated congestion management procedures, however, may well affect the sanctity of pre-liberalization long-term contracts. Such an effect could be diminished for the congestion management procedures by the non-application of the 'use-it-or-lose-it' procedure. According to such procedures, the holder of such unused capacities would lose them to the profit of the TSO, which would then sell them. The capacity-holder would accordingly lose both its capacities and the revenues from such capacities. This could reasonably be argued to be a disproportionate interference with the sanctity of pre-liberalization long-term contracts.[207] Softer procedures, such as 'use-it-or-lend-it' or 'use-it-or-sell-it', could be more proportionate. Under a use-it-or-lend-it regime, the non-used capacity of a given capacity-holder is put at the disposal of other grid users but is reallocated to the initial capacity-holder as soon as it decides to use it.[208] Under a use-it-or-sell-it approach, a capacity-holder has the choice between using its capacity and transforming into a financial right: ie reallocating its capacity to the market in subsequent allocation procedures and then benefiting from the income generated by this reallocation.[209] The proportionality of use-it-or-lend-it and use-it-or-sell-it approaches may be implied from the Guidelines of the Commission concerning Article 5 of Regulation 1775/2005, discussed in paras 4.148–4.149. It follows from those Guidelines that 'the initial capacity-holder will not lose the capacity contracted, but could dispose of it by nominating the gas flows meant to serve his customers'.[210] It is also underlined that, for the sale of unused capacity

[207] This was notably recognized by some of the NRAs in implementing congestion management procedures into their national orders. In Belgium, for instance, the *Commission de Régulation de l'Electricité et du Gaz* opted in its project Grid Code for use-it-or-sell-it, considering that a use-it-or-lose-it mechanism was 'too drastic and complex from a legal perspective' (Proposition (C)090716-CDC-882, 'arrêté royal relatif au code de bonne conduite en matière d'accès au réseau de transport de gaz naturel, à l'installation de stockage pour le gaz naturel et à l'installation de GNL et modifiant l'arrêté royal du 12 juin 2001 relatif aux conditions générales de fourniture de gaz naturel et aux conditions d'octroi des autorisations de fourniture de gaz naturel', available at <http://www.creg.info/pdf/Propositions/C882FR.pdf>).

[208] Congestion Management Procedures, Draft Explanatory Note of DG Energy & Transport on Article 5, 'Principles of capacity allocation mechanisms and congestion management procedures', paras 3, 4, and 5 as well as para 2.2 of the Annex to Regulation 1775/2005/EC on Conditions for Access to the Natural Gas Transmission Networks [2005] OJ L289/1 (28 September 2005), and the 11th meeting of the Madrid Forum (18–19 May 2006), 7: 'any capacity not nominated for use would be offered to other network users, but falls back to the initial capacity holder at the moment he nominates it for use'.

[209] See, Commission de Régulation de l'Energie ((CRE) the French NRA), 'Activity Report, June 2008', Annexes, 155.

[210] Commission, Staff Working Document on Capacity Allocation and Congestion Management for Access to the Natural Gas Transmission Networks Regulated under Article 5 of Regulation (EC) No 1775/2005 on Conditions for Access to the Natural Gas Transmission Networks, SEC(2007) 822 (12 June 2007), para 39 (hereafter, 'Working Document: Capacity Allocation and Congestion Management (Gas)').

on the secondary market, 'either the TSO would exceptionally take part in the secondary market with the network user's capacity on that network user's behalf or the network user would be able to use the capacity on the secondary market'.[211]

4.163 This analysis of the proportionate application of the provisions of the Third Energy Package to pre-liberalization long-term gas contracts appears to be confirmed by the Framework Guidelines recently adopted by the ACER on Capacity Allocation Mechanisms for the European Gas Transmission Network.[212] Such Framework Guidelines are to apply to cross-border interconnection points between two or more Member States as well as adjacent entry-exit systems within the same Member State, provided that the points are subject to booking procedures by users.[213] They provide for the bundling of the existing capacity contracted before the entry into force of the network code to be adopted in application of the framework guidelines. It is, however, provided that this bundled capacity shall then be 'split between the original capacity holders proportionally to their capacity rights'. In detail:[214]

> The network code(s) shall ensure that existing capacity contracted before the entry into force of the same network code(s) shall be bundled no later than five years thereafter.
>
> To this end, parties to existing capacity contracts shall aim to reach an agreement on the split of the bundled capacity at the [relevant] interconnection points . . . National Regulatory Authorities may mediate between the parties to promote such agreements.
>
> If no agreement on the split of the bundled capacity is reached, the network code(s) shall provide that the bundled capacity shall be considered split between the original capacity holders proportionally to their capacity rights.
>
> The parties to an existing capacity contract shall adjust the original capacity contracts with their respective Transmission System Operators according to the agreed split of the bundled capacity or, if no agreement is reached, to the above proportionality rule, as further detailed in the network code(s). The duration of the amended capacity contracts with bundled services shall not exceed the duration of the original capacity contracts. Any further details of this procedure shall be set out in the network code(s).

4.164 Besides these arguments, several mechanisms could be envisaged to ensure the protection of the sanctity of pre-liberalization long-term energy contracts with regard to tariffs and congestion management procedures. Those mechanisms are: (i) Article 1

[211] Working Document: Capacity Allocation and Congestion Management (Gas) (n 210), para 40.

[212] ACER, 'Framework Guidelines on Capacity Allocation Mechanisms for the European Gas Transmission Network', FG-2011-G-001 (3 August 2011) (hereafter, 'ACER: Framework Guidelines on Capacity Allocation (Gas)').

[213] ACER: Framework Guidelines on Capacity Allocation (Gas), point 1.2.

[214] ACER: Framework Guidelines on Capacity Allocation (Gas), point 2.4.2.

of the First Protocol to the ECHR; (ii) the Energy Charter Treaty (or, indeed, relevant bilateral investment treaties (BITs)[215]); and (iii) the regime concerning stranded costs (already discussed at paras 4.139 ff).[216] Without engaging in a full analysis of those mechanisms, the following general guidelines may be provided.

4.165 *(i) First Protocol to the European Convention on Human Rights and Fundamental Freedoms (ECHR).*[217] On the assumption that pre-liberalization long-term contracts are valid under the competition rules, they would constitute assets likely to fall under the protection of Article 1 of the First Protocol to the ECHR. According to that Article:

> (1) Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law.
> (2) The preceding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties.

4.166 The concept of 'possessions' is autonomously understood by the ECtHR. An established interest with economic value will generally fall within the scope of this notion. A legal right to receive a certain benefit, such as a contract, may accordingly be covered by Article 1 of the First Protocol to the ECHR. Three types of infringement of the peaceful enjoyment of one's possessions are identified by the ECtHR: deprivation, control of use, and interference with peaceful enjoyment.

4.167 Deprivation is established where an owner's property rights are terminated, usually following their legal transfer by law or the exercise of the legal power to do so. Control of use of property is distinguished from deprivation by the fact that it leads

[215] See Case C-264/09 *Commission v Slovakia* (judgment of 15 September 2011): Opinion of Advocate General Jääskinen, paras 68–110, and the judgment of the ECJ, paras 29–53 (concerning the Investment Protection Agreement, a BIT concluded between Switzerland and Slovakia prior to Slovakia's accession to the EU, and what is now Art 351 TFEU).

[216] Although note that, in its recent State aid Decisions on Polish and Hungarian PPAs (n 206), the Commission required termination of the PPAs (Poland) and removal of purchase obligations and recovery of the aid as if the contracts had never existed (Hungary): this, in effect, seems a direct order by the Commission to terminate private contracts: see Hancher, n 206, 253–254. See, further, the Opinion of Advocate General Jääskinen in Case C-264/09 *Commission v Slovakia* (judgment of 15 September 2011), paras 32–37, where he 'doubts that the Member State should be required to annul a valid private law contract . . . such an action would be contrary to the principle of legal certainty and would risk punishing innocent third parties in respect of a breach committed by a Member State' (para 37). The ECJ's judgment would appear to reach a similar result (esp paras 48–52).

[217] For a deeper analysis of this point, see A Johnston 'Chapter 4: Take-or-Pay Contracts, for Renewables: An Analysis of European Legal Issues' in B Delvaux, M Hunt, and K Talus (eds), *EU Energy Law and Policy Issues* (Rixensart (Belgium): Euroconfidentiel, 2008), 274–283.

either to the imposition of positive requirements upon the use of the property or to restrictions of owners' activities. If the conditions for deprivation or control of use are not met, interference with peaceful enjoyment could be shown for 'any kind of interference which is hard to pin down'.[218]

4.168 If an infringement to peaceful enjoyment of one's possessions is shown, compensation may be granted, according to certain conditions. There is no guarantee of full compensation at market value, legitimate objectives of public interest being the possible ground and justification for the interference.

4.169 The question of whether the application of regulated tariffs and regulated congestion management procedures, as transposed into national laws, constitute an infringement to peaceful enjoyment of pre-liberalization long-term contracts could be settled by the courts. The justifiability of those measures and the proportionality of their interference with the sanctity of such contracts are then likely to be taken into account.

4.170 *(ii) Energy Charter and the Energy Charter Treaty.*[219] The Energy Charter was adopted on 17 December 1991 in order to develop energy cooperation amongst the states of Eurasia. It was followed by the adoption, on 17 December 1994, of the Energy Charter Treaty (ECT). This Treaty aims to promote East–West industrial cooperation in domains such as investment, transit, and trade.[220]

4.171 Both the Energy Charter and the ECT are relevant in the context of the question of the pre-liberalization long-term energy contracts. Here, we focus upon the promotion and protection of investments provided by the ECT.

4.172 The notion of 'investment' is defined in this Energy Charter as 'every kind of asset, owned or controlled directly or indirectly by an Investor'.[221] This notably includes 'any right conferred by law or contract or by virtue of any licences and permits granted pursuant to law to undertake any Economic Activity in the Energy Sector'.[222] Pre-liberalization long-term energy contracts, assuming that they are compatible with the EU competition rules, are likely to fall within the scope of this definition.

4.173 Investments are promoted and protected by Part III of the ECT. According to its Article 10(1):

> Each Contracting Party shall, in accordance with the provisions of this Treaty, encourage and create stable, equitable, favourable and transparent conditions for

[218] L Sermet, *The European Convention on Human Rights and Property Rights* (rev. edn, Strasbourg: Council of Europe Publishing, 1998), 29.

[219] For an outline, see the discussion at paras 11.01 ff, and the references cited therein.

[220] For general discussion and further references, see T Wälde (ed), *The Energy Charter Treaty: An East-West Gateway for Investment and Trade* (The Hague: Kluwer Law International, 1996) and C Bamberger and T Wälde, 'The Energy Charter Treaty', in M Roggenkamp et al (eds), *Energy Law in Europe: National, EU and International Regulation* (2nd edn, OUP, 2007), Ch 3.

[221] Art 1(6), para 1 of the ECT.

[222] Art 1(6), para 1(f) of the ECT.

Investors of other Contracting Parties to make Investments in its Area. Such conditions shall include a commitment to accord at all times to Investments of Investors of other Contracting Parties fair and equitable treatment. Such Investments shall also enjoy the most constant protection and security and no Contracting Party shall in any way impair by unreasonable or discriminatory measures their management, maintenance, use, enjoyment, or disposal. In no case shall such Investments be accorded treatment less favourable than that required by international law, including treaty obligations. Each Contracting Party shall observe any obligations it has entered into with an Investor or an Investment of an Investor of any other Contracting Party.

4.174 Article 13 of the ECT protects investments against expropriation:

(1) Investments of Investors of a Contracting Party in the Area of any other Contracting Party shall not be nationalized, expropriated or subjected to a measure or measures having effect equivalent to nationalization or expropriation (hereinafter referred to as 'Expropriation') except where such Expropriation is:
   (a) for a purpose which is in the public interest;
   (b) not discriminatory;
   (c) carried out under due process of law; and
   (d) accompanied by the payment of prompt, adequate and effective compensation.

   Such compensation shall amount to the fair market value of the Investment expropriated at the time immediately before the Expropriation or impending Expropriation became known in such a way as to affect the value of the Investment (hereinafter referred to as the 'Valuation Date').

   Such fair market value shall at the request of the Investor be expressed in a Freely Convertible Currency on the basis of the market rate of exchange existing for that currency on the Valuation Date. Compensation shall also include interest at a commercial rate established on a market basis from the date of Expropriation until the date of payment.

(2) The Investor affected shall have a right to prompt review, under the law of the Contracting Party making the Expropriation, by a judicial or other competent and independent authority of that Contracting Party, of its case, of the valuation of its Investment, and of the payment of compensation, in accordance with the principles set out in paragraph (1).

(3) For the avoidance of doubt, Expropriation shall include situations where a Contracting Party expropriates the assets of a company or enterprise in its Area in which an Investor of any other Contracting Party has an Investment, including through the ownership of shares.

4.175 These provisions of the ECT may be invoked for the protection of any investment realized within the EU. While in the past most of the disputes targeted by such provisions concerned the former countries of the Soviet Union and Turkey, in

recent years more and more disputes have involved Member States of the EU. For example, under its provisions a dispute was brought on 17 April 2009 before the International Centre for Settlement of Investment Disputes by the German undertaking Vattenfall against the German Federal Republic.[223] The dispute concerned the construction of a power plant in Germany. Two disputes were also brought against Hungary by the undertakings Electrabel (Belgium) and EDF (France) in the context of the implementation of long-term electricity contracts.[224]

4.176 A dispute between an investor and a contracting party is governed by Article 26 of the ECT. If it cannot be settled amicably, it may be brought before: the courts of the contracting party; a previously agreed dispute settlement procedure; or an international arbitration tribunal, such as the International Centre for Settlement of Investment Disputes, a sole arbitrator or an ad hoc arbitration tribunal established under the Arbitration Rules of the United Nations Commission on International Trade Law or the Arbitration Institute of the Stockholm Chamber of Commerce. Case law related to the implementation of Article 26 is compiled by the Energy Charter Secretariat.[225] It follows from this case law that three conditions have to be met for a contracting party to be found liable to an investor:

(1) the investment interference must be the result of an action from the State or one of its bodies;
(2) the investment interference must constitute a violation of the obligations of contracting parties regarding the promotion and protection of investments (Part III of the ECT); and
(3) the investment interference must lead to a loss or a damage for the investor. The substantial reduction of the economic value and of the security of investments has been accepted in the past as a loss and damage for investors.[226]

4.177 The question of whether the application of regulated tariffs and regulated congestion management procedures, as transposed into national laws, could fall within the scope of the ECT could yet be settled by courts. The justifiability of those measures and the proportionality of their interference with the sanctity of such contracts will then have to be examined.[227]

[223] See <http://ita.law.uvic.ca/documents/VattenfallRequestforArbitration.pdf>.

[224] *Electrabel SA v Republic of Hungary* (ICSID Case No ARB/07/19) and *EDF International SA v Republic of Hungary*, United Nations Commission on International Trade Law.

[225] Available at <http://www.encharter.org/index.php?id=213&L=0>.

[226] *Nykomb Synergetics Technology Holding AB v Latvia* (16 December 2003), available at <http://www.encharter.org/fileadmin/user_upload/document/Nykomb.pdf>.

[227] See the Opinion of AG Jääskinen in Case C-264/09 (n 216), at paras 60–64 on the ECT. See, further, J Kleinheisterkamp, 'The Next 10 Year ECT Investment Arbitration: A Vision for the Future—From a European Law Perspective' (LSE Law, Society and Economy Working Paper 7/2011).

5

REGULATORY AUTHORITIES AND EUROPEAN COOPERATION

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A. Introduction

As the detail of EU-level legislation on the energy sector has grown, so has the realization that the effective application and enforcement of such rules are dependent upon strong, well-resourced, and independent national energy regulators in the Member States. At the same time, the impact of the cross-border relations between such regulators, both within the EU and with third countries, has become clearer, as has the need for a degree of coordination at European level between regulatory initiatives and activities (particularly where market liberalization and integration have faced conflicting national regimes and demands, causing delays, cost increases, and creating disincentives to invest in important new generation, transmission, and transit capacity). This chapter discusses the current incarnation of the provisions on national regulatory authorities in the energy sector and the growth of cooperation on energy issues at the EU level, in the form of various formal and informal bodies and institutions. The growth in the detail and complexity of provisions concerning these regulatory issues and bodies is a key characteristic of the Third Package. **5.01**

B. National Regulatory Authorities

5.02 The development of EU-level legislative requirements concerning national regulatory authorities (NRAs) over the three legislative packages has been striking. After meeting with initial resistance from some Member States, which wished to retain their own specific national regulatory arrangements, successive reforms have provided more detailed rules concerning NRAs. The Second Package (see Articles 23 (Elec) and 25 (Gas)) generalized the requirement of specific national energy regulatory authorities in each Member State across the EU, with a specified set of minimum powers and a requirement that such NRAs be independent from the energy industries with whose regulation they were charged. A requirement that such NRAs coordinated their activities *inter se* was also introduced, as was the need to communicate with the Commission. These have been developed and new provisions added by the Third Package. Many of the specific functions of NRAs in particular fields are discussed in the individual chapters devoted to these issues (see, eg, unbundling (Ch 3) and third party access (TPA) (Ch 4)), while the potential role of NRAs under other EU energy legislation is also addressed (see Part III on security of supply). Here, we will lay out the general framework concerning NRAs under the Third Package.

(1) A single regulatory authority

5.03 The Third Package makes clear that '[e]ach Member State shall designate a single national regulatory authority at national level' (Articles 35(1) (Elec)[1] and 39(1) (Gas)[2]); this is a change from the Second Package, under which it was possible for Member States to spread the competences and tasks of energy regulation at national level across one or more bodies (eg an energy regulator, a government ministry, a national competition authority). Previously, a number of Member States had reserved tariff decisions and some other matters to government ministries; the new provisions on the independence of NRAs would also create problems for such an approach to core NRA functions today: this will be discussed shortly. Nothing in the Third Package prevents this single NRA from remaining an entity made up of several bodies (for example a director, a board, and a secretariat) with different decision-making responsibilities. However, in its Interpretive Note on the regulatory authorities,[3] the Commission emphasizes that 'such structures all need to be integrally part of the single [NRA] entrusted with the duties and powers listed

[1] Third Electricity IEM Directive 2009/72/EC [2009] OJ L211/55.
[2] Third Gas IEM Directive 2009/73/EC [2009] OJ L211/94.
[3] Commission Staff Working Paper: Interpretive Note on Directive 2009/72/EC Concerning Common Rules for the Internal Market in Electricity and Directive 2009/73/EC Concerning Common Rules for the Internal Market in Natural Gas: The Regulatory Authorities (Brussels, 22 January 2010) (hereafter, 'Interpretive Note: Regulatory Authorities'), 4.

in the [Third Package] Directives and Regulations and each of these bodies and structures must meet all the independence requirements [therein]' (on which see paras 5.06 ff).

5.04 However, the Third Package does make provision for two possible exceptions from this default position with regard to NRAs, insofar as regional regulatory authorities (Articles 35(2) (Elec) and 39(2) (Gas)) and small and isolated systems (Articles 35(3) (Elec) and 39(3) (Gas)) are concerned. With regard to regional authorities, '[p]aragraph 1 of this Article shall be without prejudice to the designation of other regulatory authorities at regional level within Member States': this is intended to accommodate those Member States whose federal or devolved structure divides such regulatory powers along sub-national regional lines. In the case of 'small systems on a geographically separate region', meanwhile, a Member State may 'by way of derogation from paragraph 1 of this Article' also designate a regional regulator where the consumption of that region in 2008 was less than 3 per cent of that Member State's total consumption (which in practice is likely to apply only to small islands). In both cases, however, there should be only one national representative for that Member State in the Agency for the Co-operation of Energy Regulators (ACER) (on which see paras 5.57 ff), so arrangements will have to be made at national level to designate that representative accordingly.

5.05 Exactly how far a Member State has discretion to allocate the tasks otherwise entrusted to the single NRA to such 'other' regulatory authorities is not entirely clear from the wording of these provisions. It has been suggested that the small and isolated systems may be given a fully-fledged regulator whose territorial scope is limited to that geographically separated area, while regional regulatory authorities might enjoy a wide range of those powers ordinarily granted to the single NRA, subject to competence in the last resort for that single NRA, particularly where the matters involved have a national (as opposed to purely regional) aspect.[4]

(2) Independence

5.06 The provisions on the independence of NRAs have been significantly strengthened by the Third Package, effectively resulting in a form of unbundling or ring-fencing of the duties of NRAs from all outside powers which might seek to direct or instruct them in their activities (see the reference in para 5.07 to the NRA being 'legally distinct and functionally independent'). These far-reaching provisions may have significant consequences, not just for national institutions, but also for the energy regulatory systems and practices of many Member States. They are closely connected with provisions concerning the *accountability* of NRAs for the performance of their duties (discussed at paras 5.36 ff).

[4] E Cabau, 'National Regulatory Authorities', in C Jones (gen. ed.), *EU Energy Law, Volume I: The Internal Energy Market—The Third Liberalisation Package* (3rd edn, Leuven: Claeys & Casteels, 2010), ch 6, 221–222.

5.07 **(a) The general principle:** Articles 35(4) (Elec) and 39(4) (Gas) provide that 'Member States shall guarantee the independence of the regulatory authority and shall ensure that it exercises its powers impartially and transparently'. To achieve this, each Member State is required in particular to ensure that, when carrying out its regulatory tasks,[5] its NRA:

> (a) is legally distinct and functionally independent from any other public or private entity;
> (b) ensures that its staff and the persons responsible for its management:
> (i) act independently from any market interest; and
> (ii) do not seek or take instructions from any government or other public or private entity . . . This requirement is without prejudice to close cooperation, as appropriate, with other relevant national authorities or to general policy guidelines issued by the government not related to the [NRA's] regulatory powers and duties. . . .[6]

5.08 Thus, both as an institution and in its personnel, the Member State must ensure the independence of its energy NRA. Institutionally, a NRA can no longer be a part of a national government department but is required to have a legally distinct status, ensuring that it can take its decisions in an autonomous manner. The Commission's Interpretive Note takes the view that this also precludes the sharing of offices and personnel between the NRA and government bodies (or, indeed, any private entity),[7] which bears a striking resemblance to the position with regard to unbundling (discussed in Ch 3).

5.09 The provisions concerning the NRA's staff and management are designed to prevent it from becoming beholden to particular outside influences, whether political or economic: in this way, the Commission hopes that the NRA will contribute to the creation of a 'stable and predictable investment climate' and will respect the requirement to take its decisions impartially (Interpretive Note, at p 6). It is noteworthy, however, that the Directive is less detailed in this area with regard to NRAs than in its provisions concerning the independence of the staff of the independent transmission operator (ITO) (see Article 19 in each of the Third IEM Directives, and our discussion at paras 3.56 ff).[8] Nevertheless, the Commission's Interpretive

[5] Defined as those 'conferred upon it by this Directive and related legislation', thus including other tasks under the Third IEM Directives relating to, eg TPA and unbundling, as well as other legislation such as the latest Electricity and Gas Regulations (eg their Art 3) and possibly also measures concerning Security of Supply and Carbon Capture and Storage (for discussion of the 'competent authority' to be designated under those provisions, see paras 10.43 ff and Ch 13.B.2 (esp para 13.39) respectively).

[6] Note also that this does not preclude judicial review or parliamentary supervision of the NRA's decisions or activities 'in accordance with the constitutional laws of the Member States (Recitals 34 (Elec) and 30 (Gas)).

[7] Interpretive Note: Regulatory Authorities (n 3), 6.

[8] eg there are no detailed provisions concerning time intervals between work in the private sector and then moving to the NRA or *vice versa*.

Note (at p 7) makes a range of suggestions concerning the more detailed implications of the general position laid down in Articles 35(4) (Elec) and 39(4) (Gas). Member States should develop national rules to protect such independence in the NRA's staff, preventing them from holding positions or investments in energy companies and requiring the NRA and the appointing authority to the NRA's Board to verify compliance with these requirements on a case-by-case basis. Further, the Commission has taken the view that dissuasive sanctions should be established at national level, to be imposed against anyone attempting to direct, instruct, or improperly influence the NRA in its decision-making.

5.10 One difficult issue under these provisions will concern the extent to which Member State governments remain free to develop their own national energy policy and require that the NRA contribute to meeting such policy goals. The Third IEM Directives specifically do not intend to prejudice the operation of such general government policy guidelines, insofar as they are compatible with the EU Treaties and legislation *and* where they do *not* relate to the NRA's powers and duties. Where national policy goals become rather specific, it may be difficult to adopt them without risking infringement of the rules on the independence of the NRA in the performance of the wide range of tasks with which it is entrusted under the Third IEM Directives.[9]

5.11 **(b) Safeguarding NRA independence:** Articles 35(5) (Elec) and 39(5) (Gas) of the Third IEM Directives also endeavour to protect the independence of the NRA in its activities. They require Member States to ensure that:

> (a) the [NRA] can take autonomous decisions, independently from any political body, and has separate annual budget allocations, with autonomy in the implementation of the allocated budget, and adequate human and financial resources to carry out its duties; and
> (b) the members of the board of the regulatory authority or, in the absence of a board, the regulatory authority's top management are appointed for a fixed term of five up to seven years, renewable once.
>
> In regard to point (b) . . . Member States shall ensure an appropriate rotation scheme for the board or the top management. [They] may be relieved from office during their term only if they no longer fulfil the conditions set out in this Article or have been guilty of misconduct under national law.

5.12 *(i) Autonomous and independent decision-making:* The Commission's Interpretive Note suggests (at p 9) that this autonomy has both an *ex ante* and an *ex post* aspect: the former requires the NRA to be left to take decisions without interference,

[9] See, eg, the UK's Transmission Access Review Process, and in particular, Department of Energy and Climate Change, 'Government Response to the technical consultation on the model for improving grid access' (27 July 2010), where it claimed to be laying down the 'strategic policy framework within which Ofgem will regulate the market' by requiring that certain costs relating to grid access be 'socialized' across all parties liable for use of system charges, rather than 'fixing or approving any specific methodology' (at 12 and 25).

without the need for prior approval or authorization (albeit within the goals of the national energy policy, provided that this is compatible with EU law); the latter 'means that the decisions of the NRA are immediately binding and directly applicable without the need for any formal or other approval or consent of another public authority or any other third parties', although they may be subject to judicial review or other independent appeal routes established at national level.

5.13 *(ii) Budget and financial resources:* The 'power of the purse' has been a key element in the independence and autonomy of public bodies throughout the ages, and with the expanding role attributed to NRAs by the Third Package, it was important to ensure that they were adequately resourced *and* that the tightening of the purse strings was not a threat which could be used by national governments to undermine the NRA's independence. At the same time, the Directives do not seek to prevent the operation of normal national parliamentary scrutiny of such budgets, as Recitals 34 (Elec) and 30 (Gas) acknowledge: national budgetary law and rules should provide the framework within which the rules on the NRA's budget allocation and implementation should be set under national law. Where that budget is part of the overall State budget, the Commission's Interpretive Note suggests (at p 9) that the allocation for the NRA must now clearly be separated from the general budget, to ensure that the allocation can be identified and assessed as adequate to allow the NRA to perform its functions. Once allocated, it is clear that the NRA shall have autonomy in implementing that budget and, in accordance with Articles 35(4)(b)(ii) (Elec) and 39(4)(b)(ii) (Gas) (discussed at paras 5.07 ff), it can neither seek or receive instructions on how it should be spent.

5.14 *(iii) Board/management appointment and term:* Fixed-term appointments aim to ensure that the senior positions in the NRA cannot be subjected to appointment and dismissal by political whim or displeasure, thus protecting the independence of the NRA and the autonomy of its decision-making processes over time. In its Interpretive Note (at p 11), the Commission stresses that 'the power of Member States to appoint members of the board of the NRA . . . should not result in any instruction being given concerning the regulatory powers and duties of the NRA'. This kind of political influence may be easier to criticize than to prove and weed out, however, in spite of the provisions on transparency.

5.15 **(c) Nature of the principle and provisions under the Directives:** It should also be emphasized that these provisions are not exhaustive of the requirement of the NRA's independence and should rather be seen as key elements which are required to be specified precisely in the Directives. The general requirement of independence may still catch other national arrangements and structures not explicitly addressed directly in these provisions.

(3) Objectives and general principles

5.16 **(a) General principles: transparency and impartiality:** As previously noted, Articles 35(4) (Elec) and 39(4) (Gas) provide that 'Member States shall . . . ensure that [the NRA] exercises its powers impartially and transparently'. Impartiality in decision-making is of course a core element in any scheme of regulation, aiming to ensure that decisions are taken in the general interest and based on objective criteria. In its Interpretive Note (at p 5), the Commission asserts that Member States must provide for dissuasive sanctions to be imposed where the impartiality rule is breached.

5.17 Transparency is increasingly viewed as a general principle of EU law,[10] and it is a key element of the balance struck by the Third Package with regard to the role of NRAs. On the one hand, they are granted wide-ranging new powers and responsibilities, and a firmly independent decision-making function; the *quid pro quo* for this is that their activities must be open to scrutiny, to ensure impartiality and accountability[11] to users of the system and to the national system's own structures of political responsibility. Thus, the rules for an NRA's decision-making and other procedures should be published, and information concerning the NRA, its organization, and structure should be made available to the public. The Commission also argues in its Interpretive Note (at p 5) that transparency requires consultation of stakeholders before key decisions are adopted, including publication of consultation documents, public hearings, and collation and publication of responses to such consultation, including reasons for how those responses were considered and taken into account. Final NRA decisions should also be made public, thus informing the public about the reasons for such decisions and showing the impartiality with which such decisions are taken. Similarly, such transparency should also extend to a report on how the budget allocated was in fact spent (Interpretive Note, at p 5), in coordination with the NRA's reporting duties (see Articles 37(1)(e) (Elec) and 41(1)(3) (Gas), discussed at para 5.38).

5.18 **(b) Objectives:** Under Articles 36 (Elec) and 40 (Gas) of the Third Package Directives, NRAs are provided with a series of general objectives. In the performance of its regulatory tasks under these Directives, the NRA is to take 'all reasonable measures . . . within the framework of their duties and powers' to pursue the following objectives:

(a) promoting, in close cooperation with [ACER], regulatory authorities of other Member States and the Commission, a competitive, secure and environmentally sustainable internal market in electricity/natural gas within the [EU], and effective market opening for all customers and suppliers in

[10] See, eg, Art 15 TFEU.
[11] On accountability of NRAs generally, see paras 5.36 ff.

the [EU], and ensuring appropriate conditions for the effective and reliable operation of electricity/gas networks, taking into account long-term objectives;

(b) developing competitive and properly functioning regional markets within the [EU] in view of the achievement of the objectives referred to in point (a);

(c) eliminating restrictions upon trade in electricity/natural gas between Member States, including developing appropriate cross-border transmission capacities to meet demand and enhancing the integration of national markets which may facilitate electricity/natural gas flows across the [EU];

(d) helping to achieve, in the most cost-effective way, the development of secure, reliable, and efficient non-discriminatory systems that are consumer-oriented, and promoting system adequacy and, in line with general energy policy objectives, energy efficiency as well as the integration of large- and small-scale production of electricity/gas from renewable energy sources and distributed generation/production in both transmission and distribution networks;

(e) facilitating access to the network for new generation/production capacity, in particular removing barriers that could prevent access for new market entrants and of electricity/gas from renewable energy sources;

(f) ensuring that system operators and system users are granted appropriate incentives, in both the short and the long term, to increase efficiencies in system performance and foster market integration;

(g) ensuring that customers benefit through the efficient functioning of their national market, promoting effective competition and helping to ensure consumer protection; and

(h) helping to achieve high standards of public service[12] in electricity supply/for natural gas, contributing to the protection of vulnerable customers and contributing to the compatibility of necessary data exchange processes for customer switching.

5.19 These objectives are neither a conferral of competence nor of specific powers, but so that (for example) they do not establish general competence in competition law enforcement or the pursuit of energy efficiency. In such areas, close consultation with other relevant national authorities is envisaged by the Third Package, to ensure the coordination of the activities of these different bodies in the overall pursuit of these general objectives: thus, any competences of the NRAs in these areas are also not exclusive in nature. While it would in theory be possible for a Member State to be in breach of the Third IEM Directives were an NRA to fail to take measures within its powers to achieve these objectives, in practice this would be difficult for the Commission to establish. It would have

[12] In the Third Electricity IEM Directive, 'universal and public service'.

to show that the measures not taken were: reasonable, within the NRA's powers and duties, and not an encroachment upon other authorities' competences.[13]

The specific duties and powers of NRAs are laid down in the subsequent provisions of the Third Package Directives, to which we now turn. **5.20**

(4) Duties and powers of NRAs

By contrast with the position under the Second Package Directives (where a list of duties was provided, but very few specific powers of NRAs were specified), the Third IEM Directives in Electricity and Gas make significant changes (Articles 37 (Elec) and 41 (Gas)). The NRA's duties have been expanded greatly, but it has also been laid down for the first time in EU-level legislation that a Member State must also grant its NRA significant powers to ensure that it is able to carry out its functions effectively. Both the duties and the powers listed under these Directives are a minimum harmonization list: Member States are free, insofar as this is compatible with EU law (eg concerning free movement or competition), to require NRAs to perform further duties and/or to confer greater powers upon them than required under the Third Package. **5.21**

The NRA's powers and duties relating to particular topics under the Third Package are addressed in the relevant specific chapters (in particular, on unbundling and the independent system operator (ISO) and ITO options (Articles 37(3) and (5) (Elec) and 41(3) and (5) (Gas), see Ch 3). The general provisions are discussed in the following sections. **5.22**

(a) Duties: Under the Third Electricity and Gas IEM Directives, Articles 37(1) and 41(1) (respectively) provide a long list (paragraphs (a) to (u) in both cases) of the minimum duties of the NRAs. In large part, these lists are identical for both electricity and gas, diverging in substance only where specific differences between the two require.[14] It is not helpful simply to reproduce the full list here and the reader is referred to the Directives themselves for full details; insofar as these duties relate to certain specific topics, they have been covered elsewhere in this volume (eg concerning: consumer protection, in Ch 7; unbundling in Ch 3; and TPA in Ch 4). In its Interpretive Note, the Commission divides these duties into 'core' and 'monitoring' duties, in part because it is possible for Member States to provide that the latter may be performed by a body other than the NRA (we will return to this point shortly). **5.23**

[13] Cabau (n 4), 229.

[14] Viz: in the Electricity Directive, paras (r), (s), and (t); and in the Gas Directive, paras (f), (n), (s), and (t).

5.24 *(i) Core duties:* The Commission considers the *core* NRA duties to be those which relate to:

- tariffs for access to transmission and distribution networks (including fixing or approving tariffs or methodologies for their calculation);
- unbundling (checking for cross-subsidies);
- general oversight of energy companies (ensuring compliance with the rules of EU law);
- consumer protection (ensuring effective enforcement of the Annex I measures (discussed in Ch 7) and access to consumption data); and
- implementation of, and compliance with, legally binding decisions of the Commission or ACER (Articles 37(1)(d) (Elec) and 41(1)(d) (Gas)).

5.25 Two of these categories are worthy of more detailed discussion, in line with their treatment in the Commission's Interpretive Note. The first concerns network tariffs, laid down in general in paragraph (1)(a) of the relevant Articles and developed in more detail in paragraphs (6) to (8) and (10) of each. Under paragraphs (6) and (7), the NRA is required to fix or approve both network tariffs/methodologies *and* the terms/methodologies for network access (including balancing services and cross-border infrastructures). These must be approved, set, and published 'sufficiently in advance of their entry into force'. This is a change from the Second Package, where it was still possible for Member States to require the NRA to submit such matters to another body (often the relevant government department) for final approval: now, this task must be performed by the NRA. In practice, the NRA will take such decisions on the basis of a proposal from the transmission system operator (TSO), distribution system operator (DSO), or liquefied natural gas (LNG) system operator, or a proposal agreed between any of them and their network users (see Recitals 36 (Elec) and 32 (Gas)).

5.26 In performing this tariff/methodology-setting function, the NRA 'shall ensure that transmission or distribution system operators are granted appropriate incentive, over both the short and long term, to increase efficiencies, foster market integration and security of supply and support the related research activities' (Articles 37(8) (Elec) and 41(8) (Gas)). This illustrates the need for the coordination of the NRA's work with that of ACER, since (for example) those research plans are submitted to ACER for its opinion.[15]

5.27 The second category, and another noteworthy innovation of the Third Package, is the conferral of a general competence upon NRAs to ensure compliance with EU law within their remit. Strictly, the Third IEM Directives refer to 'ensuring compliance of transmission and distribution system operators and, where relevant, system owners, as well as of any electricity/natural gas undertakings, with their obligations

[15] Interpretive Note: Regulatory Authorities (n 3), 14.

under this Directive and other relevant [EU] legislation, including as regards cross-border issues'. In its Interpretive Note, the Commission argues that (without prejudice to its own role in securing compliance with the TFEU) these provisions mean that 'the NRA has the power to ensure compliance with the entire sector-specific regulatory "*acquis communautaire*" relevant to the energy market, and this vis-à-vis not only the TSOs but any electricity or gas undertaking' (at p 15). One uncertainty which this interpretation might create concerns whether this NRA enforcement role extends to the enforcement of the free movement rules[16] of the TFEU, as well as the specific provisions of the EU's energy legislative oeuvre: at the very least, the NRA would clearly be under an obligation not to take decisions which might place its Member State in breach of the free movement rules. The further possible implications of TFEU free movement law are dependent upon the extent to which those provisions are applicable to the relevant actors in the energy sector, since a degree of uncertainty remains as to the horizontally directly effective nature of those provisions under EU law. This means that the status of the relevant energy undertaking (a private party or a 'State body')[17] may determine the extent to which it might be subject to the free movement rules under the TFEU. Of course, insofar as the EU's energy legislation has already harmonized many such issues concerning imports, exports, and the provision of services, that legislation would apply in any case and would clearly fall within the role of the NRAs under Articles 37 and 41 of the Third Package Directives.

5.28 *(ii) Monitoring duties:* The Third Package Directives also contain a long list of *monitoring* duties which Member States must ensure are performed within their national systems. These cover a wide range of activities and issues, which generally concern infrastructure and network access, market monitoring and assessing the development of competition, and checking the application and enforcement of consumer protection measures. However, by virtue of the first sub-paragraph of Articles 37(2) (Elec) and 41(2) (Gas), it is open to Member States to entrust these monitoring functions to a body other than the NRA, although 'in such a case, the information resulting from such monitoring shall be made available to the [NRA] as soon as possible'. If it does not so specify, the presumption is that these tasks are also to be performed by the NRA.

5.29 In its Interpretive Note, the Commission is at pains to stress that this covers *all* monitoring information, not just a final report or summary, and should thus include confidential information collected. Indeed, the Commission goes so far as to argue

[16] Clearly, with regard to EU (and national) competition law, the NRA's role will function in coordination with the pre-existing competences under EU and national law: see Arts 37(2) (Elec) and 41(2) (Gas), third sub-paragraph, where it is emphasized that 'approvals given by the [NRA] are without prejudice to . . . any penalties imposed by other relevant authorities or the Commission' (and see also the second sub-paragraph of these Articles concerning cooperation with other national authorities).

[17] Case C-188/89 *Foster v British Gas* [1990] ECR I-3313.

that 'a Member State has to guarantee that the NRA has specific access to all data resulting from the monitoring exercise' (Interpretive Note, at p 15). Indeed, many of the NRA's core tasks would be difficult, if not impossible, to perform effectively without access to much of such monitoring data: how, for example, would the NRA be able to scrutinize whether any cross-subsidization was taking place between different levels of a vertically integrated energy undertaking (under Articles 37(1)(f) (Elec) and 41(1)(f) (Gas) respectively) in the absence of data concerning wholesale and resale prices (which is to be monitored according to paragraphs (i) and (j) of the same Articles 37(1) and 41(1))? In addition, the Commission suggests that, even if another body is entrusted with these monitoring functions, it is still open to the NRA to conduct its own monitoring activities, as part of the performance of its own irreducible core functions (Interpretive Note, at p 16): this would garner much of the information for the NRA itself, although a preferable approach might involve organized cooperation and information exchange between the NRA and the separate monitoring body.

5.30 *(iii) Cross-border issues:* The NRAs are also expected to play a vital role in developing cross-border cooperation and trade between Member States: the Third Package Directives are, after all, concerned with the development of an Internal Energy Market in the EU. One aspect of this cooperation is now embodied in the ACER (discussed at paras 5.57 ff); another set of NRA duties is laid down by Articles 38 (Elec) and 42 (Gas). They require the NRAs '[to] closely consult and cooperate with each other, and . . . provide each other and the [ACER] with any information necessary for the fulfilment of their tasks under' the Third IEM Directives; any NRA receiving such information is to ensure the same level of confidentiality with regard to that information as is required of the originating NRA (paragraph 1 of those Articles). This general obligation is augmented by paragraph 2, which lays down specific obligations of inter-NRA cooperation at least at a regional level,[18] in order to:

(a) foster the creation of operational arrangements in order to:
   - enable optimal management of the network,
   - promote joint electricity exchanges and the allocation of cross-border capacity, and
   - enable an adequate level of interconnection capacity, including through new interconnectors within the region and between the regions, to allow for development of effective competition and improvement of security of supply, without discriminating between supply undertakings in different Member States;

[18] In light of the experiences under the so-called 'mini-fora' conducted under the auspices of the Florence and Madrid Fora (on which see paras 5.42 ff), which launched Regional Initiatives in 2006 as a means to move away from separate national energy markets towards greater cross-border trade and integration. For discussion, see F Gräper and C Schoser, 'The Establishment of Common Network Rules', in C Jones (gen ed), *EU Energy Law, Volume I: The Internal Energy Market—The Third Liberalisation Package* (3rd edn, Leuven: Claeys-Casteels, 2010), Ch 12, 532–534.

(b) coordinate the development of all network codes for the relevant TSOs and other market actors; and
(c) coordinate the development of rules governing the management of congestion.

Paragraph 3 confirms that NRAs must be given the right to enter into cooperative arrangements with each other to foster such regulatory cooperation, while paragraph 4 reminds NRAs to carry out the specific activities in paragraph 2 'in close consultation with other relevant national authorities and without prejudice to their specific competences'. Finally, under paragraph 5 the Commission is empowered to adopt guidelines on these NRA duties of cooperation *inter se* and/or with ACER: such measures would be adopted following the comitology procedure known as the regulatory procedure with scrutiny (as referred to in Articles 46(2) (Elec) and 51(3) (Gas)). **5.31**

(b) Powers: The Third Package Directives, in Article 37(4) (Elec) and Article 41(4) (Gas) lay down a series of specific powers which Member States must ensure are given to their NRAs. The list is the minimum which must be granted to NRAs, to which Member States may add if they wish. These powers, in essentially identical terms for both electricity and gas, are intended to enable the NRAs to carry out their 'duties' (discussed in paras 5.23 ff) 'in an efficient and expeditious manner', and involve: **5.32**

(a) issuing binding decisions to undertakings;
(b) carrying out investigations[19] into the functioning of the electricity/gas markets, and imposing any necessary and proportionate measures[20] to promote effective competition and ensure the proper functioning of the market (liaising with NCAs, financial regulators, and the Commission where appropriate in conducting investigations relating to competition law);
(c) requiring information from undertakings where relevant to fulfilling the NRA's tasks (including justifications for refusal to allow TPA and measures necessary to reinforce the network);
(d) imposing effective, proportionate, and dissuasive penalties on undertakings not complying with their obligations under the Directives or any relevant legally binding decisions of the NRA or ACER,[21] or to propose that a

[19] Which the Commission views as a law enforcement power, including the correlative powers to carry out inspections on the premises of electricity and gas undertakings (Interpretive Note (n 3), 17). This raises questions about procedural safeguards under such circumstances, perhaps relying upon provisions already present in national law for NCAs with regard to competition investigations.

[20] Which can include virtual power plants or gas release programmes (Recitals 37 (Elec) and 33 (Gas)), but (according to the Commission's Interpretive Note (n 3), 17) other measures could be envisaged, including gas capacity and storage capacity release programmes, and requiring a TSO to make certain investments (Interpretive Note: Regulatory Authorities (n 3), 18).

[21] Which will, in time, include compliance with the network codes adopted through the EU-level comitology procedure, as well as the guidelines adopted by the Commission on the advice of ACER (since the latter has no enforcement powers of its own and will have to rely upon NRAs in this regard).

competent court impose such penalties. This includes the power to impose penalties for non-compliance with the obligations under the Third IEM Directives upon the TSO of up to 10 per cent of the TSO's annual turnover; or upon a vertically integrated undertaking of up to 10 per cent of its annual turnover;[22] and

(e) granting the NRA appropriate rights of investigation and powers of instructions for dispute settlement (on which see Articles 37(11) and (12) (Elec) and 41(11) and (12) (Gas)).

5.33 Perhaps most noteworthy among this list are the enforcement teeth provided to the NRA's role by paragraphs (b) and (d). Both will raise questions for the implementing Member State with regard to procedural protections for undertakings potentially subject to such sanctions: the model developed and much tested under the EU and national competition law regimes may provide useful guidance in this regard.[23] We should also note the NRA's role as a dispute settlement body under Articles 37(11) (Elec) and 41(11) (Gas), where a third party has a complaint against a TSO or DSO's performance of its obligations under the Third IEM Directives. The NRA is to issue a decision within two months of receipt of the complaint (unless the NRA seeks further information (when a two-month extension applies, or further where the complainant agrees to an extension)). Once issued, that decision is binding unless and until overruled on appeal (on which see Articles 37(15) to (17) (Elec) and 41(15) to (17) (Gas), discussed at para 5.40).

5.34 In the original Commission proposal for the Third Package Directives,[24] a power was also included for the NRAs to contribute to ensuring high standards of universal and public service, but this was relegated to recitals in the final version (see Recitals 37 (Elec) and 33 (Gas)). It has been suggested[25] that there is thus no *obligation* on Member States to grant such a power to NRAs, but rather that NRAs must contribute to those goals within the framework of its other powers (as listed in paras 5.32 ff).

5.35 In addition to these powers, the NRA has a key role under the Third Package Directives (Articles 40 (Elec) and 44 (Gas)) in record-keeping and the exchange of information with regard to the supply market, to promote transparency and market integrity in energy trading. This information concerns 'all transactions in electricity/gas supply contracts and electricity/gas derivatives with wholesale customers and transmission system operators [as well as storage and LNG operators]' (paragraph (1) of each Article).[26] Under paragraph 3 of the same Articles, the NRA

[22] These thresholds come from those applicable under EU competition law.
[23] For discussion, see (eg) R Whish & D Bailey, *Competition Law* (7th edn, Oxford: OUP, 2012).
[24] COM(2007) 530.
[25] Cabau (n 4), 243.
[26] This data is to include details on the characteristics of such transactions: duration, delivery and settlement rules, quantity, dates and times of execution, transaction process, and means of identifying the customer, as well as all unsettled contracts and derivatives (para 2 of the relevant Articles).

may decide to release this data to market participants, after duly addressing any difficulties raised by commercially sensitive information contained therein.

(5) Accountability, appeal, and review

5.36 The concomitant of the significantly increased role, responsibilities and powers of the NRAs under the Third Package is the need to provide carefully for NRAs' accountability[27] for the performance of their functions.

5.37 **(a) Political/institutional aspects:** The obligation imposed upon NRAs to perform their functions in a transparent manner has been discussed previously (paras 5.16 ff), and is an important component of ensuring the accountability of the NRA, including publication of information and decisions with reasons for action taken,[28] consultation, and reporting on how it has spent its budget each year.

5.38 More generally, the Third IEM Directives impose reporting obligations on the NRAs. Under Articles 37(1)(e) (Elec) and 41(1)(e) (Gas), the NRA must report 'annually on its activity and the fulfilment of its duties to the relevant authorities of the Member States, the [ACER] and the Commission. Such reports shall cover the steps taken and the results obtained as regards each of the tasks listed' in those Articles (as discussed). Although not expressly laid down in those paragraphs, the Commission has indicated that such reports should be published, due to the NRA's transparency obligations (Interpretive Note, at 19).

5.39 **(b) Legal aspects:** The NRAs' new powers and function also make it vital that their decisions are amenable to appeal and/or review before an independent court or other tribunal. On the specific issue of NRA decisions concerning tariffs/methodologies, Articles 37(12) (Elec) and 41(12) (Gas) provide that 'any party who is affected and who has a right to complain . . . may submit a complaint for review. Such a complaint shall not have suspensive [*sic*] effect'. This rather limited provision aims to ensure that, where a Member State does provide for such a review, its effects should not be disruptive to the introduction of the relevant tariff/methodology decision (by implementing relatively short time limits of two months from publication and preventing such review from suspending the application of that decision). It does not oblige Member States to introduce such a review procedure.[29]

5.40 Articles 37(15) to (17) (Elec) and 41(15) to (17) (Gas) lay down a general 'right of appeal' against NRA decisions. The specific procedures laid down in paragraphs

[27] In its Interpretive Note: Regulatory Authorities, the Commission emphasizes (at 20) the link between independence and accountability, and suggests that various actions might be taken at national level to increase parliamentary scrutiny of NRAs, including hearings in connection with NRA budget discussions or appointment of board/management personnel, and the submission of a draft NRA work programme to the national Parliament.
[28] See also Arts 37(16) (Elec) and 41(16) (Gas), discussed at para 5.40.
[29] Cabau (n 4), 250.

11 and 12 of each of these Articles (as discussed) are 'without prejudice to the exercise of rights of appeal under [EU] or national law' (paragraph 15 of both Articles). Paragraph 16 reinforces the points already made concerning transparency and the giving of reasons: 'Decisions taken by [NRAs] shall be fully reasoned and justified to allow for judicial review. The decisions shall be available to the public while preserving the confidentiality of commercially sensitive information.' Then, in paragraph 17, the Directives establish a right of appeal: 'Member States shall ensure that suitable[30] mechanisms exist at national level under which a party affected by a decision of [an NRA] has a right of appeal to a body independent of the parties involved and of any government.' The combination of the terms 'review' and 'appeal' under this set of provisions may cause certain difficulties for some Member States where notions of review are of a more limited nature than a full appeal on the merits. Further, the notion of 'a party affected by a decision' seems, in principle, to be broader than simply the addressee of a given NRA decision, which may require some national systems to extend their appeal/review systems to include challenges to NRA decisions by third parties as well.[31]

5.41 Finally, the NRAs are also subjected to a review procedure to check their compliance with EU-level Guidelines: under Articles 39(1) (Elec) and 43(1) (Gas), an NRA or the Commission may request the opinion of ACER as to whether another NRA has acted in compliance with the various Guidelines which the Commission is empowered to adopt under the Third IEM Directives and Regulations, and the ACER Regulation. ACER's opinion is to be adopted within three months (paragraph 2) and, while not binding on the NRA, is likely to carry significant weight and thus may often be complied with by that NRA without the need for further formal steps. The Commission may subsequently decide to examine the matter further (paragraph 5) and may ultimately require the relevant NRA to withdraw its decision where it does not comply with the Guidelines (paragraph 6(b)): in such a case, the NRA is obliged to comply with the Commission's decision within two months of its adoption (paragraph 8). The Commission is empowered by paragraph 9 of these Articles to adopt Guidelines setting out the procedure to be followed under this review procedure, which again must be adopted following the regulatory procedure with scrutiny under the comitology rules.

[30] In its Interpretive Note, the Commission suggests that this 'suitability' requirement may mean that particular procedures should be adopted by Member States to address certain situations: eg rapid court procedures to deal with urgent situations.

[31] See, in the UK, Ofgem, 'Consultation Paper: Regulating Energy Networks for the Future: RPI-X@20 Emerging Thinking—Third party right to challenge our final price control decisions' (January 2010) and Department of Energy and Climate Change, 'Implementation of the EU Third Package—Decision Paper' (December 2010), adding a dedicated consumer body to the list of potential holders of the right to challenge Ofgem decisions.

(6) Regulation on energy market integrity and transparency

The Commission proposals[32] on energy market integrity and transparency have now led to the adoption on 10 October 2011 of Regulation 1227/2011/EU on wholesale energy market integrity and transparency (often known as 'REMIT').[33] The provisions of this new measure are certainly likely to present challenges for the NRAs, both in their sole capacity but also as a hybrid with national financial regulatory bodies and with national competition authorities (NCAs), at both the Member State and the EU level. **5.42**

At Union level, NRAs are expected to work with each other and with ACER,[34] informing ACER of any contraventions of the Regulation.[35] Even though primary responsibility for this task is attributed to ACER, under the Commission proposals it was envisaged that the NRAs will have an extensive role in ensuring efficient market monitoring,[36] and this is confirmed by the final text of the Regulation.[37] Whilst the Regulation envisages a strong degree of cooperation between the NRAs and ACER (see Articles 1(1) and (3), 7 to 10, and 16), the latter's powers to request NRAs to supply information and to commence investigations in respect of suspected breaches (see Article 16(4)) may create a challenging hierarchical structure for NRAs. In addition, efficient market monitoring may not only entail a potentially substantial strain on available resources, but may also involve NRAs in activities where they have minimal expertise to date. This may be alleviated (or indeed exacerbated) by the acknowledgment that NCAs[38] and other more general market monitoring bodies (see the 'competent financial authority' referred to in Article 2(9)) may also be part of the overall monitoring framework. Further, such monitoring is also likely to prove particularly difficult where trading activities and related investigations on market abuse encompass a number of jurisdictions: as energy markets (and related transactions) begin to spread across national borders, the need for intensive coordination between NRAs (and other relevant bodies) may increase significantly. **5.43**

Furthermore, under the Regulation, the NRAs have responsibility for ensuring that the prohibitions on insider trading and market manipulation are respected and are therefore seen as being vital to the effective enforcement of the Regulation **5.44**

[32] COM(2010) 726 (8 December 2010) available at: <http://ec.europa.eu/energy/gas_electricity/markets/doc/com_2010_0726_en.pdf>.

[33] [2011] OJ L326/1 (8 December 2011); it entered into force on 28 December 2011 (by virtue of its Art 22).

[34] ACER was established under Regulation 713/2009/EC of the European Council and of the Parliament of 13 July 2009, establishing an Agency for the Co-operation of Energy Regulators, [2009] OJ 211/1 (14 August 2009). See our discussion on ACER at paras 5.58 ff.

[35] Art 11 of the Commission proposal; Art 16 of the Regulation.

[36] Recital 13 and Art 6 of the Commission proposal.

[37] See Art 7 of the Regulation.

[38] See Arts 7(2) and (3), 10(1), 12(1), 16(1) and (3) of the Regulation.

across the Member States.[39] This task may again prove testing for the NRAs: as acknowledged in the Commission's Impact Assessment accompanying the proposal for the Regulation, an 'energy-specific meaning of insider information or market manipulation' remains to be 'practically established'.[40] The Regulation endeavours to provide relatively detailed definitions of these terms (see Article 2(1), (2), and (3)), and the Commission proposals[41] and the final text of the Regulation envisage that the NRAs should have wide-ranging investigatory powers for the exercise of this role, such as the right to carry out on-site inspections and request a court to impose the temporary prohibition of a professional activity.[42] Thus, for instance, the European Economic and Social Committee has observed that the powers conferred on the NRAs are 'both comprehensive and penetrating'; at the same time, however, it has emphasized the need 'for greater certainty of enforcement of the regulation in this area', suggesting the possibility of permitting only 'a relatively short period for Member States to fulfil their obligation to guarantee that the authorities are granted these powers of investigation'.[43]

5.45 A certain degree of useful guidance may perhaps be found in the current framework of the Market Abuse Directive (MAD).[44] Indeed, the Commission itself—whose proposals for a Regulation were based on the advice of the Committee of European Securities Regulators (CESR) and the European Regulators Group for Electricity and Gas (ERGEG) on the need for a tailored market abuse regime for energy sector products not covered by the MAD—has stressed the important links between the two legislative initiatives.[45] It should be noted, however, that the MAD is itself under review: the Commission adopted legislative proposals on the revision of the MAD on 20 October 2011,[46] and that, in particular, the specific definition of 'inside information' used in relation to commodity derivatives has already come under scrutiny. An added layer of difficulty for NRAs in this regard may be provided by the expectation that they will also need to interact

[39] Art 13 of the Regulation.
[40] COM(2010) 726, at 21.
[41] Art 10 and Recital 19 of the Commission proposal.
[42] Art 13(2) of the Regulation.
[43] Opinion of the European Economic and Social Committee on the 'Proposal for a regulation of the European Parliament and of the Council on energy market integrity and transparency', para 5.4.
[44] Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation, [2003] OJ L 96/16 (12 April 2003).
[45] CESR and ERGEG advice to the European Commission in the context of the Third Energy Package (CESR/08-527, CESR/08-739, CESR/08-998), presented to the Commission in October 2008–January 2009.
[46] See Commission proposal for a Regulation of the European Parliament and of the Council on insider dealing and market manipulation (COM(2011) 651) and Commission Proposal for a Directive of the European Parliament and of the Council on criminal sanctions for insider dealing and market manipulation (COM(2011) 654) (both 20 October 2011). For the relevant documentation and developments, see <http://ec.europa.eu/internal_market/securities/abuse/index_en.htm>.

closely with competent financial authorities to deal in a coordinated manner with market abuse on wholesale energy markets, including both commodity and derivatives markets.[47]

5.46 The Commission proposals also referred to the possibility of adopting delegated acts clarifying further the legislative framework put forward, which may entail a number of additional latent duties and challenges for NRAs. The final text of the Regulation (while adding some detail on such delegated rule-making) retained this possibility: see Articles 6, 8(2) and (6),[48] and 20 of the Regulation.

5.47 At the same time, however, the Commission stressed the need to respect subsidiarity and highlighted the centrality of NRAs to the anticipated legislation. Indeed, in the Explanatory Memorandum to the proposal for a Regulation, the Commission explained that NRAs and other Member State authorities, such as financial regulators and competition authorities, have a direct interest in the market results in the wholesale energy markets sector and can contribute an indispensable understanding of the various markets across the Member States.[49] These roles were retained, and indeed that of the NCAs enhanced, in the final text of the Regulation. Thus, there will clearly be a wide range of cooperation and coordination issues for NRAs under this Regulation, at the national level, between Member States, and with ACER at the EU level.

C. European Bodies (Florence and Madrid Fora, and ACER)

(1) Introduction

5.48 Cooperation at the European level is the cornerstone of the development of sound, effective, and interconnected internal markets for electricity and gas. Such cooperation was launched as early as the end of the 1990s with the work of the Florence and Madrid Fora.

5.49 Following the adoption of the Third Energy Package, cooperation at the European level has been strengthened further with the creation of the ACER, as well as the European Network of Transmission System Operators for Electricity (ENTSO-E) and the European Network of Transmission System Operators for Gas (ENTSO-G).

[47] Recital 21 of the Commission proposal.
[48] NB the Commission and Council have attached conflicting 'Statements' to the official text of the Regulation concerning the exercise of such Commission delegated/implementing powers under Art 8(2)(a) and 8(6)(a): the Commission considers that such matters could only be addressed by legislative measures, while the Council is adamant that the text of the Regulation specifically requires the Commission to adopt such implementing acts and that this is a 'legally binding' obligation: see [2011] OJ L326/1, at L326/16.
[49] Explanatory Memorandum to the proposed Regulation, para 4.3.3.

(2) Cooperation within the Florence and Madrid Fora

5.50 Shortly after the adoption of the first electricity and gas Directives, in 1996 and 1998 respectively, two Fora were created to provide a neutral and informal EU-level framework for discussing issues and exchanging experiences concerning the establishment of competitive internal markets for electricity and natural gas. The Forum dedicated to the electricity first met on 5 and 6 February 1998 in Florence, Italy, and accordingly became known as the 'Florence Forum'. For gas, the Forum is known as the 'Madrid Forum' following its first meeting in Madrid, Spain, on 30 September and 1 October 1999.[50]

5.51 These Fora were created to provide the necessary technical and practical details for the implementation of the harmonized rules adopted at the European level 'to achieve the basic goal of an effectively functioning single market',[51] such rules being, in accordance with the subsidiarity principle, limited to the general framework and principles for the introduction of competition in the electricity and natural gas markets.

5.52 In order to reach an overall consensus over such technical and practical details, the Florence and Madrid Fora aimed at gathering all parties involved in the process of the liberalization of the electricity and gas markets: governments, the European Commission, national regulators, TSOs, electricity and gas traders, industry, consumers, network users, and power exchanges. Such wide-ranging participation allowed the Fora to become a platform for informal discussions, open exchange of experiences, and benchmarking.

5.53 Since their creation, the Florence and Madrid Fora have usually met twice a year. They have focused on issues related to the cross-border trade of electricity and gas.

5.54 The Florence Forum notably addressed questions linked to the setting of tariffs for cross-border electricity trade, the management of scarce interconnection capacity and the implementation of Inter-TSO compensation mechanism. This latter mechanism provides for the compensation of electricity TSOs for the costs they incurred while hosting cross-border flows on their grids.[52]

5.55 The Madrid Forum has examined, among other issues, the tariff-setting methodologies for cross-border gas trade, the allocation and management of scarce

[50] For discussion of the operation of these Fora up to 2004, see B Eberlein, 'Regulation by Co-operation: the "Third Way" in Making Rules for the Internal Energy Market', in PD Cameron (ed), *Legal Aspects of EU Energy Regulation: Implementing the New Directives on Electricity and Gas Across Europe* (OUP, 2005), ch 4. More recently, see PD Cameron, *Competition in Energy Markets: Law and Regulation in the European Union* (2nd edn, OUP, 2007), ch 2, esp. paras 3.12–3.39.

[51] Minutes of the 1st European Gas Regulatory Forum, Madrid, 30 September and 1 October 1999.

[52] The documentation concerning the work of the Florence Forum may be found at <http://ec.europa.eu/energy/gas_electricity/electricity/forum_electricity_florence_en.htm>.

interconnection capacity, and other technical and commercial barriers to the creation of a fully operational internal gas market.[53]

5.56 Following the adoption of the Third Energy Package, the Florence and Madrid Fora remain major actors in promoting and facilitating the progress of the electricity and natural gas markets, ensuring the incorporation of the benefits of experience directly from the sector. Gathering all stakeholders involved in the electricity and gas markets, the Florence and Madrid Fora will continue to meet after the establishment of the ACER, ENTSO-E, and ENTSO-G. The last/most recent meetings of these Fora, respectively on 23 and 24 March 2011 for the Florence Forum and on 21 and 22 March 2011 for the Madrid Forum, accordingly focused on the preparation of the work of the ACER, ENTSO-E, and ENTSO-G.

(3) Cooperation within ACER, ENTSO-E, and ENTSO-G

5.57 During the negotiations which led to the adoption of the Third Energy Package, it appeared necessary to reinforce cooperation between Member States, particularly at the level of the NRAs and of the TSOs, to remove the remaining obstacles to cross-border trade in electricity and natural gas and achieve the objectives pursued by the EU's Energy Policy. Cooperation at the European level was thus officially institutionalized with the creation of three new entities: ACER, ENTSO-E, and ENTSO-G.

5.58 **(a) The Agency for Co-operation of Energy Regulators (ACER):** The creation of ACER aims to fill a regulatory gap at EU level and to contribute towards the effective functioning of the internal markets in electricity and gas. It was established by Regulation 713/2009/EC[54] ('the ACER Regulation') with the mission to assist NRAs in exercising, at EU level, the regulatory tasks which they perform in the Member States and, where necessary, to coordinate their action.

5.59 A detailed description of ACER and its internal structure and functioning will not be provided here.[55] However, certain key aspects of ACER and its role, tasks, and powers should be highlighted. First, a full grasp of ACER's functioning cannot be acquired simply by reading the ACER Regulation, because various functions and powers are also included in the other legislative instruments of the Third Package (in particular the Electricity[56] and Gas[57] Regulations and the Third Electricity and Gas IEM Directives) and there are regular cross-references between those instruments in that regard.

[53] Documentation on the work of the Madrid Forum may be found at <http://ec.europa.eu/energy/gas_electricity/gas/forum_gas_madrid_en.htm>.

[54] [2009] OJ L211/1.

[55] For details, see F Ermacora, 'The Agency for the Co-operation of Energy Regulators (ACER)', ch 7 in C Jones (gen ed) (n 4), esp 295–326.

[56] Regulation 714/2009/EC [2009] OJ L211/15.

[57] Regulation 715/2009/EC [2009] OJ L211/36.

5.60 ACER has a range of tasks with regard to TSOs and networks, including a key role in the development of network codes and development plans, as well as monitoring functions: these are highlighted at paras 5.67 ff in the context of cooperation at the EU level. A range of functions has also been entrusted to ACER vis-à-vis NRAs: it may make recommendations to NRAs and market actors to assist them in sharing good practices and is to provide a framework within which NRAs can cooperate with each other (Article 7 of the ACER Regulation). Linked to this is the power of ACER (Article 5 of the Third Electricity IEM Directive) to make recommendations concerning the compatibility of technical safety criteria and rules between Member States, to ensure interoperability between and non-discrimination by national systems. ACER is also charged with certain monitoring functions concerning NRAs: NRAs may request ACER to provide an opinion on whether that NRA (Article 7 of the ACER Regulation) or any other NRA (Third IEM Directives: Articles 39 (Electricity) and 43 (Gas)) has complied with the Third Package legislation and Guidelines adopted thereunder. Failure of the NRA in question to comply with ACER's opinion (which is to be issued within three months) under these provisions will lead to ACER informing the Commission of the matter, whereupon the Commission may decide to initiate enforcement proceedings under the TFEU. Under Article 3(1) of the Electricity and Gas Regulations, ACER may also be required by the Commission to issue an opinion on the certification of TSOs (under Article 10(6) of the Third IEM Directives) in connection with the implementation of the unbundling requirements (as discussed in Ch 3 at paras 3.99 ff).

5.61 In its relationship with NRAs, ACER has also been endowed with the power to adopt binding decisions on certain issues. Under Article 8 of the ACER Regulation, ACER is empowered to adopt decisions concerning cross-border infrastructure (including access thereto and its operational security) *only* where the relevant NRAs have been unable to reach agreement on such matters or where such NRAs jointly request ACER to do so. That provision also lays down the minimum content of such access conditions (Article 8(2)) and procedural rules on the roles of ACER and the Commission thereunder. It has been argued[58] that an agreement between NRAs to disagree is not sufficient 'agreement' to exclude ACER's powers under Article 8, although this is not explicit in its provisions. A similar fall-back role is laid down in Article 9(1) of the ACER Regulation, in conjunction with Article 17(5) of the Electricity Regulation and Article 36(4) of the Third Gas IEM Directive concerning the exemption of new infrastructure from the normal regulatory regime of the Third Package.[59]

5.62 Given this ability of ACER to adopt decisions which may have legal effects upon individuals and NRAs, it was necessary to create provisions which address appeals

[58] Ermacora (n 55), at 286.
[59] For details, see Ermacora (n 55), 288–289.

against ACER's decisions. A Board of Appeal was thus created by Article 18 of the ACER Regulation, comprised of members of current or former senior staff of NRAs, appointed by ACER's Administrative Board (Article 12) on a proposal from the Commission. The Board takes decisions on the basis of a majority of four out of its six members, who must act independently at all times and who may not perform other functions within ACER while serving on that Board. Article 19 of the ACER Regulation lays down the Appeals procedure for challenging ACER decisions under Articles 7, 8, or 9 of the ACER Regulation:[60] it may be invoked by any natural or legal person, including the NRAs, where they are the addressee of the ACER decision or are directly and individually concerned by it (Article 19(1)). In turn, such appellate decisions may be challenged before the General Court under Article 263 TFEU; similarly, ACER may be subject to an action for failure to act under Article 265 TFEU.

5.63 Under Article 5 of the ACER Regulation, ACER may also perform a general advisory role to the EU's institutions at the request of the European Parliament, Council of Commission, or on its own initiative, ACER may provide an opinion or recommendation 'on any of the issues relating to the purpose for which it was established'. It is also, under Article 11 of the ACER Regulation, to perform a general monitoring and reporting role with regard to the internal markets in electricity and gas, providing a public annual report, including identifying any barriers to the completion of the internal market and possible proposals for addressing those difficulties. This role is to be conducted in close cooperation with energy NRAs and is 'without prejudice to the competences of competition authorities' (Article 11(1)).

5.64 ACER's various explicit tasks must also be performed with an eye to the goals of Trans-European Energy Networks (on which see Ch 6) and the enhancement of energy security (Recitals 14 and 15 to the ACER Regulation), even though ACER has not been given any specific functions or powers in relation to these issues.

5.65 Given the Third Package's appreciation of the need for increased cooperation between the EU and third countries, it is consistent that the ACER Regulation also provides for third country participation in the work of ACER, under its Article 31, where those third countries have entered into agreements with the EU which require them to apply EU law in the energy field and, where relevant, environmental and competition law provisions as well.

5.66 Finally, Article 34 of the ACER Regulation provides for the Commission to conduct a review of the operation of ACER (within three years[61] of the first Director of ACER taking up his duties),[62] assessing the results it has achieved and the working

[60] Art 20 acknowledges that recourse may be had to the General Court under Art 263 TFEU to challenge ACER measures not covered by the Art 19 appellate procedure.
[61] And at least every four years thereafter (Art 34(1)).
[62] Art 34(3); the first Director is Alberto Pototschnig, who began work on 3 March 2011.

methods employed. That evaluation will be submitted to the ACER's Board of Regulators, which is to issue recommendations concerning possible changes to the ACER Regulation, ACER itself, and its operation (Article 34(2)). The Commission may forward these, along with its own proposals, to the European Parliament and the Council.

5.67 **(b) The European Networks of Transmission System Operators:** ENTSO-E was established by Regulation 714/2009/EC[63] with the purpose of ensuring cooperation at EU level between electricity TSOs, thereby promoting the completion and functioning of the internal market. ENTSO-G was created by Regulation 715/2009/EC[64] with the same purpose for the natural gas market.

5.68 **(c) Cooperation concerning networks: codes, guidelines, and development plans:** The main work of ACER, ENTSO-E, and ENTSO-G is to adopt the necessary network codes and plans for the development of fully and efficient interconnected European markets in electricity and gas. The adoption of network codes is intended to provide the necessary technical rules to ensure non-discrimination, effective competition, and the efficient functioning of the market. In particular, these codes are to cover issues such as: network connection rules; third-party access rules; balancing rules; interoperability rules; capacity allocation; and congestion management rules, etc. Such codes are to be adopted by the European Commission[65] following a procedure involving both the ACER and ENTSO-E, or ENTSO-G (as appropriate).[66]

5.69 The ACER should first adopt 'framework guidelines' on the basis of an annual work programme from the European Commission, identifying the priorities of actions for a given year. The project for priorities for 2012 and beyond was opened to consultation by the European Commission on 10 March 2011.[67] ACER's guidelines should set out clear and objective principles for the development of network codes.

5.70 Such codes are then to be drafted in a project by ENTSO-E/ENTSO-G, on the basis of ACER's framework guidelines and the European Commission's work programme. Projects will be reviewed by ACER and finally approved by the European Commission. Alternative procedures are provided in the event that

[63] [2009] OJ L211/15.
[64] [2009] OJ L211/36.
[65] Avoiding potential problems concerning formal rule-making by delegated agencies rather than the Commission, in light of Case 9/56 *Meroni & Co, Industrie Metallurgische v High Authority* [1957-1958] ECR 133. For critical discussion of this general issue, see most recently M Chamon, 'EU Agencies between *Meroni* and *Romano* or the Devil and the Deep Blue Sea' (2011) 48 CMLRev 1055.
[66] Art 6 of Regulations 714/2009/EC and 715/2009/EC.
[67] Commission Public Consultation Paper, 'Establishment of the priority list for the development of network codes for 2012 and beyond' (10 March 2011) (available at <http://ec.europa.eu/energy/international/consultations/20110410_external_dimension_en.htm>).

either ENTSO-E/ENTSO-G or ACER fails to fulfil its tasks (see Article 6 of the Electricity and Gas Regulations). Once adopted, Article 7 of both the Electricity and Gas Regulations provide that 'persons likely to have an interest' in the relevant network code may propose draft amendments thereto: on receipt of such proposals, or under proposals issued on its own initiative, ACER must consult all stakeholders and may make reasoned proposals to the Commission, which may decide to adopt amendments to those codes as a result.

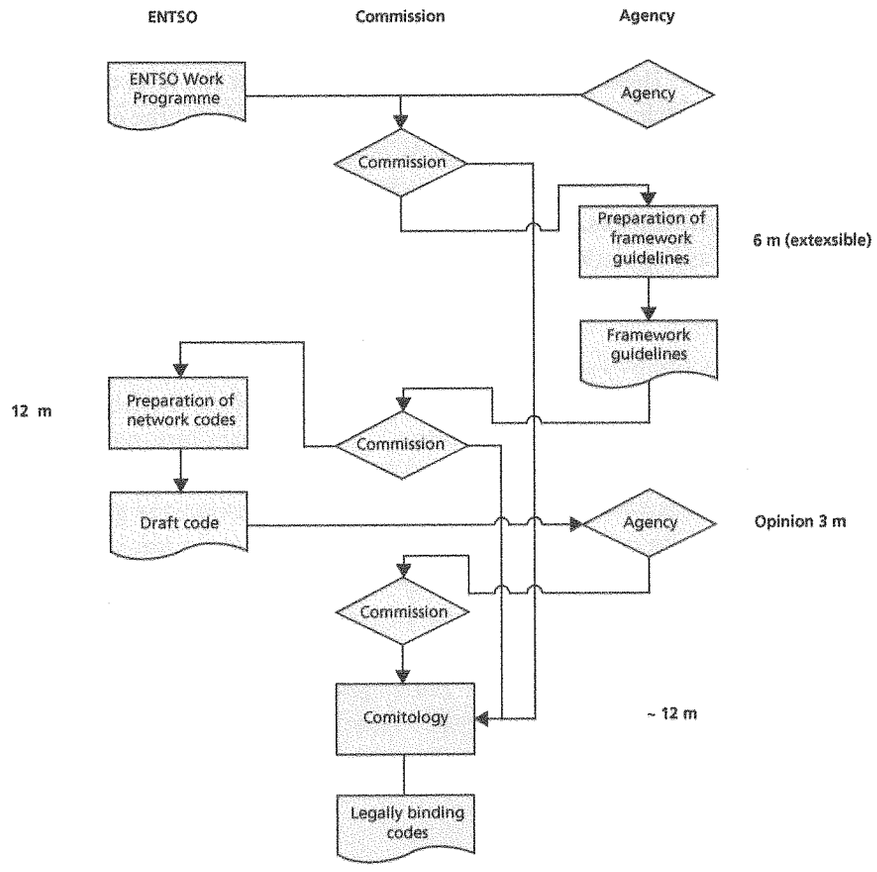

Figure 4 Procedure for the Adoption of Network Codes

5.71 The European Commission has summarized the procedure for the adoption of the network codes in its work programme (put out for consultation between 10 March and 10 April 2011) in the diagram reproduced as Figure 4.[68]

[68] Commission Public Consultation Paper, 'Establishment of the priority list for the development of network codes for 2012 and beyond' (n 67), 7.

5.72 Progress has been made on the development of these Framework Guidelines by ACER. On 29 July 2011, Framework Guidelines were adopted by ACER for the capacity allocation and congestion management for electricity,[69] while on 3 August 2011 it adopted Capacity Allocation Mechanisms for the European Gas Transmission Network.[70] The full technical detail of these Guidelines goes beyond the remit of this work, although they are discussed in outline where relevant to TPA questions concerning long-term gas contracts (see para 4.163) and energy contracts more generally (see para 8.23).

5.73 Besides participating in the development of network codes, ENTSO-E and ENTSO-G are each required to adopt a non-binding EU-wide ten-year network development plan.[71] These plans are to provide adequacy at the level of the generation for the electricity market and at the level of the supply for the gas market. Under Article 6 of the ACER Regulation, ACER is charged with monitoring the implementation of new interconnector capacity, the implementation of EU-wide network development plans, and regional cooperation between TSOs under the Electricity and Gas Regulations.

[69] ACER, 'Framework Guidelines on Capacity Allocation and Congestion Management for Electricity', FG-2011-E-002 (29 July 2011).

[70] ACER, 'Framework Guidelines on Capacity Allocation Mechanisms for the European Gas Transmission Network', FG-2011-G-001 (3 August 2011).

[71] Art 8(3) of Regulations 714/2009 and 715/2009.

6

TRANS-EUROPEAN ENERGY NETWORKS

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6.01 The availability of infrastructure capacity in network-bound sectors such as gas and electricity is obviously a vital issue for the development of cross-border trade, competition, and markets,[1] but it is also crucial to securing access to the supply of energy, both within the EU and into the EU from third states.[2] Furthermore, developing key network infrastructure can be instrumental in raising standards of living in less prosperous areas, by connecting them to other regions, markets, and opportunities. Network infrastructure thus directly impinges upon EU objectives in the fields of the internal market, security, and cohesion policy, while in recent years it has also become apparent that many of the EU's environmental goals[3] (particularly in the energy field) are increasingly dependent upon infrastructure development.[4] All of these objectives are clearly reflected in the EU rules concerning Trans-European Energy Networks (TEN-E).[5]

[1] See, for an early recognition, Commission, White Paper: Towards an EU Energy Policy, COM(1995) 682 (13 December 1995).

[2] See, eg, Recitals 7 and 8 to Decision 1364/2006/EC [2006] OJ L262/1.

[3] Technically, environmental goals are in any case to be integrated into the achievement of other EU objectives thanks to Art 11 TFEU.

[4] Grid access for electricity generated from renewable sources (see para 7.35 and Ch 12), grid capacity to deal with intermittent generation sources such as wind power, 'smart grids' and smart meters to improve demand management and efficiency (see paras 7.36 ff and 7.68 to 7.75), etc.

[5] See, eg, Recitals 2, 3, and 7, and Art 3 of Decision 1364/2006/EC [2006] OJ L262/1.

A. TEN-E: Treaty and Legislative Bases

6.02 Originally introduced by the Treaty of Amsterdam, the legal basis for EU activities in the field of Trans-European Networks (TENs) in transport, telecommunications, and energy infrastructures is now found in Articles 170, 171, and 172 TFEU. Measures in this field are to operate within the framework of 'open and competitive markets' (an important point to which we will return) and 'shall aim at promoting the interconnection and interoperability of national networks as well as access to such networks' taking 'account in particular of the need to link island, landlocked and peripheral regions with the central regions of the Union' (Article 170(2) TFEU). The EU is to adopt guidelines on the subject, establishing the objectives and priorities of such policies and identifying projects of common interest[6] to be pursued and is to implement measures required to facilitate interoperability between networks (eg technical standardization) (Article 170(1) TFEU).

6.03 Where a Member State supports a project of common interest as identified in the relevant guidelines, the EU may add its support through 'feasibility studies, loan guarantees or interest-rate subsidies', always being careful to consider the potential economic viability of such projects. EU cooperation with third countries to promote projects of mutual interest is also possible by virtue of Article 171(3) TFEU. Article 172 TFEU provides that guidelines and measures in this field are to be adopted by the European Parliament and the Council under the ordinary legislative procedure of the TFEU.[7]

6.04 These provisions have led to the creation of an EU system for TEN-E under which the projects of common interest (and priorities among them) are defined in a Decision (currently, Decision 1634/2006/EC)[8] and the mechanism for providing the EU funding is laid down in a Regulation (Regulation 680/2007/EC).[9]

B. The TEN-E Decision: Projects and Priorities

6.05 The scope of the Decision extends beyond high pressure gas pipelines and high voltage electricity transmission networks: according to Article 2, also covered are

[6] Note that a Member State must approve guidelines or projects which specifically relate to its territory: Art 172 TFEU.

[7] On which, see, eg, A Dashwood et al, *Wyatt & Dashwood: European Union Law* (6th edn, Oxford: Hart Publishing, 2011), ch 4.

[8] [2006] OJ L262/1.

[9] [2007] OJ L162/1. Previously, the relevant rules were to be found in Regulation 2236/95/EC [1995] OJ L228/1, as amended by Regulations: 1655/1999/EC [1999] OJ L197/1, 788/2004/EC [2004] OJ L138/17, 807/2004/EC [2004] OJ L143/4, and 1159/2005/EC [2005] OJ L191/16. Art 20 of the new Regulation 680/2007/EC makes clear that any projects underway under the old regime of Regulation 2236/95/EC continue to be subject to it (as amended).

'any equipment or installations essential for the system in question to operate properly, including protection, monitoring and control systems', as well as liquefied natural gas (LNG) facilities (reception, storage, regasification) and underground gas storage facilities connected to gas pipelines.

6.06 The objectives of such TEN-E actions are specified in Article 3 of the Decision, which essentially repeats the goals listed in Article 170 TFEU (Article 3(a) to (c)), with the addition of the need for such projects to contribute to sustainable development and the protection of the environment (Article 3(d)). The identification of priorities for action is commenced by Article 4, which lays down the key issues in electricity and gas,[10] and all such priorities 'shall be compatible with sustainable development'. Projects to achieve these objectives are then identified, among which there are projects of 'common interest' and 'priority projects', the latter containing a particularly important category of 'projects of European interest'. The significance of these categorizations is the eligibility and priority afforded to each category when applying for funding.

6.07 A project of common interest must: fall within the scope of the Decision (Article 2), meet its objectives and priorities (Articles 3 and 4), and show its economic viability (Article 6). Further criteria to qualify as such a project are provided in Annex II (which largely consists of a list of potential linkages between countries where the relevant objectives of the Decision need to be met), and this is further specified by a lengthy list of particular projects of common interest in Annex III.

6.08 Priority projects must meet the following criteria under Article 7(4): '(a) they shall have a significant impact on the competitive operation of the internal market; and/or (b) they shall strengthen security of supply in the [Union]; and/or (c) they shall result in an increase in the use of renewable energies.' A list of the axes for such priority projects is provided in Annex I: such projects can only have such priority in applying for funding if they meet the criteria and fall along one of the relevant axes. Within that list in Annex I, specific projects of European interest[11] are identified, which are to be given appropriate priority when allocating support budgets under the associated Regulation (Article 2 of the Decision) or under other EU measures. Alongside this priority, more intense activity by Member States is required to ensure regular exchanges of information and coordination meetings (Article 8(6)) concerning projects of European interest;

[10] Aiming at adaptation and development of networks to support the internal energy market (eg addressing bottlenecks and congestion issues), establishing networks in isolated (etc) regions, ensuring interoperability of networks within the EU and with various neighbouring countries, and meeting the needs of gas consumption and the integration of renewable energy into electricity grids.

[11] Subsequently, within these projects of European interest the Commission adopted the Priority Interconnection Plan, COM(2006) 846 (10 January 2007), identifying (*inter alia*) key projects experiencing delays and proposing the designation of European coordinators.

such projects are to be implemented rapidly and Member States have various obligations to report to the Commission on the timetable for their completion. Further, Article 10 makes it possible to appoint a European coordinator to facilitate a project of European interest, if significant delays to the project have arisen.[12]

6.09 More generally, the Decision charges the Member States and the Commission with securing a 'more favourable context' for the development of TEN-Es: Article 11 encourages the Commission on technical cooperation, streamlining authorization procedures, and providing assistance to such projects, if necessary by proposing initiatives to promote these goals, using the appropriate comitology procedure[13] laid down in Article 14.

6.10 When considering all projects, their effects upon competition and security of supply must be taken into account (Article 12). As Recital 4 highlights, the general rule is that the construction and maintenance of energy infrastructure should be subject to market principles and it should only be in rare circumstances that EU financial aid is made available for construction and maintenance of such infrastructure (and if this is proposed, it must be justified carefully). Thus, the basic assumption is that TSOs will be the major players in such projects, covering the costs of such investments through the tariffs paid by their network users.[14] This principle is carried forward in the TEN-E Regulation when one considers the aspects of such projects for which funding may be made available.

C. The TEN-E Regulation: EU Financial Aid

6.11 Under Article 3 of Regulation 680/2007/EC, only projects of common interest shall be eligible for aid under the Regulation, and only provided that those projects comply with EU law (see also Article 12).

6.12 When deciding whether to award aid (and how much: Article 6(2)) under the Regulation, Article 5(1) provides that aid shall be granted to projects of common interest 'in relation to their contribution to the objectives and priorities defined' in the TEN-E Decision.

[12] To date, four coordinators have been appointed, covering five projects, of which two projects remained ongoing at the time of writing: see <http://ec.europa.eu/energy/infrastructure/tent_e/coordinators_en.htm> for details, including coordinators' reports.

[13] On this procedure, see, eg, C Bergström, *Comitology: Delegation of Powers in the European Union and the Committee System* (Oxford: OUP, 2004).

[14] See, eg, Report on the Implementation of the Trans-European Energy Networks in the period 2007–2009, COM(2010) 203 (4 May 2010), 4.

Under Article 5(3), the priority status accorded to projects of European interest is made clear, insofar at they contribute to: **6.13**

(a) the development of the network so as to strengthen economic and social cohesion by reducing the isolation of the less-favoured and island regions of the Community;

(b) the optimization of the capacity of the network and the completion of the internal energy market, in particular projects concerning cross-border sections;

(c) the security of energy supply, diversification of sources of energy supplies and, in particular, interconnections with third countries;

(d) the connection of renewable energy resources; and

(e) the safety, reliability, and interoperability of interconnected networks.

Under Article 5(4), any decision to grant EU aid must consider, inter alia: **6.14**

(a) the maturity of the project;

(b) the stimulating effect of Community intervention on public and private funding;

(c) the soundness of the financial package;

(d) socio-economic effects;

(e) environmental consequences;

(f) the need to overcome financial obstacles; and

(g) the complexity of the project, for example that which arises from the need to cross a natural barrier.

The types of funding available are listed in Article 6 of the Regulation, and these include: **6.15**

- financing of feasibility studies (up to a maximum of 50 per cent of the cost) (Articles 2(8) and 6(1)(a) and (2)(a));
- interest rate rebates on loans from the European Investment Bank (Article 6(1)(c));
- a financial contribution to provisioning and capital allocation for European Investment Bank (EIB) guarantees (for a maximum of five or, exceptionally, seven years: Article 6(1)(d));[15] and
- grants for works (up to a maximum of 10 per cent[16] of the eligible cost) (Article 6(1)(a) and (2)(b)(ii)).

[15] The Annex to the Regulation provides further details concerning the operation of such loan guarantee instruments.

[16] Note that this appears to have removed the higher maximum level of 20 per cent of eligible costs introduced into Art 5(3)(b) of Regulation 2236/95/EC by the amendment contained in Art 1(1) of Regulation 807/2004/EC: this higher level was an exception from the ordinary 10 per cent, and applied to 'priority projects on the energy networks'. In the light of Recital 12 to the new Regulation, this seems a strange outcome.

6.16 To emphasize the TEN-E scheme's relatively small contribution to the overall costs of any given project, one can do little better than to quote the Commission's latest report on the subject:[17]

> The budget of the TEN-E funding programme amounts to €155 million for the budget period 2007–2013[18] of which some €70 million [is] for the period 2007–2009. Although the maximum co-financing rate is up to 50 per cent for studies and 10 per cent of eligible costs of works, it rarely amounts to more than 0.01 to 1 per cent of the total investment cost of a project.

6.17 Alongside the TEN-E programme, therefore, other funding sources are important. EIB funding makes a relatively significant contribution to infrastructure investment in the energy sector (see COM(2010) 203, at p 5), and the Structural and Cohesion Funds[19] and the European Regional Development Fund[20] have also provided substantial sums in this regard. So far as projects with neighbouring countries are concerned, resources available under the European Neighbourhood Policy and technical assistance funds have also been used in the energy field.

6.18 Article 11 of the TEN-E Regulation imposes monitoring and reporting obligations upon Member States with regard to projects receiving EU aid under this programme. This includes notification to the Commission of the systems of management and control that are set up to ensure the efficient implementation of the project and the checking of expenditure in conformity with the conditions for the grant of aid. Article 13 empowers the Commission to cancel, suspend, reduce, or discontinue aid granted and even seek its reimbursement where certain time limits and other conditions for the grant of such aid have not been met.

D. Possible Future Reforms

6.19 Under Articles 9(2) and 15 of the TEN-E Decision and Article 17 of the new financial aid Regulation, the Commission must submit reports on the operation of these provisions every two years. In the most recent report[21] (and the first to

[17] COM(2010) 203, at 4–5.

[18] Note that this amounts to just under 1.9 per cent of the total resources allocated to TENs (Art 18 of the Regulation), compared with €8.13 billion allocated to transport.

[19] See Council Regulations 1083/2006/EC (laying down general provisions on the ERDF, ESF, and the Cohesion Fund, [2006] OJ L210/25) and 1084/2006/EC (establishing a Cohesion Fund, [2006] OJ L210/79). Eg, under Council Decision 2006/702/EC (on strategic guidelines on cohesion, [2006] OJ L291/11) support is provided to projects for the development of renewables and the improvement of energy efficiency.

[20] See Council Regulation 1080/2006/EC on the ERDF, [2006] OJ L210/1: see its Art 4(9) on energy investments improving certain TEN-E projects.

[21] Report on the Implementation of the Trans-European Energy Networks in the period 2007–2009, COM(2010) 203 (4 May 2010): <http://ec.europa.eu/energy/infrastructure/studies/doc/2010_0203_en.pdf>. For the preceding period, see the Commission's Report on the Implementation of the Trans-European Energy Networks Programme in the period 2002–2006,

be adopted under the new Regulation), authorization procedures for cross-border projects are highlighted as an important constraint: while some Member States have taken steps to streamline such procedures, planning delays can still add years to such projects. The Commission suggests that measures[22] adopted at EU level could secure more coordination and consistency in this area.

6.20 In its conclusions, the Commission emphasized that the current TEN-E programme is not well designed to meet the new energy policy challenges facing the EU and its Member States, due to its lack of flexibility and its minimal financial resources. Various reforms were proposed, including:

- better definition of EU energy infrastructure strategic priorities (taking account of new technologies, distributed generation, the need for CCS pipeline networks, etc);[23]
- a new, clearer approach to project definition (to replace the messy categorization discussed in paras 6.05 ff);
- better exploitation of potential cooperation between Member States in individual projects (concerning both political and practical planning issues, to ensure appropriate priority is given to such projects at national level, etc); and
- the need to attract a level of investment which matches the scale of the challenges in energy infrastructure (this may allow public funding for the completion of such projects where clear and widespread European benefits can be shown, as well as market failures which have prevented these key projects from being realized).

E. Links Between TEN-Es and Other Areas of EU Energy Law

6.21 We have noted that a range of EU energy policy objectives—internal market and competition, security of supply, environmental and sustainability goals—can be seen in the evolution of the TEN-Es programme. While the status of a given project as a TEN-E does not in itself exempt that infrastructure from the rules otherwise applicable under EU law, it may support arguments made by Member States

COM(2008) 770 (13 November 2008), which provides details of projects completed, applications received, and decisions taken under the TEN-E programme, including the amounts granted and the types of expenditure involved. This should be read in conjunction with its contemporaneously published Green Paper: Towards a Secure, Sustainable and Competitive European Energy Network, COM(2008) 782 (13 November 2008).

[22] Clearly, the Commission's earlier Recommendation on the subject (1999/29/EC [1999] OJ L8/27) is not having the desired effect.

[23] Most recently, a contribution to this goal was made by Regulation 617/2010/EU, Euratom [2010] OJ L180/7, which imposes obligations upon Member States to notify energy infrastructure investment projects to the Commission.

or undertakings for exemptions or derogations from certain rules. For example, Member State subsidies to support certain TEN-E infrastructure projects, when granted on top of EU funding under the TEN-E programme, may benefit from the designation of the project as one of 'European interest' when seeking authorization from the Commission for such aid (Article 107(3)(b) TFEU). Similarly, applications to exempt new infrastructure from some of the rigours of the internal market legislation in gas and electricity are also likely to overlap with TEN-E status.[24] The Commission has adopted a number of Decisions concerning such exemptions under the Second Gas IEM Directive[25] and the Electricity Regulation,[26] and many of these were priority projects or projects of European interest within the TEN-E definitions.

F. European Energy Programme for Recovery

6.22 In the wake of the global financial crisis, the EU made available various funds to promote certain infrastructure and development projects within the EU, in the hope of helping to stimulate economic recovery. Regulation 663/2009/EC[27] was adopted with some speed, setting up a 'European Energy Programme for Recovery' (EEPR) which aimed to stimulate recovery, strengthen security of energy supply, and reduce greenhouse gas emissions (Article 1). The total budget made available was €3.98 billion, divided among its sub-programmes on gas and electricity infrastructure (€2.365 billion), CCS (€1.05 billion), and offshore wind energy (€0.565 billion) respectively.

6.23 For our purposes here, the relevant part of the Regulation is Chapter II, Section 1, concerning gas and electricity infrastructure projects which, given the funds allocated, is clearly the main focus of the Regulation. The objectives of the Regulation in this regard repeat those in the TEN-E Decision and Regulation, while the priorities are stated in Article 5 to be 'urgently to adapt and develop energy networks of particular importance to the [Union] in support of the operation of the internal energy market and, in particular, to increase interconnection capacity, security and diversification of supply and to overcome environmental, technical and financial obstacles'. Projects will *only* be eligible if they intend to carry out one of the specified projects in Part A of the Annex to the Regulation and are within the maximum amount of EEPR support there specified. They must also satisfy the selection criteria in Article 8, which again mostly repeat those in the

[24] For discussion of these exemptions, see Chs 3 and 4 (on unbundling and TPA, respectively).
[25] Available at <http://ec.europa.eu/energy/infrastructure/exemptions/gas_en.htm>.
[26] Available at <http://ec.europa.eu/energy/infrastructure/exemptions/electricity_en.htm>.
[27] [2009] OJ L200/31. For related documentation; see <http://ec.europa.eu/energy/eepr>.

TEN-E Regulation, with certain specific additions.[28] The key differences from the TEN-E Regulation, however, are the project elements which may be funded and the extent of funding available, both in absolute terms (as already noted) and as a proportion of the eligible costs of the individual project: here, up to a maximum of 50 per cent of such project-related costs may be awarded (Article 9(2)).

6.24 The Commission's first report on the implementation of the EEPR[29] explains the process, the bids received in response to the call for tenders, and the projects finally selected. A wide range of strong proposals was received, and the EEPR has served to accelerate the development of some key infrastructure projects, attracting co-financers and encouraging them to make investment commitments, estimated at almost ten times the value of the funds committed (circa €2.3 billion) under the EEPR. These benefits are also having knock-on effects along the supply chain, in particular enhancing manufacturing, assembly, and installation of gas and electricity transmission infrastructure and off-shore wind turbines.[30] The remaining unspent funds (circa €146 million) from the EEPR are to be reallocated to support energy saving, energy efficiency, and renewable energy projects.[31]

[28] In particular, Art 8(2): '(f) the contribution to the continuity and interoperability of the energy network, and to the optimisation of its capacity; (g) the contribution to the improvement of service quality, safety and security; (h) the contribution to the creation of a well-integrated energy market.'
[29] Report on the Implementation of the European Energy Programme for Recovery, COM(2010) 191 (24 April 2010).
[30] Report on the Implementation of the European Energy Programme for Recovery, COM(2010) 191 (24 April 2010), 8.
[31] Regulation 1233/2010/EU amending Regulation 663/2009 (15 December 2010) [201] OJ L346/5; see, further Commission, 'Report on the implementation of the European Energy Programme for Recovery', COM(2011) 217 (20 April 2011).

7

CONSUMER PROTECTION AND PUBLIC SERVICE OBLIGATIONS

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A. Introduction

7.01 Traditionally, consumer protection and public service obligations have been dealt with mainly at Member State level. Under a State-owned monopoly, electricity and gas suppliers provided a public service, hence the assumption that they would act in the public interest, ensuring that the consumer would be supplied and protected as a priority, rather than focusing on turning a profit. The reality, of course, was sometimes rather different, and energy supply regimes at national level were subject to numerous other economic and political pressures beyond serving the consumer.[1] And, of course, even government-owned monopolies had budgetary constraints which could sometimes (perhaps often) affect services.[2]

[1] eg the use of the energy system to fund industrial, employment, and regional policies, such as subsidizing coal mining via guaranteed purchasing by power generators. See, eg: M Chick, *Electricity and Energy Policy in Britain, France and the United States since 1945* (Cheltenham (UK): Edward Elgar, 2007), esp ch 2; and D Helm, *Energy, the State, and the Market: British Energy Policy since 1979* (rev paperback edn, OUP, 2004), esp chs 2, 4, and 5.

[2] C Jones (gen ed), *EU Energy Law—Volume I: The Internal Energy Market—The Third Liberalisation Package* (3rd edn, Leuven: Claeys & Casteels, 2010), 394.

7.02 This background explains the paucity of references to public service obligations (PSOs) in the earlier energy internal market Directives. With regard to PSOs, the former Directives stated in their preamble that the free play of competitive forces might not guarantee the security of supply, environmental, and/or consumer protection. Consequently, at the time of the first wave of energy liberalization legislation, the Member States were authorized to impose some PSOs upon the companies of the sector. Those PSOs could relate to safety, including the security of supply, the regularity, the quality and the prices of the supply, as well as environmental protection (see Article 3 of Second Electricity and Gas IEM Directives of 2003).[3] Indeed, when introduced, it has been demonstrated that competition 'has also led in many respects to an increase rather than a decrease in standards of consumer protection. But a risk does exist that, unchecked, some public service elements could be reduced'.[4]

7.03 An increasing focus on consumer protection and PSO issues at EU level appeared in the Second Package of Directives and has been strongly developed in the Third Package.

7.04 In a general way, the EU obliges the Member States to take measures which are essential to achieve the goals of economic and social cohesion, environmental protection (which can include measures of energy efficiency and demand-management as well as measures aimed to combat the climate change), and promoting the security of energy supply. These goals have also been reinforced at Treaty level, both in the EU Charter of Fundamental rights (Article 36) and in Articles 14 and 106 TFEU, as well as under particular provisions in the sector-specific legislation (including in particular in the telecommunications sector).[5]

7.05 In the Third Package, the Electricity and Gas IEM Directives also aim, by the means of PSOs, to protect certain categories of consumers, in particular 'vulnerable consumers'. For this purpose, Appendix I of the Third Electricity IEM Directive contains a list of obligations and measures for consumer protection. Under the energy legislation (Articles 3(15) (Elec) and 3(11) (Gas)), the Member States must inform the Commission of all the measures that have been taken at national level to fulfil the obligations of universal service and public service, including environmental protection and consumer protection, and they must assess, monitor, and report upon their possible effects on national and international competition.

[3] Directives 2003/54/EC and 2003/55/EC, respectively.
[4] C Jones (n 2), 394.
[5] See, eg P Nihoul, 'The Status of Consumers in European Liberalisation Directives' [2009] *Yearbook on Consumer Law* 67 (also available at <http://ssrn.com/abstract=1862823>) and, for comparison with the electronic communications sector, see the same author's 'Les consommateurs sont-ils protégés dans l'environnement libéralisé? Une analyse fondée sur l'étude du cadre réglementaire européen relatif aux communications électroniques' (2009) 1 *Opinio Juris in Comparatione*, no 3 (available at <http://ssrn.com/abstract=1355890>).

Article 3(14) of the Third Electricity IEM Directive and Article 3(10) of the Third Gas IEM Directive explicitly permit Member States to derogate from certain specific requirements of the Directives where it proves necessary to do so to achieve specified public service objectives. More generally, Article 3(2) in both Directives implies that PSOs may operate as derogations from otherwise applicable general rules of EU law (such as the TFEU's competition and free movement rules). **7.06**

B. Definition of PSOs

Energy supplies are essential to the functioning of the modern economy, and of course to the daily lives of companies and citizens. Electricity is, in the modern developed world, clearly considered an essential good: supply interruptions are potentially hugely expensive and considered unacceptable. Gas is perhaps less often considered similarly essential—since it can often be replaced by an alternative product: electricity can provide cooking and heating facilities, for example—although it is clearly of huge importance, particularly once houses and businesses are connected to, and come to rely upon, the gas supply network.[6] **7.07**

According to the character of energy as an 'essential good', and as a result of the full household market opening required after the Third Package, the new Directives contain a number of public service-related guarantees. The starting assumption here, as with regard to security of supply (see Ch 10), is that competition and the market will generally deliver supplies at levels of service and price which will be adequate to protect and benefit the end user. But it is also recognized that some goals for the energy supply system may not be achieved straightforwardly via market forces, hence the provisions of Article 3(2) in both Directives, and Articles 3(14) (Elec) and 3(10) (Gas) respectively. This framework has prompted one set of commentators to note that, in the context of the Electricity and Gas IEM Directives, 'public service' means 'the guaranteeing, through regulatory standards, measures or requirements, of levels of consumer or environmental protection that might otherwise not be maintained through the simple operation of the market mechanism'.[7] **7.08**

More generally, customer protection measures under the EU's energy legislative framework are often discussed in the context of phrases such as 'public service' or 'public service obligation' (PSO), although these are malleable and context-dependent terms. Their meaning depends upon the circumstances in which they are used and the perspective from which one views such issues (eg those upon whom the obligations are imposed: transmission system operators (TSOs), distribution **7.09**

[6] C Jones (n 2), 394.
[7] C Jones (n 2), 395.

system operators (DSOs), suppliers, or those relying upon possible rights concomitant upon such obligations (businesses, consumers)). Under the Third Package, however, the obligations imposed by the Directives (see their Article 3 and Annex I) require Member States to achieve the relevant results (imposing a positive duty on Member States (using the word 'shall') to achieve the specified PSO objectives), while leaving discretion to the Member States to decide exactly *how* this will be achieved and by *whom*.

7.10 Therefore, the focus here will be upon these specific obligations, grouping them under a number of common headings and pointing out overlaps between categories where appropriate.

7.11 It is important to note that there is also a limitation upon the range of areas for which PSOs *can* be imposed by Member States under Article 3(2) of the Third Electricity and Gas IEM Directives, and the details of Consumer Protection are detailed in Annex I of the Third Electricity and Gas IEM Directives. Thus, PSOs may relate to security (including security of supply), regularity, quality and price of supplies, and environmental protection, including energy efficiency, energy from renewable sources, and climate protection.[8] The public service requirements should be clearly and publicly defined at national level and may take national circumstances into account.[9] Thus, the implementation of the PSOs may vary from one Member State to another.

7.12 It is clear from the case law of the ECJ that such national PSOs must also respect the proportionality test in their operation: in *Federutility*, Italy was in principle permitted to empower its NRA to use a PSO to adopt 'reference prices' for gas supplies (which, in practice, were set at levels below market prices) provided that this pursued the objective of protecting final consumers, as part of 'the reconciliation which Member States must make . . . between the objective[s] of liberalisation and . . . the necessary protection of final consumers'.[10] This required positive justification, because the basic premise of the EU's Energy IEM legislation is to achieve a liberalized and competitive market in which suppliers are free to deliver their products to all customers.[11] Such PSO-authorized interventions in the market mechanism should: (1) be limited in duration (and thus are best regarded as only transitional in nature, not permanent); (2) go only so far as necessary to achieve the consumer protection objective;[12] and (3) respect the Article 3(2) requirement that

[8] Art 3(2) of the Third Electricity and Gas IEM Directives.

[9] See, eg, Recital 50 to the Third Electricity IEM Directive.

[10] Case C-265/08 *Federutility et al v Autoritá per l'energia elettrica e il gas* (ECJ, judgment of 20 April 2010), at para 32.

[11] *Federutility* (n 10), at paras 17–19.

[12] In particular, the Court emphasized (*Federutility* (n 10), at paras 40–43) that, while it *was* possible to use reference prices for business as well as household customers, account must be taken of the different position in which those two categories of customers find themselves. Failure to do so would breach the proportionality criterion.

PSOs be clearly defined, transparent, non-discriminatory, and verifiable, while also guaranteeing equal access to consumers for EU gas companies.[13] It was for the national court to verify whether these conditions had been satisfied by the Italian reference price scheme in this case. One might wonder how well qualified national courts are to conduct this assessment, whether here or under the new Gas Security of Supply Regulation.[14]

C. Description of PSOs

(1) Universal service obligation in electricity

Article 3(3) of the Third Electricity IEM Directive provides that: **7.13**

> Member States shall ensure that all household customers, and, where Member States deem it appropriate, small enterprises (namely enterprises with fewer than 50 occupied persons and an annual turnover or balance sheet not exceeding EUR 10 million), enjoy universal service, that is the right to be supplied with electricity of a specified quality within their territory at reasonable, easily and clearly comparable, transparent and non-discriminatory prices. To ensure the provision of universal service, Member States may appoint a supplier of last resort. Member States shall impose on distribution companies an obligation to connect customers to their network under terms, conditions and tariffs set in accordance with the procedure laid down in Article 37(6). Nothing in this Directive shall prevent Member States from strengthening the market position of the household, small and medium-sized consumers by promoting the possibilities of voluntary aggregation of representation for that class of consumers.

By this Article, Member States have the obligation to ensure that all household customers and, where Member States deem it appropriate, small enterprises, benefit from universal service. Universal service is defined as 'the right to be supplied with electricity of a specified quality within their territory at reasonable, easily and clearly comparable, transparent and non-discriminatory prices'. **7.14**

Moreover, where universal service is also provided to small enterprises, measures to ensure that such universal service is provided may differ according to whether they are aimed at household customers or small enterprises.[15] **7.15**

Only the Third Electricity IEM Directive contains this obligation, which thus does not apply to natural gas. This partly reflects the reasons discussed in the preceding **7.16**

[13] *Federutility* (n 10), at paras 33–47; Art 3(2) expressly requires Member States to have 'full regard' to the provisions of the Treaty, in particular what is now Art 106 TFEU: the structure of analysis thereunder clearly informed the Court's reasoning in *Federutility*.

[14] K Talus, *Vertical Natural Gas Transportation Capacity, Upstream Commodity Contracts and EU Competition Law* (Alphen aan den Rijn: Kluwer Law International, 2011), 59–60.

[15] Recital 45 to the Third Electricity IEM Directive.

paragraphs, as well as the practical consideration that not all regions of the EU are connected to a gas transmission network or to the distribution network.

7.17 The electricity universal service obligation (USO) involves various different aspects.

7.18 (a) **Connection to the grid:** First, all households have the right to be connected to the grid. Therefore, 'Member States shall impose on distribution companies an obligation to connect customers to their network under terms, conditions and tariffs set in accordance with the procedure laid down in Article 37(6)'.[16]

7.19 (b) **Supply:** Once connected, households have the right to be supplied with electricity. This obligation may cover two aspects. First, Article 3(3) of the Third Electricity IEM Directive may require the allocation of a supplier to each customer at the point at which the market is opened. Customers not wishing to switch would remain with the incumbent.

7.20 Second, the continuity and the quality of the supply must be ensured. The concept of 'security' or 'continuity of supply' is broadly conceived in Article 3 of the Third Directives: Article 3(2) of the Third Electricity IEM Directive aims at the security of supply in the sense of 'regularity, quality and price of supplies'. Reference must also be made to Article 3(3) of the Third Electricity IEM Directive, which establishes 'the right to be supplied with electricity of a specified quality'.[17] The physical quality of the energy supplied is regulated through the technical rules contained in the grid codes, or under a supply licence requirement. The physical quality of the energy supplied (using a so-called 'on spec clause') is also typically governed by the terms of supply contracts (see Ch 8 on Energy Contracts).

7.21 (c) **Supply at reasonable price:**[18] Third, under Article 3(3) they have the right to be supplied with electricity at 'reasonable, easily and clearly comparable, transparent, and non-discriminatory prices'.

7.22 Moreover, Recital 50 to the Third Electricity IEM Directive provides that 'the public service requirements, including as regards the universal service, and the common minimum standards that follow from them, need to be further strengthened to make sure that all consumers, especially vulnerable ones, are able to benefit from competition and fair prices'.

7.23 National regulatory authorities (NRAs) have a duty to monitor the effectiveness of market opening and competition at the retail level: this concerns market opening for all customers and the protection of the customers with regard to PSOs. Within

[16] Art 3(3) of the Third Electricity IEM Directive; Art 37(6) of the same Directive makes the regulator responsible, directly or indirectly, for the approval of connection and access tariffs.
[17] Art 3(3) of the Third Electricity IEM Directive.
[18] See also the discussion of the *Federutility* case at para 7.12.

this framework, Article 37(1)(j) of the Third Electricity IEM Directive provides that the regulatory authority shall have the following duties:

> monitoring the level and effectiveness of market opening and competition at wholesale and retail levels, including on electricity exchanges, prices for household customers including prepayment systems, switching rates, disconnection rates, charges for and the execution of maintenance services, and complaints by household customers, as well as any distortion or restriction of competition, including providing any relevant information, and bringing any relevant cases to the relevant competition authorities.

7.24 In addition to this monitoring role, the NRA has an obligation to monitor[19] the compatibility of supply prices with competition law. Article 37(1)(o) of the Third Electricity IEM Directive provides that the NRA will publish 'recommendations, at least annually, in relation to compliance of supply prices with Article 3, and providing these to the competition authorities, where appropriate'.[20]

7.25 (d) **Supplier of last resort:** Fourth, a safety net is required in the event that any household customer's supplier fails to meet its contractual obligations and, for example, goes into liquidation. It is in this context that Article 3(3) of the Third Electricity IEM Directive provides that 'Member States may appoint a supplier of last resort'.

7.26 The possibility for Member States to implement the USO by appointing a supplier of last resort may be a positive development for customers. The appointment of a supplier of last resort must be accompanied by financial or other compensation or the grant of exclusive rights: this must be achieved in a non-discriminatory and transparent way (Article 3(2)).

7.27 Different Member States have different definitions and national systems put in place for the designation of a supplier of last resort for electricity and gas. The notion of supplier of last resort may be compared to the definition of 'default supplier', where the situation is markedly different:

> The term supplier of last resort appears in Article 3 in the existing Directives, but no definition is given. This status review shows that a supplier of last resort is not the same as a default supplier. A majority of the countries do have a definition of supplier of last resort for electricity and gas. For electricity, 20 respondents out of 27 have a definition, and for gas 16 out of 25 respondents have a definition. For those countries which have a definition, it is most common that the supplier of last resort is appointed when a supplier goes bankrupt or when a customer cannot find a supplier on the market. It is also worth noting that it is not unusual for the supplier

[19] The precise national division of competences with regard to the enforcement of competition law in the energy sector varies from one Member State to the next: eg in the UK there is concurrent competence for both Ofgem and the OFT in this regard. In other Member States, competition law enforcement is strictly reserved to the specific national competition authorities.
[20] Art 37(1)(o) of the Third Electricity IEM Directive.

of last resort to also act as the default supplier, or vice versa. Some countries do not separate or distinguish between the terms. The supplier of last resort is most commonly designated by the regulator.

This status review shows that it is almost always the case that the default supplier is in fact the same as the incumbent supplier, and in half of the responding countries the role of supplier of last resort falls on the incumbent supplier. To choose incumbent suppliers to act as default supplier and supplier of last resort is, from a competition perspective, not the best solution . . . A market-oriented solution for appointing a default supplier/supplier of last resort could be to have a tendering procedure to facilitate competition between suppliers . . . An increased number of suppliers would give the customers more options, which would lead to enhanced competition in the retail markets.[21]

7.28 In some Member States, the supplier of last resort also acts as a default supplier. This means that not all countries separate the two functions.

7.29 For the supplier of last resort, on both the electricity and gas markets, it can be concluded that:

The supplier of last resort is, like the default supplier, most commonly designated by the regulator and in half of the cases it is the incumbent supplier that acts as the supplier of last resort. The service of the supplier of last resort is, like the service of the default supplier, normally not time limited. This is of course not an ideal situation if competition amongst suppliers should be promoted and enhanced . . . If there is no time limit, the customers are more likely to remain with the supplier of last resort than if the service of the supplier of last resort is time limited . . . Competition in the retail markets is essential to ensure high quality services at the lowest prices and to maximise customer empowerment.[22]

7.30 In countries where there are no definitions of 'default supplier' and/or 'supplier of last resort', there are support systems which ensure that the customer is supplied with energy in some specific situations. Those systems will be activated when a customer does not choose a supplier, when a supplier goes bankrupt, when a contract expires, or when a customer cannot find a supplier on the market.[23]

(2) Security of supply

7.31 Measures to protect and promote security of energy supply have become a critical part of any modern set of rules in this area, and are discussed in detail in Chapters 9 and 10. As will become apparent from that treatment, the precise definition of what is covered by the term 'security of supply' is fraught with difficulty. At this point, it suffices to note that the terms used in Article 3(2) of both Directives are

[21] ERGEG, 'Status review of the definitions of vulnerable customer, default supplier and supplier of last resort of 16 July 2009, Ref: E09-CEM-26-04, Status Review of vulnerable customer, default supplier and supplier of last resort' available through <http://www.energy-regulators.eu>, 7–8.
[22] ERGEG (n 21), 31.
[23] ERGEG (n 21), 31.

capable of covering a broad conception of the term, yet the details concerning consumer protection in Annex I in both Directives focus on narrower notions of continuity, quality, and reliability of supplies. The Third Electricity and Gas IEM Directives, therefore, allow scope for the use of both broader and narrower conceptions of security of supply, although Member States and undertakings must take care to ensure that they are able to use the specific notion upon which they rely under the relevant provision(s) of the Directive in question.

(3) Quality and price of supply

7.32 While it is possible to discuss PSOs, which aim to ensure the quality and reasonable price levels of energy supplies in their own terms, the operation of such provisions makes most sense when discussed in the specific context of particular actors (whether TSOs, suppliers and the like, or customers (household, Small and Medium-sized Enterprises (SMEs), and other legal persons)). Accordingly, issues of prices and quality have been addressed as they arise in the remaining paragraphs of this chapter.[24]

(4) Environmental issues and protection

7.33 **(a) Environmental labelling:** Under Article 3(9) of the Third Electricity IEM Directive, Member States must ensure that electricity suppliers[25] provide final customers with information (in or with their bills *and* in promotional materials[26] made available to customers) concerning:

(a) the contribution of each source of energy to the supplier's overall fuel mix over the preceding year, in a comprehensible manner which (at national level) allows clear comparison with the mix of other suppliers; and
(b) references to existing sources (eg web pages) where the environmental impact of electricity produced from that fuel mix is publicly available. 'Environmental impact' means at least the carbon dioxide emissions and radioactive waste resulting from the relevant electricity generation.

7.34 Where the relevant electricity supply is obtained via an electricity exchange or imported from an undertaking established outside the EU, these obligations may

[24] See esp paras 7.76 ff, on specific customers.
[25] A concept not defined in the Directive, but clearly encompassing pure traders as well as more 'traditional' supply companies. Traders may find the calculation of such proportions difficult, as may exchanges, even after the advent of some certification rules in the EU's Renewables Directives (see Art 5 of Directive 2001/77/EC [2001] OJ L283/33 and now Art 15 of Directive 2009/28/EC [2009] OJ L140/16). See the discussion in Ch 12.A.2.
[26] This term is not defined by the Directive and it raises questions concerning its reach: clearly, leaflets sent or handed to customers would be covered, but the position of television, internet, and newspaper advertising is less obvious. Jones et al (n 2) suggest that the latter are excluded because they are only 'directed at', but not 'made available to' final customers (at 413–414).

be fulfilled by using aggregate figures for the preceding year from that exchange or from the relevant undertaking (Article 3(9), second paragraph). The third paragraph of Article 3(9) requires the NRA to monitor whether these obligations are being met by suppliers: ensuring comparability, for example, may require the development of common terms and categories, which is unlikely to occur spontaneously among supply companies. Similarly, active involvement by the NRA may be required to establish how imports from non-EU undertakings must satisfy these requirements: care should be taken by NRAs to ensure that such principles do not amount to infringements of international trade law, by engaging in consultation with prospective importers and ensuring that those principles do not discriminate against non-EU suppliers.

7.35 **(b) Priority grid access for renewables:** Under Article 16(2)(a) of the Second Renewables Directive, TSOs and DSOs are required to guarantee the transmission and distribution of electricity generated from renewable sources, and Article 16(2)(b) requires Member States to provide for either priority or guaranteed grid access for renewables. Further, Article 16(2)(c) demands that priority be given by TSOs to renewable generating installations in dispatching decisions, insofar as secure operation permits this. It is worth emphasizing that nothing in the Third Electricity IEM Directive or the Second Renewables Directive establishes any priorities as *between* renewables generators with regard to grid access. This is a matter that is left to Member States to regulate as they wish, subject of course to compatibility with the unbundling requirements (eg TSO duties concerning non-discrimination, independence, etc discussed in Ch 3), EU free movement law (eg with regard to imports of renewables), and EU and national competition law (eg concerning the behaviour of incumbent generators with large market share and/or TSO behaviour under the essential facilities doctrine).

7.36 **(c) Energy efficiency and climate change:** Articles 3(10) (Elec) and 3(7) (Gas) are in almost identical terms and require Member States to 'implement measures to achieve the objectives of social and economic cohesion and environmental protection'. The key difference between the two provisions is that, under the Electricity Directive, such measures '*shall* include energy efficiency/demand-side management measures and means to combat climate change, and security of supply, where appropriate'.[27] Under the Gas Directive, meanwhile, there is no mention of energy efficiency or demand management, and greater leeway is provided to Member States, whose measures '*may* include' combating climate change and improving supply security (emphases added). Under both of these provisions, it is specified that such 'measures may include, in particular, the provision of adequate economic incentives, using, where appropriate, all existing national and [EU] tools, for the

[27] However, the addition of the phrase 'where appropriate' under the Electricity Directive leaves open to question the strength of the obligation imposed by Art 3(10) upon Member States.

maintenance and construction of the necessary network infrastructure, including interconnection capacity'. Clearly, however, any such 'incentives' provided by Member States must comply with the EU State aid rules.[28]

7.37 Greater detail concerning possible energy efficiency measures is provided in Articles 3(11) (Elec) and 3(8) (Gas): Member States or their NRA shall 'strongly recommend that . . . undertakings optimise the use of electricity/gas, for example by providing energy management services, developing innovative pricing formula[e], or introducing intelligent metering systems or smart grids, where appropriate'.

7.38 While the wording of all of these provisions uses the imperative 'shall' formulation, it cannot be denied that, beyond requiring Member States to do *something* on pursuit of these goals, they 'contain very little [in the way of] substantive legal obligations which Member States can be obliged to meet. [They are] therefore more of a statement of political intent than . . . legally binding requirement[s]'.[29] And given that specific EU legislation on such matters is developing, it seems more likely that detailed guidance on such measures should be sought, there, and in Member States' own domestic law- and policy-making.

(5) Information duties

7.39 Member States have a clear obligation to ensure that consumers and citizens are easily able to identify any PSOs implemented with respect to electricity and gas.

7.40 Moreover, as has already been mentioned, Member States must inform the Commission of all the measures that have been taken to fulfil the obligations of universal service and public service, including the environmental protection and consumer protection and their possible effects on national and international competition.

7.41 This notification duty is mentioned in Article 3(15) of the Third Electricity and Article 3(11) of the Third Gas IEM Directives, which provide that:

> Member States shall, upon implementation of this Directive, inform the Commission of all measures adopted to fulfil universal service and public service obligations, including consumer protection and environmental protection, and their possible effect on national and international competition, whether or not such measures require a derogation from this Directive. They shall inform the Commission subsequently every two years of any changes to such measures, whether or not they require derogation from this Directive.

7.42 These notification requirements are intended to keep the Commission well and regularly informed of such measures adopted at national level. This will assist the

[28] Confirmed by Recitals 49 (Elec) and 46 (Gas) respectively.

[29] C Jones (gen ed), *EU Energy Law—Volume I: The Internal Energy Market—The Third Liberalisation Package* (3rd edn, Leuven: Claeys & Casteels, 2010), 431.

Commission in performing its general[30] and specific[31] monitoring and reporting duties (concerning environmental protection, supply security, and consumer protection) under the Third Package Directives, as well as its more general duties under the TFEU with regard to the competition and free movement rules. Member States, too, could learn from each other's experiences in the PSO field, either directly or via benchmarking and reporting conducted by the Commission.[32]

(6) Relations with suppliers

7.43 (a) **Choice of supplier:** Since 1 July 2007, all consumers in the EU have had the right to choose their supplier, both in the electricity and gas markets. This affects the various EU Member States in different ways: some countries have had a free electricity market for years while others may be implementing this for the first time and have not yet organized meter operations and meter values. Reducing such obstacles is one of the single most important issues for achieving a well-functioning end user market.

7.44 (b) **Contractual provision:** Annex I of the Third Electricity and Gas IEM Directives impose a requirement that certain information is given to final customers when concluding energy contracts with a supplier. The information given to the customer must include the identity of the supplier, the services provided, the duration of the contract, the compensation and refund arrangements, the consumer's rights, the applicable prices, their consumption data, etc.

7.45 These obligations to provide information to consumers are discussed in detail at paras 7.58 ff and in Chapter 8 on 'Energy Contracts'.

7.46 (c) **Switching process:** Article 3(7) of the Third Electricity and 3(3) of the Third Gas IEM Directives provide that 'Member States shall ensure that the eligible customer is in fact able easily to switch to a new supplier'. This imposes an obligation on Member States to ensure that eligible customers can easily switch supplier. This provision was adopted after the European Regulators' Group for Electricity and Gas (ERGEG) stated that:

> All customers shall be able to switch electricity supplier. Since 1 July 2007, all customers in both the gas and electricity markets of the EU are eligible to take part in the free market, switch supplier or renegotiate the terms and conditions with their existing supplier. This is a significant reform. However, declaring that all customers have full market access is not enough. In addition, the organisation of the market must be such that customers have easily accessible information about suppliers and

[30] See Arts 47 (Elec) and 52 (Gas) of the IEM Directives.

[31] See Art 3(2) of each IEM Directive: such PSOs must be 'clearly defined, transparent, non-discriminatory and verifiable'.

[32] C Jones (gen ed) (n 29), 432.

> their offers. A switch of supplier must be simple to carry out for both for customers and suppliers and DSOs must act as market facilitators, not market actors.[33]

The switching process may be divided into three stages: **7.47**

(i) Access to information: In the first stage, the customer searches for information on prices, products, contracts, and suppliers. The customer also examines the terms of his or her contract with his or her present supplier and collects the data which is required to perform the switch of supplier. **7.48**

At this stage, the consumer should have access to his or her entry on the database. This access will allow him or her to have access to all the information he or she needs to make the switch. This access to consumer information is thus essential. The fact that customers are entitled to receive all consumption data in an easily understandable, harmonized format is a means of improving customers' ability to switch supplier.[34] The relevant data include all information that a consumer would need either to assess his or her own consumption pattern or compare his or her consumption costs with offers provided by other suppliers. **7.49**

The information should also be understandable for consumers: '[t]aken together, these new provisions of Article 3 and Annex I are designed to make it easier for consumers to understand their own consumption, to use this information either to compare it with offers from other energy suppliers, or to allow other suppliers to have access to their consumption data so as to provide them with a new offer of supply.'[35] **7.50**

(ii) The supplier switching procedure: The second stage lasts from when the customer signs a new contract and the customer or the new supplier have collected all the required data until the agreed date where the switch is going to take place. Meter reading should be registered on the switching day itself by automatic meter reading, but can also be handled in different ways by manual meter reading. The second stage can be referred to as the theoretical duration of the switch.[36] **7.51**

(iii) Execution of the switch, delay, or cancellation: The third stage takes into account the cases where there is an error, a delay, or perhaps the cancellation of the switch by the customer or the DSO, thereby prolonging the real duration of the switch. **7.52**

[33] Obstacles to supplier switching in the electricity retail market—Guidelines of Good Practice and Status Review of 10 April 2008, available through <http://www.energy-regulators.eu>, 4.

[34] Arts 3(5) of the Third Electricity IEM and 3(6) of the Third Gas IEM Directives.

[35] Commission Staff Working Paper, Interpretative Note on Directive 2009/72/EC Concerning Common Rules for the Internal Market in Electricity and Directive 2009/73/EC Concerning Common Rules for the Internal Market in Natural Gas: Retail Markets (22 January 2010) (hereafter, 'Interpretive Note: Retail Markets'), 5.

[36] ERGEG, 'Obstacles to supplier switching in the electricity retail market—Guidelines of Good Practice and Status Review of 10 April 2008' available through <http://www.energy-regulators.eu>, 5.

The third stage ends when the customer receives a confirmation letter from the new supplier and/or the first bill and additionally when the account with the former supplier has been settled.[37]

7.53 Switching should be quick and easy for the customer. Articles 3(5)(a) (Elec) and 3(6)(a) (Gas) provide that 'Member States shall ensure that: where a customer, while respecting contractual conditions, wishes to change supplier, the change is effected by the operator(s) concerned within three weeks'.

7.54 *(iv) No charge for switching:* Annex I(1)(j) in both IEM Directives provides that 'customers receive a final closure account following any change of electricity supplier no later than six weeks after the change of supplier has taken place'. Customers may not be charged for switching. Indeed:

> in order to promote switching, customers must be confident of the benefits of switching supplier. This means that the customer must be able to obtain a more preferable contract and that he/she must perceive that it is in fact beneficial to make the switch. Although customers are not charged for switching, there are both real and perceived costs related to switching, including fees, search costs, psychological costs and more. These costs make it less attractive to switch supplier. In cases where regulated prices are set lower than market prices, the customer has no incentive to switch. Thus, a market with regulated prices hinders the development of the retail market as there is no real competition between electricity suppliers.[38]

7.55 Thus, no charge can be levied by a DSO for the administrative costs involved when a customer changes supplier. Any such cost must be paid by all consumers and is thus socialized.

7.56 It is also important to ensure that all consumers have easy access to information on the switching procedure, supply prices, and products. To make the first stage more efficient and convenient for the customer, it is useful if each NRA requires the creation of a website providing information concerning suppliers, products, prices, etc. This measure is recommended by ERGEG.[39]

7.57 *(v) Non-discrimination:* It is important to ensure that the DSOs do not create obstacles to switching. Most DSOs are either vertically integrated with a supplier or within the same corporation as a supplier. As stated by ERGEG, '[t]he DSO then has an incentive to discriminate against other suppliers within their grid area. Without clear regulation making such conduct illegal, the consequences for the market could be severe'.[40]

[37] See n 36.
[38] See n 36, 8.
[39] See n 36, 5.
[40] See n 36, 26.

(7) Transparency and information provision

Article 3(5)(b) of the Third Electricity IEM Directive requires: **7.58**

> Member States [to] ensure that . . . (b) customers are entitled to receive all relevant consumption data.

Annex I of both the Third Electricity and Gas IEM Directives contain very important provisions concerning the measures that will be taken by the Member States to ensure respect for public service and consumer protection requirements (as per Article 3 of both Directives). These Annexes also provide details[41] concerning the information to be provided to consumers: **7.59**

> **Measures on consumer protection.**
> Without prejudice to EU rules on consumer protection, in particular Directive 97/7/EC of the European Parliament and of the Council of 20 May 1997 on the protection of consumers in respect of distance contracts and Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts, the measures referred to in Article 3 are to ensure that customers:
> (a) have a right to a contract with their electricity service provider that specifies:
> – the identity and address of the supplier,
> – the services provided, the service quality levels offered, as well as the time for the initial connection,
> – the types of maintenance service offered,
> – the means by which up-to-date information on all applicable tariffs and maintenance charges may be obtained,
> – the duration of the contract, the conditions for renewal and termination of services and of the contract and whether withdrawal from the contract without charge is permitted,
> – any compensation and the refund arrangements which apply if contracted service quality levels are not met, including inaccurate and delayed billing,
> – the method of initiating procedures for settlement of disputes in accordance with point (f),
> – information relating to consumer rights, including on the complaint handling and all of the information referred to in this point, clearly communicated through billing or the electricity undertaking's web site. Conditions shall be fair and well-known in advance. In any case, this information should be provided prior to the conclusion or confirmation of the contract. Where contracts are concluded through intermediaries, the information relating to the matters set out in this point shall also be provided prior to the conclusion of the contract;
> (b) are given adequate notice of any intention to modify contractual conditions and are informed about their right of withdrawal when the notice is given. Service providers shall notify their subscribers directly of any increase in charges, at an appropriate time no later than one normal billing period after the increase comes into effect in a transparent and comprehensible manner. Member States shall ensure that customers are free to withdraw from contracts

[41] The extent of which has grown markedly since the first appearance of these Annexes in the Second Energy Package in 2003.

if they do not accept the new conditions notified to them by their electricity service provider;

(c) receive transparent information on applicable prices and tariffs and on standard terms and conditions, in respect of access to and use of electricity services;

(d) are offered a wide choice of payment methods, which do not unduly discriminate between customers. Prepayment systems shall be fair and adequately reflect likely consumption. Any difference in terms and conditions shall reflect the costs to the supplier of the different payment systems. General terms and conditions shall be fair and transparent. They shall be given in clear and comprehensible language and shall not include non-contractual barriers to the exercise of customers' rights, for example excessive contractual documentation. Customers shall be protected against unfair or misleading selling methods;

(e) are not charged for changing supplier;

(f) benefit from transparent, simple and inexpensive procedures for dealing with their complaints. In particular, all consumers shall have the right to a good standard of service and complaint handling by their electricity service provider. Such out-of-court dispute settlement procedures shall enable disputes to be settled fairly and promptly, preferably within three months, with provision, where warranted, for a system of reimbursement and/or compensation. They should, wherever possible, be in line with the principles set out in Commission Recommendation 98/257/EC of 30 March 1998 on the principles applicable to the bodies responsible for out-of-court settlement of consumer disputes;

(g) when having access to universal service under the provisions adopted by Member States pursuant to Article 3(3), are informed about their rights regarding universal service;

(h) have at their disposal their consumption data, and shall be able to, by explicit agreement and free of charge, give any registered supply undertaking access to its metering data. The party responsible for data management shall be obliged to give those data to the undertaking. Member States shall define a format for the data and a procedure for suppliers and consumers to have access to the data. No additional costs shall be charged to the consumer for that service;

(i) are properly informed of actual electricity consumption and costs frequently enough to enable them to regulate their own electricity consumption. That information shall be given by using a sufficient time frame, which takes account of the capability of customer's metering equipment and the electricity product in question. Due account shall be taken of the cost-efficiency of such measures. No additional costs shall be charged to the consumer for that service;

(j) receive a final closure account following any change of electricity supplier no later than six weeks after the change of supplier has taken place.

7.60 Annex I of the Third Gas IEM Directive is identical in its substance, except for its paragraph (g), which requires Member States to ensure that:

> customers . . . connected to the gas system are informed about their rights to be supplied, under the national legislation applicable, with natural gas of a specified quality at reasonable prices.

7.61 The role of the NRAs with regard to national retail markets and consumer protection has also been considerably reinforced.

7.62 (a) **Information for consumers:** Annex I(1)(i) to both the Third Electricity and Gas IEM Directives requires that:

> customers . . . are properly informed of actual electricity consumption and costs frequently enough to enable them to regulate their own electricity consumption. That information shall be given by using a sufficient time frame, which takes account of the capability of customer's metering equipment and the electricity product in question. Due account shall be taken of the cost-efficiency of such measures. No additional costs shall be charged to the consumer for that service.

7.63 Inaccurate and patchy billing records were the subject of regular complaints by consumers, which hindered proper assessment of the service and prices provided, often discouraging switching. Improved information for consumers should be the result of this provision, which should facilitate the proper functioning of the market. Articles 3(16) (Elec) and 3(12) (Gas) provide that:

> The Commission shall establish, in consultation with relevant stakeholders including Member States, the national regulatory authorities, consumer organisations, electricity undertakings and, building on the progress achieved to date, social partners, a clear and concise energy consumer checklist of practical information relating to energy consumer rights. Member States shall ensure that electricity suppliers or distribution system operators, in cooperation with the regulatory authority, take the necessary steps to provide their consumers with a copy of the energy consumer checklist and ensure that it is made publicly available.

7.64 It is the responsibility of Member States to ensure that the information is communicated to consumers in an effective manner. The creation of a checklist should help to ensure respect for those provisions. Also, the relevant information should be provided to customers in their contracts.

7.65 Annex I(1)(a) of the Third Electricity and Gas Directives also provide that 'customers . . . have a right to a contract with their electricity service provider that specifies . . . information relating to consumer rights, including on the complaint handling and all of the information referred to in this point, clearly communicated through billing or the electricity undertaking's web site'.

7.66 Concerning the billing information and obligations, Annex I(1)(i) of the Directives states that consumers must be properly informed of actual electricity/gas consumption and costs frequently enough to enable them to regulate their own electricity/gas consumption. These provisions are intended to ensure that consumers do not pay an excessive amount as part of a regular payment system and that consumers have access to a range of methods for payment. It is reasonable to assume that consumers should have access to systems that are paid in arrears or in advance and are accessible to all consumers, including those without bank accounts or access to the internet.[42]

[42] Interpretative Note: Retail Markets (n 35), 6.

7.67 The Commission has also noted that the introduction of appropriate smart meters would greatly assist the fulfilment of this obligation (see the discussion at paras 7.68 ff). Those measures will protect and help the consumer to know what they should eventually expect to pay for their levels of energy consumption, again facilitating consumer choice between competing suppliers.

7.68 (b) **Intelligent metering systems—smart metering:** In the context of transparency and information, an important step has been taken in Annex I(2) of the Third Electricity and Gas IEM Directives. Encouraging the active participation of consumers in the market was identified as a key aspect in the negotiations for the Third Energy Package, and much of this is reflected in the expanded provisions in the Annexes to the two IEM Directives; smart metering was viewed as being of particular significance as a consumer information provision device (as well as a possible means for improving demand-side management in the future).[43] The Third Electricity IEM Directive provides that:

> Member States shall ensure the implementation of intelligent metering systems that shall assist the active participation of consumers in the electricity supply market. The implementation of those metering systems may be subject to an economic assessment of all the long-term costs and benefits to the market and the individual consumer or which form of intelligent metering is economically reasonable and cost-effective and which timeframe is feasible for their distribution.
>
> Such assessment shall take place by 3 September 2012.
>
> Subject to that assessment, Member States or any competent authority they designate shall prepare a timetable with a target of up to 10 years for the implementation of intelligent metering systems. Where roll-out of smart meters is assessed positively, at least 80 per cent of consumers shall be equipped with intelligent metering systems by 2020.
>
> The Member States, or any competent authority they designate, shall ensure the interoperability of those metering systems to be implemented within their territories and shall have due regard to the use of appropriate standards and best practice and the importance of the development of the internal market in electricity.[44]

7.69 A similar provision has been included in the second paragraph of Annex I to the Third Gas IEM Directive, with the difference that the timetable for the implementation of intelligent metering systems does not have the same assessed targets: '[s]ubject to that assessment, Member States or any competent authority they designate, shall prepare a timetable for the implementation of intelligent metering systems'.

[43] In the UK, for example, this has also been seen as a priority of government policy. For recent developments, see Ofgem: 'Smart Metering Spring Package—Addressing Consumer Protection Issues' (February 2011) and 'Commercial interoperability: proposals in respect of managing domestic customer switching where meters with advanced functionality are installed' (18 August 2011); and Department of Energy and Climate Change, 'A consultation on draft licence conditions and technical specifications for the rollout of gas and electricity smart metering' (August 2011).

[44] Annex I, para 2 of the Third Electricity IEM Directive.

7.70 A 'smart meter' is an electronic device which can measure the consumption of energy, providing more information than a conventional meter and transmitting data using a form of electronic communication. A key feature of a smart meter is the ability to provide bi-directional communication between the consumer and supplier/operator. It should also promote services which facilitate energy efficiency within the home.[45]

7.71 With regard to gas, the provisions are similar except for the absence of binding time limits on rollout, as a result of the current lower levels of functionality available for smart meters in the field of natural gas.[46]

7.72 (c) **Smart grids:** Articles 3(11) of the Third Electricity and 3(8) of the Third Gas IEM Directives provide that:

> In order to promote energy efficiency, Member States or, where a Member State has so provided, the regulatory authority must strongly recommend that electricity and gas undertakings optimize the use of energy, for example by providing energy management services, developing innovative pricing formulas, or introducing intelligent metering systems or smart grids, where appropriate.

7.73 According to the European Technology Platform SmartGrids, smart grids may be defined in the following manner: '[a]n electricity network that cost-efficiently can integrate the behaviour and actions of all users connected to it—generators, consumers and those that do both—in order to ensure a sustainable power system with low losses and high levels of quality, security of supply and safety'.[47] Concerning the implementation of smart grids, the Commission considers that:

> the implementation of more active transmission and distribution systems in the form of smart grids is central to the development of the internal market for energy. The development of technology to deliver more efficient management of networks is more commonly known as smart grids. The new systems will improve efficiency, reliability, flexibility and accessibility and are the key next steps in the evolution of the internal market in energy. Member States are encouraged to modernize distribution networks, for example through the introduction of smart grids, which should be built in a way that encourages decentralized generation and energy efficiency.[48]

7.74 EGREG agrees with this statement and has even gone further in its paper on smart grids of 10 June 2010:

> The context for ERGEG's consideration of smart grids is set by the key energy objectives of the European Union for the year 2020—increasing renewable energy supply to 20 per cent of total demand, reducing energy consumption by 20 per cent

[45] Interpretive Note: Retail Markets (n 35), 7

[46] C Jones (n 29), 437.

[47] European Technology Platform, 'SmartGrids, Strategic Deployment Document for Europe's Electricity Networks of the Future, Final Report' available at <http://www.smartgrids.eu>.

[48] Interpretive Note: Retail Markets (n 35), 9.

with respect to 2020 forecasts and reducing greenhouse gas emissions by 20 per cent with respect to 1990 levels—and the more ambitious objectives currently being developed for 2050. The most significant contribution that the electricity supply sector will make to reducing greenhouse gas emissions will be by replacing fossil-fired generation with low or zero carbon generation technologies. Nevertheless, the other key components of the supply chain, networks and the demand side, will also have vital roles to play. Smarter networks are expected to be a key facilitator in the transition to a low-carbon energy sector.[49]

7.75 The initiative for smart grids seems likely to come from the TSOs, DSOs, and suppliers. The transition towards smart grids will be an evolutionary process and new requirements may emerge over time. The allocation of costs should be shown transparently to consumers. As stated by ERGEG, 'consumer associations emphasise that higher commodity prices will be another factor affecting the electricity price. Therefore, it is absolutely key [always] to take the price effects into account'.[50]

(8) Specific customers

7.76 (a) **Vulnerable customers:** Protection for vulnerable consumers is provided by the Third Electricity and Gas IEM Directives. Article 3(7) of the Electricity Directive provides that:

> Member States shall take appropriate measures to protect final customers, and shall, in particular, ensure that there are adequate safeguards to protect vulnerable customers. In this context, each Member State shall define the concept of vulnerable customers which may refer to energy poverty and, *inter alia*, to the prohibition of disconnection of electricity to such customers in critical times. Member States shall ensure that rights and obligations linked to vulnerable customers are applied. In particular, they shall take measures to protect final customers in remote areas. They shall ensure high levels of consumer protection, particularly with respect to transparency regarding contractual terms and conditions, general information and dispute settlement mechanisms. Member States shall ensure that the eligible customer is in fact able easily to switch to a new supplier. As regards at least household customers, those measures shall include those set out in Annex I.[51]

7.77 The absence of a clear definition of 'vulnerable customers' may result in the measures taken to protect vulnerable customers being different in each Member State. As Jones et al have noted:

> There were discussions on what would constitute a vulnerable customer. Standard estimates of the proportion of income spent on electricity and gas to heat and light a home to an unacceptable level were dismissed on two grounds. First, many consumers use fuel sources other than electricity and gas to heat their homes . . . Second, energy prices tend to be more volatile than income levels, therefore

[49] ERGEG, 'Position Paper on Smart Grids, An ERGEG Conclusions Paper', Ref E10-EQS-38-05, 10 June 2010 available through <http://www.energy-regulators.eu>, 6.
[50] ERGEG (n 49), 22.
[51] See also Art 3(3) of the Third Gas IEM Directive.

changes in energy prices can significantly alter the number of customers falling into the category.[52]

7.78 When defining vulnerable consumers, Member States will need to consider carefully the groups of consumers that should be protected, remembering that energy/fuel poverty issues are often addressed via national social security systems or other instruments of social policy, rather than through energy law and policy. Member States were concerned to ensure that interventions via energy policy should neither undermine nor duplicate such other measures.[53]

7.79 These views are now reflected in Articles 3(8) (Electricity) and 3(4) (Gas), which state:

> Member States shall take appropriate measures, such as formulating national energy action plans, providing benefits in social security systems to ensure the necessary electricity supply to vulnerable customers, or providing for support for energy efficiency improvements, to address energy poverty where identified, including in the broader context of poverty. Such measures shall not impede the effective opening of the market set out in Article 33 or market functioning and shall be notified to the Commission, where relevant, in accordance with the provisions of paragraph 15 of this Article. Such notification may also include measures taken within the general social security system.[54]

7.80 Thus the poorest segment of final consumers will be the most relevant. In addition to this, specific categories of customers might be identified, such as the handicapped, the elderly and/or other socially assisted customers: '[f]or example, elderly consumers on an extremely low income may be considered to be vulnerable during a severe winter if they use electricity to heat their home'.[55]

7.81 The reinforcement of consumer protection and the promotion of retail competition were key goals for the European Parliament. The objectives of this consumer protection, as set out by Article 3(7) are the following.

7.82 First, it obliges Member States to take appropriate measures to protect final customers. Each Member State shall 'define the concept of vulnerable customers which may refer to energy poverty' and may refer to 'the prohibition of disconnection of electricity to such customers in critical times'. These obligations are strong obligations and yet they leave discretion to the Member States to define the categories of 'vulnerable customers' and to take the appropriate measures they estimate to be the best in order to protect those consumers from 'disconnection of electricity' 'in critical times'. High levels of 'consumer protection, particularly with respect to transparency regarding contractual terms and conditions, general information and

[52] C Jones (gen ed) (n 29), 417.
[53] C Jones (gen ed) (n 29), 417.
[54] Art 3(8) of the Third Electricity IEM Directive; see, similarly Art 3(4) of the Third Gas IEM Directive.
[55] Interpretive Note: Retail Markets (n 35), 6.

dispute settlement mechanisms' will be ensured.[56] This Article requires Member States to take 'appropriate measures' or 'measures' and they 'must ensure' or they must implement 'adequate safeguards'.

7.83 This provision imposes obligations but on one hand leaves a very large degree of discretion to the Member States in choosing the methods to achieve the objectives in question. On the other hand, the issues which must be addressed are rather specific: helping vulnerable customers to avoid disconnection at critical times, providing high levels of consumer transparency, easy switching for customers from one supplier to another, provision of general information, etc.

7.84 Different countries may choose to define these concepts in different ways in this context. For example:

- 'Poverty' is traditionally defined as the inability of an individual or a family to command sufficient resources to satisfy basic needs. Basically, it is a condition in which a person's income or consumption at a certain time falls below a certain threshold, which is referred to as the poverty line.[57]
- 'Vulnerability to poverty' can be defined as the probability that a household will become poor in the near future. This concept deals with probability, that is to say a risk that a currently non-poor household may end up being poor in the near future, due to events such as natural shocks or disasters, economic shocks or crisis, security problems, and others.[58]
- The calculation of household vulnerability rests in the sustainable livelihoods approach which considers human, financial, social, natural, and physical resources. Gender dimensions (ie male-female splits), production systems, and households' consumption patterns are considered.

The following categories of people are generally considered as 'poor and vulnerable households', by order of preference: households headed by women whose male members are either dead or incapacitated through sustainable injuries, unemployed landless households, and small farmers who do not have other supplementary source of incomes.[59]

7.85 In the context of the energy crisis, the concept of 'fuel poverty' emerged in Europe and drew the attention of the European Parliament: people spending more than 10 per cent of their overall incomes for energy (electricity, gas, heating) should fall

[56] Art 3(7) of the Third Electricity IEM Directive.

[57] G Fields, 'Poverty and Income Distribution: Data for Measuring Poverty and Inequality Changes in the Developing Countries' (1993) *Journal of Development Economics* 88.

[58] AA Perdana, 'Risk Management for the Poor and Vulnerable', May 2005, Economic Working Paper Series, available at <http://www.csis.or.id/CMS/workingpaperfile/54/wpe093.pdf>.

[59] Asian Development Bank, 'Immediate Support to Poor and Vulnerable Households in Inaccessible Areas Devastated by the 2005 Earthquake, Pakistan' (JFPR-9092).

into the category of 'fuel poor'.[60] The European Parliament underlined, in a report on housing and regional policy, that:

> This impoverishment is often exacerbated by energy problems. Although growing energy prices may result in a rationalisation of use (the establishment of measures and technologies to help save energy and the introduction of sustainable energy, development of new energy sources, etc.), the combination of low income, high energy prices and inadequate heating and insulation systems resulting in 'fuel poverty' and energy exclusion.[61]

7.86 The concept of 'fuel poverty' was defined by the European Parliament in this report as 'when more than 10 per cent of income is devoted to paying energy bills'.[62] In questions raised by the European Parliament to the European Commission, the latter also underlined that '[a] policy response to energy poverty requires the input of most parts of government as it requires the combination of both social and economic policy'.[63]

7.87 The concept of 'fuel poverty' emerged in the UK, where it is defined as:

> A household is considered to be in fuel poverty if it needs to spend 10 per cent or more of its income to maintain an adequate level of warmth (usually defined as 21 degrees for the main living area, and 18 degrees for other occupied rooms).[64]

7.88 Social protection legislation generally refers to a list of 'poor and vulnerable households', taking into account (*inter alia*):

- income support;
- housing support;
- tax benefit;
- disability living allowance;
- large families;
- minimum revenue;
- the elderly;
- long-term sickness and disability, etc.[65]

[60] European Parliament, Report on Housing and Regional Policy (2006/2108(INI)), Committee on Regional Development (28 March 2007), 11; European Parliament, 'Towards a Common EU Energy Policy', 5 December 2006.

[61] Report of the European Parliament on Housing and Regional Policy (A6-0090/2007, 28 March 2007), 11.

[62] Report of the European Parliament on Housing and Regional Policy (A6-0090/2007, 28 March 2007) 11, n 1.

[63] Parliamentary Questions, 24 October 2008, Answer given by Mr Piebalgs on behalf of the Commission, E-4841/2008.

[64] DEFRA, 'Fight Must Continue on Fuel Poverty Says Ministers', 2 October 2008, at <http://www.govnet.co.uk/news/2008-10-02/fight-must-continue-on-fuel-poverty-say-ministers>.

[65] For example, see Department for Communities and Local Government, *A Decent Home: Definition and guidance for implementation* (June 2006) at <http://www.communities.gov.uk/documents/housing/pdf/138355.pdf>, at 6.26, and Department of Energy and Climate Change, *The UK Fuel Poverty Strategy: 7th Annual Progress Report 2009* (October 2009) at <http://www.decc.gov.uk/assets/decc/statistics/fuelpoverty/1_20091021091505_e_@@_ukfuelpovertystrategy7annreport09.pdf>.

7.89 In implementing these Directives, Member States will of course have to inform the Commission about the measures taken under this provision and will have to demonstrate how they fulfilled these objectives. Following those reports, the Commission will regularly publish a report analysing measures taken at national level to achieve public service objectives and comparing their effectiveness, with a view to making recommendations as regards measures to be taken at national level to achieve high public service standards.[66] According to Jones et al, however, 'notwithstanding this, the discretion given to Member States is so wide that only if it can be clearly demonstrated that the objectives stated are not met, can an infringement of the Directives be considered to exist'.[67] Moreover, such measures may differ from one Member State to the next, according to the particular circumstances in the Member States in question (under the subsidiarity principle) and may include specific measures relating to the payment of electricity bills, or more general measures taken in the social security system.[68]

7.90 Second, an important point is the possibility for Member States, in the definition of 'vulnerable customers', to refer to the prohibition on disconnection of electricity to such customers in critical times. This possibility is specifically mentioned in Article 3(7) of the Third Electricity IEM Directive, which provides:

> . . . each Member State shall define the concept of vulnerable customers which may refer to energy poverty and, *inter alia*, to the prohibition of disconnection of electricity to such customers in critical times.

7.91 In practice, it has to be noted that almost all countries have support systems for financially weak customers which are not specific to the energy sector. These support systems consist of financial support and mainly involve social allowances. A majority of countries also have non-economic support systems, such as protection against disconnection.

7.92 This protection aims also at the promotion of social and economic cohesion.

7.93 In the context of the protection of specific consumers, it is also worth mentioning that these measures also seek to promote social and economic cohesion. Article 3(10) of the Third Electricity IEM Directive provides:

> Member States shall implement measures to achieve the objectives of social and economic cohesion and environmental protection, which shall include energy efficiency/demand-side management measures and means to combat climate change, and security of supply, where appropriate. Such measures may include, in particular, the provision of adequate economic incentives, using, where appropriate, all existing national and Community tools, for the maintenance and

[66] Recital 45 to the Third Electricity IEM Directive.
[67] C Jones (n 29), 416.
[68] Recital 45 to the Third Electricity IEM Directive.

> construction of the necessary network infrastructure, including interconnection capacity.[69]

7.94 The social and economic cohesion promoted here may lead to measures taken by the Member States like 'means to combat climate change, and security of supply, where appropriate' and 'adequate economic incentives'. The question may be asked: which categories of consumers will fall within these 'objectives of social and economic cohesion and environmental protection'? Who counts in this category? It seems that the national definitions could include legal persons as well as household consumers.

7.95 Concerning the protection of vulnerable consumers on the gas market, it has to be noted that Article 3(3) of the Third Gas IEM Directive, while largely in identical terms, does contain slight differences from Article 3(7) of the Third Electricity IEM Directive. There is no USO in the Gas Directive (with no universal gas (transmission and/or distribution) network coverage in some Member States, this would have made no sense)[70] but there is still provision for a supplier of last resort as a consumer protection measure.

7.96 The protection that will be given to vulnerable consumers and the new measures that will have to be taken, also means that the Third Package Directives provide new powers for the NRAs. Thus, Member States should also grant NRAs the power to contribute to: ensuring high standards of universal and public service in compliance with market opening; the protection of vulnerable customers; and the full effectiveness of consumer protection measures.[71]

7.97 **(b) Protection of customers in remote areas:** Articles 3(7) (Elec) and 3(3) (Gas) also provide that, 'Member States shall ensure that rights and obligations linked to vulnerable customers are applied. In particular, they shall take measures to protect final customers in remote areas.' There are good reasons to make specific provisions for the protection of customers in remote areas: 'First, a transmission or distribution system operator might not wish to connect such customers, it being disproportionately expensive to do so. Second, due to transmission and distribution costs, prices may be more expensive in remote areas than in towns.'[72]

7.98 It is important to note that under the Second Package it was optional to protect final customers in remote areas; this has been increased to a binding obligation under the Third Package Directives. Customers should be treated on an equal basis irrespective of their location.

[69] Art 3(7) of the Third Gas IEM Directive is in identical terms.
[70] C Jones (n 29), 422.
[71] Recital 37 to the Third Electricity IEM Directive.
[72] C Jones (n 29), 420.

7.99 (c) **The price of supplies and regulated tariffs:** Does this protection for particular categories of customers extend to allowing Member States to require that supplies be provided at reasonable tariffs? As discussed at para 7.12 in connection with the *Federutility* case, the starting presumption of the IEM Directives is the development and maintenance of competitive markets: prices should be set in the market (subject to the application of the competition rules) and not by regulators. On the other hand, the transition to a liberalized market may raise important issues concerning energy prices,[73] as may the position of certain categories of customer, and Article 3(2) specifically acknowledges that Member States are allowed to impose PSOs 'which may relate to [the] price of supply'. After *Federutility*, it is clear that any such PSOs must, as well as meeting the criteria of the last sentence of Article 3(2) (concerning transparency, non-discrimination, and so forth), satisfy the proportionality test. The Commission's enforcement practice under the Third Package has targeted a number of Member States with regard to their rules regulating prices in general.[74] Regulated prices across all customers are likely to hinder severely the development of competitive markets if the price levels are set at or below cost, since this will provide no incentives for new market entrants to offer supply.

7.100 However, more precisely targeted price regulation concerning particular categories of customer has generally been considered more acceptable and is, indeed, a widespread practice across many Member States: that is why this issue is discussed in detail in this section of the text. First, the Directive expressly requires Member States to ensure the supply of electricity at reasonable prices to household customers and allows them to do so for SMEs. May this be extended to *any* customer located in a remote area? One set of commentators has argued that this is possible under the Directive and, indeed, that Member States are obliged to do so, subject to meeting the conditions for the imposition of a PSO laid down in Article 3(2) (as previously discussed).[75] In favour of this interpretation, it should be pointed out that Article 3(7) (Elec) refers on this point to 'final customers', rather than 'household customers'. Against this, one should point out that this provision generally refers to the protection of 'vulnerable customers', within which category it might seem strange to include legal persons beyond SMEs. Also, note that any such obligation with regard to gas supplies would only apply insofar as such customers (however defined) were connected to the gas system (Article 3(3) (Gas)).

[73] Eg volatile wholesale markets, underdeveloped competition or over-concentration at various levels of the value chain and fully depreciated assets previously built using State resources: see C Jones (n 29), 409.

[74] Against Greece, Lithuania, Poland, Portugal, and Romania, respectively: see generally Commission Press Release IP/09/1035, MEMO/09/296 and 297 (all of 25 June 2009). More recently, the Commission has continued to pressurize Member States on this issue: see Press Releases IP/11/414 (6 April 2011, concerning Italy, Poland, and Romania) and IP/11/950 (19 May 2011, concerning Portugal).

[75] C. Jones (n 29), 420–421.

Second, the combination of such protection with an electricity USO based on non-discriminatory prices poses a challenge: how might one ensure such supplies at a reasonable price in remote areas? One key element concerns the reference area by which such non-discrimination is to be assessed. Member States could create a single tariff for each geographic area, which could lead to 'different [final] prices for the same category of customer on different distribution networks'.[76] According to Jones et al, there is nothing in the Third Electricity IEM Directive which would prevent this, and we would respectfully agree. **7.101**

(9) Single points of contact, complaints, and dispute settlement

Articles 3(12) of the Third Electricity and 3(9) of the Third Gas IEM Directives provide that Member States must put in place single points of contact, in order to facilitate the provision of information to customers. This covers information about their rights, current legislation, and the means of dispute settlement[77] available to them should this become necessary: **7.102**

> Member States shall ensure the provision of single points of contact to provide consumers with all necessary information concerning their rights, current legislation and the means of dispute settlement available to them in the event of a dispute. Such contact points may be part of general consumer information points.

Annex I(1)(g) of the Third Electricity IEM Directive completes this obligation by providing that Member States must ensure that the customers, when having access to universal service under the provisions adopted by Member States pursuant to Article 3(3), are informed about their rights regarding universal service. **7.103**

Moreover, in order to build confidence among consumers so that they will actively participate in the internal energy market, it is vital that their concerns and complaints are dealt with in a transparent, effective, and non-discriminatory manner. To this end, Member States must ensure that there is an independent mechanism, such as an energy ombudsman or consumer body, to deal efficiently with complaints and facilitate out-of-court dispute settlements.[78] **7.104**

The NRA in each Member State will have the duty of monitoring the level and effectiveness of market opening and competition at wholesale and retail levels, including on electricity exchanges, prices for household customers including prepayment systems, switching rates, disconnection rates, charges for and the execution of maintenance services, and complaints by household customers.[79] **7.105**

[76] C Jones (n 29), 420.

[77] Annex I(1)(f) to each of the Third IEM Directives expands upon procedures for dealing with complaints and for settling disputes: such procedures must be 'transparent, simple and inexpensive'.

[78] Interpretive Note: Retail Markets (n 35), 6. Under Art 3(9)(c) (Elec), suppliers are also required to provide information to customers, in or with their bills *and* with any promotional material made available to them, with regard to their rights concerning available means of dispute settlement.

[79] Arts 37(1)(j) of the Third Electricity and 41(1)(j) of the Third Gas IEM Directives.

(10) Roles of market operators

7.106 The Third Directives impose an additional obligation upon TSOs, DSOs, and suppliers. This obligation consists in the fact that the roles and responsibilities of TSOs, DSOs, supply undertakings, and customers (and if necessary other market participants) are defined with respect to contractual arrangements, commitment to customers and that those rules shall be made public. Articles 41 (Elec) and 45 (Gas) thus provide that:

> In order to facilitate the emergence of well functioning and transparent retail markets in the Community, Member States shall ensure that the roles and responsibilities of transmission system operators, distribution system operators, supply undertakings and customers and if necessary other market participants are defined with respect to contractual arrangements, commitment to customers, data exchange and settlement rules, data ownership and metering responsibility.
>
> Those rules shall be made public, be designed with the aim to facilitate customers' and suppliers' access to networks, and they shall be subject to review by the regulatory authorities or other relevant national authorities.

7.107 Regarding suppliers, a facility is also granted by the Third Package Directives regarding licensing or authorization regimes. Article 3(4) of the Third Electricity IEM Directive provides that:

> Member States shall ensure that all customers are entitled to have their electricity provided by a supplier, subject to the supplier's agreement, regardless of the Member State in which the supplier is registered, as long as the supplier follows the applicable trading and balancing rules. In this regard, Member States shall take all measures necessary to ensure that administrative procedures do not discriminate against supply undertakings already registered in another Member State.[80]

7.108 This provision does not remove the need for licensing a supplier that is registered in another Member State, but should ultimately lead to licensing regimes having regard to the licensing or authorization regimes in other Member States, so that it becomes easier for suppliers to enter new markets.

7.109 Regarding large non-household customers, an important step has been taken by the Commission in opening the market. Article 41 of the Third Electricity IEM Directive provides that '[l]arge non-household customers shall have the right to contract simultaneously with several suppliers'.[81] While there is no analogous provision in the Third Gas IEM Directive, its preamble states that: 'to develop competition in the internal market in gas, large non-household customers should be able to choose their suppliers and enter into contracts with several suppliers to secure their gas requirements. Such customers should be protected against exclusivity clauses, the effect of which is to exclude competing or complementary offers.'[82]

[80] Art 3(5) of the Third Gas IEM Directive is in identical terms.
[81] Art 41 of the Third Electricity IEM Directive.
[82] Recital 17 to the Third Gas IEM Directive.

7.110 The key practical question will be how the Member States will implement these measures. Article 41 of the Third Electricity IEM Directive, it seems, should operate to prohibit exclusivity clauses in contracts with suppliers, given that its 20th Recital is in identical terms to the wording of the preamble to the Third Gas IEM Directive. It is tentatively suggested that, depending upon the precise definition of the market and the other relevant elements, the application of EU (or indeed national) competition law rules may achieve similar results in both sectors, and the right laid down in Article 41 (Elec) would bolster this reasoning.

7.111 Other technical measures will have to be taken by the Member States in their technical codes. The regulatory supervision by the NRAs of suppliers, and in particular of the incumbent supplier, should be watchful on this particular point.

(11) Roles of regulators

7.112 The role of regulators with regard to the operation of national retail markets and consumer protection has also been considerably reinforced by the Third Package Directives. NRAs have been given the considerably enhanced role of ensuring that customers benefit from the efficient functioning of their national market, of promoting effective competition, and of helping to ensure consumer protection.[83]

7.113 If the relevant NRA does not have competence to enforce competition law, it will have to work in close cooperation with the relevant competition authorities and financial regulators.[84]

7.114 Article 37(1)(j) of the Third Electricity IEM Directive and Article 41(1)(j) of the Third Gas IEM Directive provide that the NRA shall have the duty of:

> monitoring the level and effectiveness of market opening and competition at wholesale and retail levels, including on electricity exchanges, prices for household customers including prepayment systems, switching rates, disconnection rates, charges for and the execution of maintenance services, and complaints by household customers, as well as any distortion or restriction of competition, including providing any relevant information, and bringing any relevant cases to the relevant competition authorities.[85]

7.115 Articles 37(2) of the Third Electricity and 41(2) of the Third Gas IEM Directives make clear that 'where a Member State has so provided, the monitoring duties set out in paragraph 1 may be carried out by other authorities than the regulatory

[83] Art 36(1)(g) of the Third Electricity IEM Directive and Art 40(1)(g) of the Third Gas IEM Directive. On NRAs generally, see Ch 5.
[84] Interpretive Note: Retail Markets (n 35), 4; with regard to financial regulators, the significance of this cooperation will be enhanced by the advent of the Regulation on Energy Market Integrity and Transparency (REMIT), on which see paras 5.42 ff.
[85] Art 37(1)(j) of the Third Electricity IEM Directive and Art 41(1)(j) of the Third Gas IEM Directive.

authority. In such a case, the information resulting from such monitoring shall be made available to the regulatory authority as soon as possible'.

7.116 The Commission's Interpretative Note on the retail markets strongly emphasizes this enhanced position of the NRAs. As has previously been noted in Chapters 3, 4, and especially 5, the definition of the roles and responsibilities of energy undertakings with regard to various matters[86] involves a stronger role for the NRAs. But the Interpretative Note goes further and recommends that '[i]nteraction between the organizations should be reinforced by legislation, where appropriate, in order to facilitate the sharing of confidential information and market investigations'.[87]

7.117 National regulatory authorities will also be responsible for 'publishing recommendations, at least annually, in relation to compliance of supply prices with Article 3, and providing these to the competition authorities, where appropriate'.[88]

[86] Art 41 of the Third Electricity IEM Directive and Art 45 of the Third Gas IEM Directive.
[87] Interpretive Note: Retail Markets (n 35), 4.
[88] Art 31(1)(o) of the Third Electricity IEM Directive and Art 41(1)(p) of the Third Gas IEM Directive.

8

LIBERALIZATION AND ENERGY CONTRACTS

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A. Introduction

(1) The liberalization

8.01 The liberalization of the energy market for natural gas and electricity has wrought deep changes to the contractual relationships in these sectors. Market liberalization has brought new players into the energy sector, which was characterized in the majority of Member States by a monopolistic structure. This has had concomitant effects in the development of the unique character of contractual relations within the incumbent operator of the market concerned.

8.02 Before the liberalization of the energy markets, the transport and distribution infrastructures were networks with no network externalities, characterized by a natural (and sometimes legal) monopoly. Before the liberalized market regime, electricity and natural gas companies were both charged with the transmission, distribution, and supply of energy. Today, the liberalization of the market offers to each end user the possibility to choose his or her supplier. The main consequence of the liberalization for contracts in energy has been to break up the formerly single contract concluded between the incumbent operator and the final customer into

several different contracts.[1] This evolution raises different legal issues which will be analysed in what follows.

(2) Law applicable to energy contracts

8.03 As there are no specific 'energy laws' applicable to 'energy contracts', energy contracts are usually governed by the general civil and commercial law applicable to the relevant contracts and obligations. With the evolution of the law, the Third Electricity and Gas Directives now impose particular obligations on the Member States in the context of consumer protection (see Ch 7). The national regulatory authority (NRA) in a Member State may also impose some obligations in this regard. Otherwise, energy contracts are contracts regulated in most of the Member States by civil and commercial law.

8.04 The contracts between a user of natural gas or electricity and its transmission system operator (TSO) and/or its supplier will, as any other contract, contain provisions relating to payment options and billing and guarantees (financial) of the parties or the confidentiality of data. In some Member States, these contracts can be explicitly regulated by the Member State and can be submitted to the control of the competent NRA which approves them. These contracts are, in the main, not really negotiable and must be indistinctly applied to the different users of the same network; however, practice has demonstrated that certain clauses, in particular those relating to bank or financial guarantees, are likely to lead to certain differences.

8.05 The contracts between an end user of natural gas or electricity and its supplier will contain all of the common provisions usual in commercial law and relating to the supply of goods, as well as particular provisions relating to the supply of energy. Those contracts may differ from user to user: these differences will depend upon the bargaining power of the customer vis-à-vis its supplier.

8.06 Therefore, if the matter is not specifically addressed by the 'energy law', then common law or contract law will be applicable to the issues that may arise during the drafting or the renegotiation of energy contracts. However, certain clauses of these contracts should meet the requirements and characteristics specific to these sectors.

[1] 'In order to develop competition in the internal market in electricity, large non-household customers should be able to choose their suppliers and enter into contracts with several suppliers to secure their electricity requirements', Recital 20 of the Third Electricity IEM Directive 2009/72 and 'Large non-household customers shall have the right to contract simultaneously with several suppliers', Art 40 of the Third Electricity IEM Directive, and Recital 17 and Art 41 of the Third Gas IEM Directive 2009/73.

(3) Distinguishing between the energy contracts

As contractual freedom is a principle in most of the Member States, a contract shall be governed by the law chosen by the parties. By their choice, the parties can select the law applicable to the whole or only to part of the contract:[2] **8.07**

> A contract shall be governed by the law chosen by the parties. The choice shall be made expressly or clearly demonstrated by the terms of the contract or the circumstances of the case. By their choice the parties can select the law applicable to the whole or to part only of the contract.

Also, parties can, by mutual agreement, change the law previously applicable to the contract (Article 3(2) of the Rome I Regulation). **8.08**

According to Recital 19 of the same Regulation, if the parties have not made a choice of applicable law, the applicable law should be determined by the rule specified for the particular type of contract. **8.09**

As a consequence, each company has developed its 'own contracts'. In order to offer protection for the consumers vis-à-vis big companies, in many Member States new energy contracts have been divided into two categories, one called 'regulated' contracts[3] and the other 'non-regulated' contracts. To protect the rights of the consumer, the supply of goods or services to a person is covered by special provisions, according to the principle of the protection of the weaker party.[4] For example, Article 6(1) of the Rome I Regulation protects the consumer by providing that the applicable law to consumer contracts is the law of the country where the consumer has his habitual residence: **8.10**

> Without prejudice to Articles 5 and 7, a contract concluded by a natural person for a purpose which can be regarded as being outside his trade or profession (the consumer) with another person acting in the exercise of his trade or profession (the professional) shall be governed by the law of the country where the consumer has his habitual residence.

Because of the natural monopoly of the undertakings (transmission grid operator, distribution grid operator, etc) on their grid (only one grid is built and there is no real possibility to build another one in the Member State), the 'regulated' contracts are those relating to the grid: grid access contracts, responsible party access contracts, connection contracts, etc. Those contracts require a stronger control and are submitted to the competent NRA's control. **8.11**

With regard to the second kind of contract, the parties have the possibility to negotiate because there is less regulation. As for those contracts (contracts of supply, **8.12**

[2] Art 3 of Regulation 593/2008/EC of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations ('Rome I'), [2008] OJ L177/6 (4 July 2008).

[3] G Block, L Hage, and J-P Pinon, 'Electricity and Gas', *RPDB*, Bruylant, 2007, n° 1261–1266.

[4] Convention on the law applicable to contractual obligations (Rome Convention): see now the Rome I Regulation (593/2008/EC) (n 2).

trading, etc) competition is possible and very little regulation or control by the NRA is exercised.

8.13 For instance, supply contracts are not regulated per se. Nevertheless, even if those contracts are not regulated, the Third Electricity IEM Directive provides that:

> Without prejudice to Community rules on consumer protection, in particular Directive 97/7/EC of the European Parliament and of the Council of 20 May 1997 on the protection of consumers in respect of distance contracts [and] Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts, [the measures of Article 3 of the Third Electricity IEM Directive] are to ensure that customers [have specific rights, such as] 'the right to a contract with their electricity service provider that specifies the identity and address of the supplier, the services provided, the service quality levels offered, as well as the time for the initial connection, . . . the types of maintenance service offered, . . . the duration of the contract, . . . the conditions for renewal and termination of services and of the contract and whether withdrawal from the contract without charge is permitted, . . . any compensation and the refund arrangements, . . . the method of initiating procedures for settlement, [etc].[5]

8.14 Previously, the EU had already established a general regulated system of consumer protection against unfair contract terms in the Directive 93/13/EEC,[6] Article 3 of which provides that:

> (1) A contractual term which has not been individually negotiated shall be regarded as unfair if, contrary to the requirement of good faith, it causes a significant imbalance in the parties' rights and obligations arising under the contract, to the detriment of the consumer.
>
> (2) A term shall always be regarded as not individually negotiated where it has been drafted in advance and the consumer has therefore not been able to influence the substance of the term, particularly in the context of a pre-formulated standard contract.

8.15 So, this Directive preserves the general principle of contractual freedom, but establishes a regulated framework for the situation where the consumer is not involved in the drafting and negotiation of contracts.

8.16 Also, Directive 97/7/EC[7] regulates some aspects of contracts concluded between the consumer and the seller. Notably, the contract must contain some prior information, such as the name of the seller or the delivery costs (see its Article 4). These consumer protection questions have been dealt with in Chapter 7.

[5] Annex 1 to the Third Electricity IEM Directive.

[6] Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts, [1993] OJ L95/29 (21 April 1993).

[7] Directive 97/7/EC of the European Parliament and of the Council of 20 May 1997 on the protection of consumers in respect of distance contracts, [1997] OJ L144/19 (4 June 1997).

In the gas and electricity sectors, these new contracts may be depicted as shown in Figure 5. **8.17**

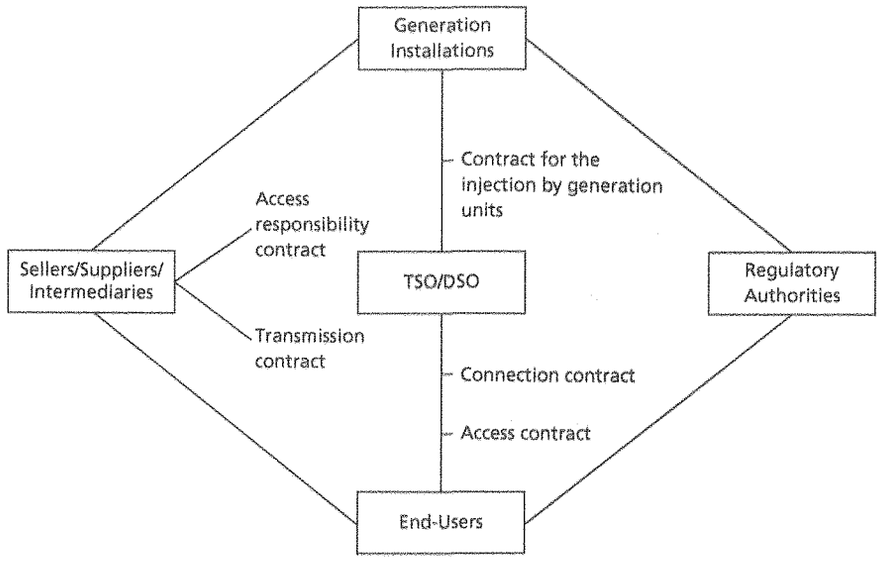

Figure 5 Structure of Energy Contracts and Parties

These distinctions may sometimes be purely theoretical, because practice shows that, as between these two categories, resulting from the previous 'unique' contract of the former monopolists in the markets of electricity and natural gas, there exist considerable and significant links between such contracts. **8.18**

(4) Evolution in the European rules—law applicable to contract

Even if contractual freedom is an important basic principle in most of the Member States, with the adoption of the various Packages of electricity and gas Directives, harmonization in the field of energy contracts is slowly, but progressively, occurring. **8.19**

Article 5 TEU lays down the principle of subsidiarity in EU law. This principle means that the Member States remain responsible for areas which they are capable of managing more effectively themselves, while the EU is permitted to exercise those powers which the Member States cannot discharge satisfactorily. For example, in a case which concerned the validity of Directive 98/44/EC on the legal protection of the biotechnological inventions, the European Court of Justice pro- **8.20**

ceeded to check the compatibility of the Directive with the principle of subsidiarity and concluded that:

> The objectives of the proposed action cannot be sufficiently achieved by the Member States and can therefore, by reason of the scale or effects of the proposed action, be better achieved by the [EU].

The objective pursued by the Directive, to ensure smooth operation of the internal market by preventing or eliminating differences between the legislation and practice of the various Member States in the area of the protection of biotechnological inventions, could not be achieved by action taken by the Member States alone. As the scope of that protection has immediate effects on trade, and, accordingly, on intra-EU trade, it is clear that, given the scale and effects of the proposed action, the objective in question could be better achieved by the EU.[8]

8.21 In the energy sector, the latest EU legislation attempts to harmonize the regulation of energy contracts in different Member States.

8.22 Today, the Agency for the Cooperation of Energy Regulators (ACER) established by Regulation 173/2009[9] is charged with the elaboration of Guidelines. These Guidelines aim to harmonize the grid codes of each Member State, which help the NRA to elaborate the terms and conditions of some contracts, such as access contracts or connection contracts. This topic has also been discussed in both the Madrid Forum[10] and the Florence Forum.[11]

8.23 Articles 6 of the Electricity Regulation 714/2009[12] and 8 of and Gas Regulation 715/2009[13] provide a list with areas in which framework guidelines and networks codes can be developed. Those areas are third party access rules, capacity allocation and congestion management rules, network security, and reliability rules, etc. On 29 July 2011, Framework Guidelines were adopted by ACER for the capacity allocation and congestion management for electricity[14] as well as on 3 August 2011 for

[8] Case C-377/98 *Netherlands v Parliament & Council* [2001] ECR I-7079.

[9] Art 7 of Regulation 713/2009/EC of the European Parliament and of the Council of 13 July 2009 establishing an Agency for the Cooperation of Energy Regulators [2009] OJ L211/1.

[10] On 28 May 2009: see 16th meeting of the European Gas Regulatory Forum, Madrid (14–15 January 2010), at <http://ec.europa.eu/energy/gas_electricity/gas/forum_gas_madrid_en.htm>.

[11] On 4 June 2009: see 17th meeting of the European Electricity Regulatory Forum, Florence (10–11 December 2009), at <http://ec.europa.eu/energy/gas_electricity/electricity/forum_electricity_florence_en.htm>.

[12] 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, [2009] OJ L211/15.

[13] Regulation (EC) No 715/2009/EC of the European Parliament and of the Council on conditions for access to the natural gas transmission networks and repealing Regulation (EC) No 1775/2005, [2009] OJ L211/36 (13 July 2009).

[14] ACER, 'Framework Guidelines on Capacity Allocation and Congestion Management for Electricity', FG-2011-E-002 (29 July 2011).

capacity allocation mechanisms for the European Gas Transmission Network.[15] This latter Framework Guideline is examined further in the context of third party access and long-term gas contracts (paras 4.163ff). The Commission can adopt legally binding guidelines under Article 18 of the Electricity Regulation and Article 23 of the Gas Regulation. Article 23(1) of the Gas Regulation 715/2009 provides that:

> Where appropriate, Guidelines providing the minimum degree of harmonisation required to achieve the aims of this Regulation shall specify:
>
> (a) details of third-party access services, including the character, duration and other requirements of those services, in accordance with Articles 14 and 15;
>
> (b) details of the principles underlying capacity-allocation mechanisms and on the application of congestion-management procedures in the event of contractual congestion, in accordance with Articles 16 and 17;
>
> (c) details of the provision of information, definition of the technical information necessary for network users to gain effective access to the system and the definition of all relevant points for transparency requirements, including the information to be published at all relevant points and the time schedule for the publication of that information, in accordance with Articles 18 and 19;
>
> (d) details of tariff methodology related to cross-border trade of natural gas, in accordance with Article 13;
>
> (e) details relating to the areas listed in Article 8(6).

8.24 The Third Package of energy Directives also reinforces the protection of end-users and gives more competences to the NRAs on the different contracts concluded between the energy actors and the end users (see Ch 7 on consumer protection). For instance, Article 40 of the Third Electricity IEM Directive provides that Member States shall require supply undertakings to keep for at least five years the relevant data relating to all transactions in electricity supply contracts and electricity derivatives with wholesale customers and transmission system operators. This must be placed at the disposal of the national authorities, including the NRA, the national competition authorities, and the Commission, to enable them to fulfil their tasks.

B. Analysis of the Contracts

(1) Regulated contracts

8.25 First, the contracts relating to access to the transmission or distribution network and its utilization are generally categorized as 'regulated' contracts. Indeed, they may be explicitly regulated and may be subjected to the supervision of the NRA.

[15] ACER, 'Framework Guidelines on Capacity Allocation Mechanisms for the European Gas Transmission Network', FG-2011-G-001 (3 August 2011).

8.26 The regulated contracts may include the following:

(a) for the electricity sector:
  (i) connection contracts;
  (ii) access contracts;
  (iii) access responsibility contracts;
(b) for the natural gas sector:
  (i) connection contracts;
  (ii) contracts relating to access and transmission services;
  (iii) natural gas distribution contracts.

8.27 Because these contracts are not negotiable in substance, it is required that they must be applied without distinction to different users of the same network and be non-discriminatory. In practice, however, certain clauses—especially clauses relating to financial and bank guarantees or clauses specific to the site situation of the end user—can lead to some difference and discrimination[16] and may be negotiated, sometimes with *ex ante* or *ex post* control by the NRA.

8.28 That is why, on the basis of its legal competences, the NRA should exercise its supervision over these contracts, which are essential for ensuring competition. *Ex ante*, the NRA may give its approval or *ex post* it should check the proper functioning of markets, the respect of rights to network access and the opening of the markets to competition.

(2) Supply contracts

8.29 The second main kind of contract concerns energy supply. Energy supply contracts are more easily negotiable between the eligible client and the intermediary/supplier. There are some negotiated contracts relating to energy supply on the markets that existed before the liberalization and others which appeared only after liberalization and the arrival of new stakeholders on the markets (for example, the trading contract).

8.30 Contractual freedom in negotiating supply contracts is not unlimited: such contracts are, like other regulated contracts, subject to some regulatory interference relating to network utilization. The supply contract's provisions must conform to the applicable regulations in this matter, especially to the technical regulations in gas or electricity.

8.31 The provisions relating to energy metering or to the installation of network connections, as well as these concerning the quality and the continuity of the energy supply, should take into account the particular regulations in this field (grid codes, codes of conduct, electrical and technical codes, etc).

[16] See Comm Brussels, RK 17/2002, summary judgment, 16 February 2002, confirmed by the Brussels Court of Appeal on 12 September 2003, case 2003/5399.

8.32 Moreover, from 3 March 2011, for those contracts, Member States will also have to respect Annex 1 to the Third Package Directives. Article 1(a) of Annex 1 to the Third Gas and Electricity Directives provides that:

> the consumer has a right to a contract with their electricity service provider that specifies:
> – the identity and address of the supplier,
> – the services provided, the service quality levels offered, as well as the time for the initial connection,
> – the types of maintenance service offered,
> – the means by which up-to-date information on all applicable tariffs and maintenance charges may be obtained,
> – the duration of the contract, the conditions for renewal and termination of services and of the contract and whether withdrawal from the contract without charge is permitted,
> – any compensation and the refund arrangements which apply if contracted service quality levels are not met, including inaccurate and delayed billing,
> – the method of initiating procedures for settlement of disputes in accordance with point [1](f),
> – information relating to consumer rights, including on the complaint handling and all of the information referred to in this point, clearly communicated through billing or the electricity undertaking's web site.
>
> Conditions shall be fair and well-known in advance. In any case, this information should be provided prior to the conclusion or confirmation of the contract. Where contracts are concluded through intermediaries, the information relating to the matters set out in this point shall also be provided prior to the conclusion of the contract . . .

8.33 Indeed, the first priority of EU energy regulators is to ensure that energy consumers get the necessary protection. The proper functioning of competitive energy markets and the rights of energy consumers are closely interlinked. Well-informed and active customers create a well-functioning market. Consumers can force a supplier to deliver a quality service at the best price by the credible threat of moving their business to another supplier.[17]

8.34 In 2005, the European Regulators' Group for Electricity and Gas (ERGEG) conducted a survey of the NRAs in its member countries, which included a question on the commercial quality of energy supply: 21 responses to this Consumer Protection Questionnaire were received. ERGEG's Report on that customer questionnaire concerning customer protection and supply quality concluded that:

> Commercial quality regulation attempts to ensure standards governing commercial quality. This is achieved through the use of regulations or codes, performance

[17] 'Fact sheet: European Energy Regulators put Consumers first', Ref FS-08-02, October 2008, at <http://www.energy-regulators.eu/portal/page/portal/EER_HOME/EER_PUBLICATIONS/CEER_PAPERS/Customers/2008/FS-08-02_EUEnergyRegulatorsPutConsumersFirst_2008-10_Fin.pdf>.

standards, the dissemination of information to promote the quality of services as well as through strategies to encourage customer participation.[18]

8.35 In this way, the NRAs should set up guaranteed standards and minimum service levels which must be met in each individual case to assure the commercial quality of supply.

8.36 In addition, the NRA can intervene in energy supply contracts if they contain discriminatory and illegal clauses: eg when the competition rules are not respected. On the role of NRAs more generally, see our discussion in Chapter 5.

(3) Supply contracts and other agreements—key clauses

8.37 Since regulated contracts must contain more or less the same types of clauses, and given that the substance of these clauses may vary from Member State to Member State, it is of some interest to analyse the typical clauses in negotiated contracts.

8.38 Certain contractual provisions concerning the electricity and natural gas market are usual and are present in most of the contracts and should be analysed. These clauses (without attempting to provide an exhaustive list and acknowledging that such contracts are in constant evolution) are the following:

(1) the object of the contract;
(2) delivery point;
(3) supply type;
(4) quality;
(5) price;
(6) clauses relating to the quantity;
(7) billing;
(8) liability;
(9) *force majeure;*
(10) term/duration;
(11) jurisdiction and dispute settlement;
(12) confidentiality.

8.39 Some of these clauses are discussed in the following paragraphs.

8.40 **(a) Object of the contract:** The contract's object tends to describe what is covered by the contract, what is committed by the parties and, by signing the contract, what will be done by the parties. The clause on the object of the contract will define the components constituting the service for which the contract is signed.

[18] ERGEG, 'Report on Customer Protection', Ref E05-CFG-02-05, approved by ERGEG 30 September 2005, at <http://www.energy-regulators.eu/portal/page/portal/EER_HOME/EER_PUBLICATIONS/CEER_PAPERS/Customers/2005/E05-CFG-02-05.pdf>.

The object of the contact is defined as 'object of main obligations born from the contract'.[19] Those obligations consist of the transfer of the right to do or not to do something.[20] The contract's object enumerates each step relating to these commitments. **8.41**

In an energy supply contract, the object for the seller is to provide and supply a good quality of energy at the delivery point, and, for the buyer, the object consists in taking delivery of energy and paying the price for it. For example, in a supply contract, the contract's object may be formulated in various ways: **8.42**

- 'The contract governs all transactions the Parties shall enter into for the purchase, sale, delivery and acceptance of Natural Gas/Electricity'.[21]
- 'By signing the contract, within the limits further described hereafter, to supply energy necessary for the needs of the Site of the client, who accepts the supply. In return, the client commits to pay for this energy, according to the price and invoicing clauses and to the regulation determined in the Contract'.
- 'The supplier agrees to sell and to deliver active electrical energy to the Client in accordance with the terms and conditions of this Contract'.
- 'The client agrees to buy and off-take. He agrees to pay for the active electrical energy delivered at the off-take/delivery point according to the provisions of this Contract'.
- 'This agreement stipulates the mutual rights and obligations of the Parties in connection with the supply of electrical energy by the supplier and the off-take of this energy by the client'.

Usually, supply contracts expressly exclude some obligations concerning the connection, access, and access responsible contracts. For example: **8.43**

- 'The present contract is not applicable to the network connection modalities. Also, it does not govern the modalities relating to the network use or metering. Other separated contracts between the Network operator and the owner of the power station govern these objects'.
- 'This contract is not applicable to:
  - the supply of reactive Electrical Energy;
  - the duty of transport, local transport and/or distribution of the active Electrical Energy on the Network of the Network Operator and the quality of the supplied electricity;
  - the rent, the upkeep and the maintenance of the measurement instruments; and
  - the exploitation, the upkeep and the renewal of the Networks'.

[19] P van Ommeslaghe, *Obligations Law* (Brussels: Bruylant, 2010), vol I, 281.
[20] B Starck, H Roland, and L Bayer, *Obligations: Contracts* (4th edn, Paris: Litec, 1993), 211.
[21] Article 1, § 1 of General Agreement concerning the delivery and acceptance of Natural Gas, European Federation of Energy Traders (EFET), 11 May 2007; Article 1, § 1, of General Agreement concerning the delivery and acceptance of Electricity, EFET, 21 September 2007.

8.44 The determination of the object of the contract is essential for the good performance of contractual obligations, as it determines what will be performed by the parties and what will not.

8.45 **(b) Delivery point/off-take point:** The delivery point is the place where the consumer takes off the energy. For example, the delivery point/the off-take point is typically defined as: 'the physical place and the voltage level of a point at which the power will be supplied from the network (as defined in Annex . . . to the Contract)'. Generally, the delivery point is specified by an EAN (originally, European Article Number, which is a thirteen-digit barcode) code.

8.46 Parties may also negotiate a contract with a delivery point clause at different geographical sites. They can be established in the same Member State or in different Member States. These are known as 'multi-site' contracts or energy invitations for tender, which are created for the supply of different sites (eg sites in Western continental Europe, sites in five countries of Europe, or a combined offer in two sites located in different regions). These invitations for tender can emanate from an industrial group possessing some sites of production or a collective of energy-consumers. As an example, in October 2005 a consortium, including companies representing about 20 per cent of the electricity consumption in the Netherlands, started negotiations with the energy sector for long-term supply at preferential prices (*Het Financiële Dagblad*, 23 January 2006). The creation of such collective purchasing structures can raise certain questions concerning the relations between the individual buyers, as well as those with one or several supplier(s).

8.47 Then, during the performance of the contract, the agreed price fixed during the conclusion of the contract could become, for example after six months of execution of the contract, improperly low, because of the variability of the market. On one hand, in its *AKZO* judgment the ECJ held that a price is improperly low or predatory if the revenues do not cover the average of the total marginal costs (variable and fixed) directly attributable to the supply of the service.[22] In other words, a price, which was not 'predatory' at the time of the formation of the contract, could become so during its performance. To avoid this risk, it is sensible to include a contractual clause allowing for the revision or adaption of the price in certain circumstances and thus to maintain the economic balance of the contract.

8.48 **(c) Continuity and Quality:** One of the essential aspects for a user of energy concerns the modalities of supply and notably, the continuity of supply, especially in a market opened to competition with its multiplicity of stakeholders.

8.49 The continuity and the quality of the supply are essential points in an energy supply contract. The continuity and the quality of the supply constitute a major

[22] Case C-62/86 *AKZO v Commission* [1991] ECR I-3359.

preoccupation of the final customer. Indeed, in certain sectors or certain industries in particular (hospitals, chemicals), interruptions of the natural gas supply or in electricity can have disastrous consequences. This is the so-called 'off-spec clause' in a gas supply contract.

8.50 The average consumer also perceives the continuity of the supply to be essential. Article 3(3) of the Second Gas IEM Directive (2003/55/EC) developed this concept:

> Member States shall take appropriate measures to protect final customers and to ensure high levels of consumer protection, and shall, in particular, ensure that there are adequate safeguards to protect vulnerable customers, including appropriate measures to help them avoid disconnection . . . Member States may appoint a supplier of last resort for customers connected to the gas network.

8.51 Also, Article 3(3) of the Third Gas IEM Directive provides that:

> Member States shall take appropriate measures to protect final customers, and shall, in particular, ensure that there are adequate safeguards to protect vulnerable customers. In this context, each Member State shall define the concept of vulnerable customers which may refer to energy poverty and, *inter alia*, to the prohibition of disconnection of gas to such customers in critical times. Member States shall ensure that rights and obligations linked to vulnerable customers are applied. In particular, they shall take appropriate measures to protect final customers in remote areas who are connected to the gas system.

8.52 If the law offers protection to the domestic consumers through obligations of public service (see Ch 7), professional customers have to negotiate their level of security of supply (see Chs 9 and 10 on security of supply: the starting presumption of the EU legislation in this area is that market mechanisms will, other things being equal, suffice to secure supplies).

8.53 A former energy supply contract would have included the principle that 'the supply of energy will be neither interrupted nor reduced by the supplier, except in those cases provided for under this contract'. In this context, two clauses are essential: the definition of *force majeure* and the penalties to be paid by the supplier in case of supply outages or interruptions in deliveries.

8.54 The concept of *force majeure* is discussed at paras 8.100 ff. There was an historic tendency in energy contracts to protect the supplier, either by contractually widening the concept of *force majeure* or by planning a series of circumstances, which did not fall under the common concept of *force majeure*, but which exonerated the supplier of his liability in the event of interruptions in the continuity of supply. The amount of the penalties constituted the best signal allowing the supplier to decide which measures should be taken to ensure the deliveries. This is true for the supplier-consumer relationship, but also for the relationship between producer and importer.

8.55 Regarding industrial customers, the parties can also agree, in particular because of the high prices of the balancing services provided by the network, on the flexibility and security of increased supply by planning the possibility of acceding to additional stocks of natural gas (a technique known as 'extra-balloon').

8.56 In certain industrial domains, the continuity of the supply is extremely important as it may be difficult to put in place industrial processes for avoiding 'micro-cuts or outage' (cuts of very short duration). Other customers, whose activities can handle such micro-cuts, can conclude a contract in which they accept this type of cut. The contract can contain clauses concerning interruptions in the supply by respecting certain conditions ('clauses of interruption'), in particular in price rates. So, 'interruptible' supply contracts can be negotiated. The firmness of supply criterion can allow purchasers to save up a significant amount on the transport costs of gas, for example by using interruptible capacities:

> – 'The electrical energy is supplied in the form of three-phase alternating current of 50 hertz. The nominal tension of delivery is defined in Appendix X. The quality of the supplied electrical energy, as well as the accepted tolerances, is specified in Appendix X'.

8.57 These clauses of interruption will sometimes make the link with the liability of the parties in that case: eg by stipulating that 'the interruption being a substantial characteristic of these supplies, a compensation for losses of production or quite other damage is excluded, as far as the interruption or the reduction of supply is made in the limits planned by the contract'.

8.58 But the supplier can also make savings by relying upon this flexibility: interruptible imports, less need for storage capacity, etc can reduce the supplier's costs. The consumer who agrees to interruptions in his consumption (for example, by consuming some substitute fuel while the gas is interrupted or by reducing its industrial production), meanwhile, can take advantage by negotiating an interruptible supply contract with reduced prices.

8.59 For that purpose, the grid code and the technical regulations determine the conditions in which the network operators can proceed to interruptions or reductions of supply.

8.60 To frame the process of liberalization, regarding the continuity of the supply, the regional legislators developed a mechanism called 'supplier by default' (a concept also known under the term of 'default supplier') intended to ensure that a customer of the distribution network, once eligible, is not deprived of supply in the case where he did not make an explicit choice of a new supplier.

8.61 Moreover, ERGEG's Customer Protection Best Practice Proposition highlights the importance of quality supply of energy. Notably, ERGEG insists that distribution network operators should make their best efforts to ensure reliable and continuous

supply of good quality energy. The uninterrupted supply of energy to customers via networks is a key element of network service.[23]

8.62 **(d) Transfer of property, transfer of risks:** The parties to an energy supply contract decide where the transfer of property/title will occur as between the supplier and industrial consumer. The transfer of property can occur simultaneously or not with the transfer of risks. Generally, the transfer of property and risks occurs at the off-take points, eg:

- The property transfer of the delivered electricity is effected at the off-take Point of the Sites as defined at (. . .).
- The off-take Points are the consumption points.
- The transfer of Risks and the transfer of liability are effected at the injection point, as mentioned in (. . .) for each Site(s) of the client.
- The transfer of liability is effected at the Entry Point of the Transport and Distribution Network.

8.63 The quantity of gas to be supplied is, of course, crucial to the supplier, and it often happens that the contract includes an obligation to take a minimum level of supplies. However, the key figure will rather be the maximum debit to supply, either non-interruptible or interruptible in character. According to these figures, the supplier will determine the capacity of transport services which he will need, and the debits which he will have to command 'upstream', namely upstream to the transport network. The delivery point and, thus, the point of risk transfer is determined freely by the parties (eg price 'ex-Hub', price 'border', etc) as far as this does not conflict with the provisions of the code of conduct or with the applicable technical regulations.

8.64 Indeed, the transfer of property or risks can be more specifically regulated in certain sectors, notably liquefied natural gas (LNG). For example, at the LNG terminal there is a double or triple transfer of risks. Indeed, the shipper bears all risks relating to the LNG until the delivery point. At the delivery point, there is a transfer of risks to the terminal operator. The terminal operator is liable for all processes of transformation on natural gas. The risks pass to the shipper at the redelivery point at the outlet flange of the LNG terminal. A sample clause might read as follows:

> Custody and all risks, including risk of loss, with respect to all LNG shall remain with Shipper upstream of the Delivery Point and shall pass to Terminal Operator at the Delivery Point. All risks of the LNG received by Terminal Operator and the associated regasified Natural Gas shall remain with Terminal Operator from the Delivery Point to the Redelivery Point. All risks of regasified Natural Gas redelivered to Shipper shall pass to Shipper immediately downstream of the Redelivery Point.

[23] ERGEG, 'Customer Protection Best Practice Proposition', Ref: E05-CFG-03-06, 21 July 2006, available at <http://www.energy-regulators.eu/portal/page/portal/EER_HOME/EER_PUBLICATIONS/CEER_PAPERS/Customers/2006/E05-CFG-03-06.pdf>.

8.65 Also, a property reservation clause creates a co-ownership between the parties when the LNG is located in the terminal. Under such a clause, the shipper and/or the other shippers and/or other users and/or terminal operator shall jointly own the total quantity of the LNG and associated degasified natural gas between the delivery point and the redelivery point and each of them shall have rights for the share of its contribution to the total quantity of LNG.

8.66 To summarize, the parties are free to determine the place of transfer of property or risks, but in energy contracts some aspects of the transfer have their specificities.

8.67 (e) **Price:** In the energy market, the regulated or non-regulated aspect of the contract can determine the negotiability of the price for the services rendered.

8.68 Notably, the NRA has the duty to ensure that the tariffs and prices for connection and other networks are non-discriminatory, reasonable, and transparent.[24] The Third Electricity and Gas IEM Directives require that the regulatory authorities shall be responsible for fixing and approving, prior to their entry into force, at least the methodologies used to calculate or establish the terms and conditions for connection and access to national networks, including transmission and distribution tariffs.[25]

8.69 Also, the Third Gas and Electricity IEM Directives emphasize the importance of consumer protection (Article 3 of these Directives). Member States should ensure that all consumers have access to universal service, that is the right to be supplied with the electricity of a specified quality within their territory at reasonable, easily and clearly comparable and transparent prices.[26]

8.70 More specifically, Annex 1 of the Third Gas/Electricity IEM Directive provides measures on consumer protection. The consumer has a right 'to receive transparent information on applicable prices and tariffs and on standard terms and conditions, in respect of access to and use of electricity services'.[27] Price transparency allows the consumer to choose the supplier or to switch his or her supplier.

8.71 To summarize, the possibility to switch[28] to a new supplier, within a short period of time and without obstacles and disadvantages for the customer, is an essential pre-requisite for a functioning and efficient market.

[24] Arts 37 and 41 of the Third Electricity and Third Gas IEM Directives, respectively.
[25] ERGEG, 'Customer Protection: Best Practice Proposition', Ref: E05-CFG-03-06, 21 July 2006 (n 23), 7.
[26] ERGEG, 'Customer Protection: Best Practice Proposition', Ref: E05-CFG-03-06, 21 July 2006 (n 23), 4.
[27] Art 1(b) of Annex 1 to the Third Gas and Electricity IEM Directives.
[28] Art 1(e) of Annex 1 to the Third Gas and Electricity IEM Directives.

8.72 For the supply of energy, the final price consists of a fixed fee and a part related to the variable component ('commodity term'). The fixed fee includes the fixed parts of regulated services of transport and distribution.

8.73 Usually, the contracts refer to the index published by electricity and gas stock markets. Certain actors, however, remain reserved compared to these indices because of the liquidity of the energy stock market.

8.74 Certain suppliers offer a price without transportation and the consumer supports the risk of transport and distribution tariffs variation. The term 'tariff' usually concerns regulated prices.[29]

8.75 Price indexation is also an important issue in the negotiated contract. It is even more important for medium- or long-term contracts (see paras 8.121–8.171 on long-term contracts). Usually, the taxes, duties, royalties, and other charges are directly charged to the customer. Such a clause might provide that:

> All existing or new taxes and/or charges and/or expenses of whatever nature (including green energy levies and expenses relating to greenhouse gas emission regulations) increases and levies imposed by a competent public authority and linked to the object of this contract shall be fully borne by the client.

8.76 Generally, energy contracts include price clauses.[30] These clauses try to find the necessary balance between the stability and the foreseeable nature of situations. Notably, hardship clauses are prevalent in energy contracts,[31] particularly in long-term energy contracts.[32] Unforeseeable events which were excluded from the parties' forecasts could have the effect of undermining the economic basis of the existing market[33] or could make the performance of contractual obligations very difficult or costly.[34] Contracts for the import of gas usually contain a clause on renegotiation of prices, named 'hardship clauses', in particular 'when one of the critical parameters for the determination of the price disappears or is modified in a drastic way'. According to this type of clause, the parties will consult, in case of the emergence of economic circumstances having the effect of making the prices or the formulae inequitable or unbearable, to adapt the valuation clause and restore the contractual balance prevailing at the time of the conclusion of the contract. The

[29] *Lexicon energiemarkt Nederland en België* (Utrecht, Lemma 2003), 247.
[30] G Block, 'Arbitration and Changes in the Energy Price. Examination of the Arbitration Case Law of the ICC towards the Clauses of *Force Majeure*, Indexation, Adaptation, of Hardship and of Take-or-pay' (2009) 20(2) ICC International Court of Arbitration Bulletin 71.
[31] G Block, 'The Hardship and Adaptation Clauses in the Energy Contracts', in *Europ'Energies*, March 2008, 11.
[32] G Block, 'The Hardship and Adaptation Clauses in the Energy Contracts' (n 31), 11.
[33] A Al Faruque, 'Renegotiation and Adaptation of Petroleum Contracts: The Quest for Equilibrium and Stability' (2008) 2 *Journal of World Investment & Trade* 128.
[34] F Fucci, 'Hardship and Changed Circumstances as Ground for Non-Performance or Adjustment of Contract' (2006) *Transnational Dispute Management*, 9–11.

failure of this 'dialogue' can lead to arbitration or to the termination of the contract at the request of one of the parties.

8.77 The second kind of price clause is adaptation or indexation clauses. Parties fix the price for the duration of the contract and it is reviewed automatically.[35] This is the main difference between adaptation and hardship clauses.[36]

8.78 Finally, the take-or-pay (TOP) clause obliges the buyer to take a minimum quantity of energy and to pay for it, even if he or she does not use it[37] (see paras 8.159ff on TOP).

8.79 **(f) Billing:** The electricity and gas bills are important for proper market functioning. Previously, customers had to buy a standard product offered by a sole supplier. Post-liberalization, they can buy different products from different suppliers. These products are variables because of their prices, their quality, or their source of energy for the electricity production. Domestic clients can benefit from reductions if they pay by certain means (such as direct debit).

8.80 To ensure compliance with the competition rules, it is important to have transparent information about different properties and quality of products involved. In this way, the consumer should have the possibility to compare and to choose between different suppliers on the basis of correct and reliable information.[38] The bill should provide customers with the up-to-date information on the present price of electricity/gas energy as well as distribution network services. The rules on price information in the bill should be in accordance with the relevant rules on general price information.

8.81 Another dimension of transparency of the price elements in the bill is the accuracy of the bill. The consumer must pay according to their actual consumption instead of consumption estimates.[39]

8.82 Traditionally, the supply of energy is invoiced monthly. So, a billing clause may provide as follows:

> The (electricity/gas) supply is invoiced monthly. The bill is drawn up on the basis of the monthly consumption and the adaptation of the provisional bill of last month. The first one is calculated on the basis of provisional data and the second one and others thereafter on the basis of definitive data.

[35] C Petersen, '*Gas Natural Aprovisionamientos, SDG, SA* v *Atlantic LNG Company of Trinidad and Tobago* and price reopener clauses in a uncertain environment for LNG pricing', Paul Hastings, March 2009, 1–5.

[36] Judgment CCI n°3344, 1981, Rec. 1974–1985, 442.

[37] G Block, 'Arbitration and Changes in the Energy Price' (n 30).

[38] Art 1(a) of Annex 1 to the Third Gas and Electricity IEM Directives.

[39] ERGEG, 'Transparency of Prices: Best Practice Proposition', Ref: E05-CFG-03-06, 21 July 2006 (n 23), 8.

8.83 The billing clauses may contain payments monthly, weekly, or according to another period. Billing clauses also often contain rules on sanctions in case of non-payment of the bill.

8.84 **(g) Additional contributions, taxes, and surcharges:** Before liberalization, an energy contract would provide that 'the price includes all charges, fees and taxes charged by the supplier'. That was an 'all-in price' system.

8.85 Such clauses are no longer applicable in the current energy markets. Indeed, with the establishment of competition in the energy market, there were initiatives to create contributions or surcharges on the energy prices for financing funds or generating revenues which may or may not directly concern the energy market. Those surcharges are generally borne by the client according to their consumption, eg:

> All new taxes or increases in existing surcharges and/or charges and/or expenses of whatever nature imposed by a competent public authority and linked to the object of this contract shall be fully borne by the client and will be calculated on the basis of his consumption.

8.86 **(h) Liability and compensation clauses:** The multiplicity of players in the modern electricity and gas market raises the question of liability. Criteria concerning the liability of the parties will be determined according to the applicable law of the contract. Thus, the contract will, in most cases, specify the applicable law. If the contract provides no liability rules, the law of the delivery point will be applicable.[40]

8.87 Thus, the damage caused by negligence or fault will usually have to be compensated. However, in energy contracts the situation is more complicated because of the tripartite relations between the client, the supplier, and network operator. Moreover, the co-existence of different market actors' contracts involves the responsibilities of different parties. Sometimes, a party will incur damages as a result of the fault of another party, with whom there is no contract. In these cases, a 'back-to-back' clause will often be included in the contract in order to cover this chain of responsibility. This will, for instance, be the case for connection contracts, supply contracts, and access contracts. A 'back-to-back' clause might read as follows:

> Network operators are responsible for guaranteeing the quality and the continuity of the provision of active Electrical Energy. As a consequence, the producer of energy cannot be held liable for the consequences related to a failure of the Network such as cuts, voltage level or frequency reduction, damage arising from the malfunctioning of the Network, from the place of connection, from the placement or maintenance of the meters.
>
> In case of default or absence of the supply resulting from a failure of the Networks, the client will directly address the Network Operators.

[40] Art 4, Rome I Regulation (n 2).

8.88 The consistency of such clauses must be ensured and each party should have a right of recourse against the responsible party, even if these two parties have no contractual bond with each other; of course, this may be more difficult to achieve in some national legal systems than others.

8.89 In some Member States, it is usual for the limitation on the operator's liability to impose upon the operator a duty to act as a reasonable and prudent operator. The liability of the operator or supplier is appreciated on the basis of this standard, eg:

> 'Reasonable and Prudent Operator' as used herein to describe the standard of care to be exercised by a party in performing its obligations hereunder shall mean that degree of diligence, prudence and foresight reasonably and ordinarily exercised by experienced operators engaged in the same line of business under the same or similar circumstances and conditions having due consideration to the interest of the other party under this agreement.

8.90 The operator will be discharged of his liability if he proves that his behaviour conforms to the behaviour of a 'reasonable and prudent operator with experience in this sector'.

8.91 The liability and compensation clauses present three characteristics: the limitation of liability to gross negligence, the exclusion of indirect damages, and the imposition of caps on liability.[41]

8.92 The first characteristic consists of the limitation of the supplier's liability to cases of gross negligence, eg:

> The supplier can be held liable in case of gross negligence or wilful misconduct. In this case, the liability of the supplier will be strictly limited to direct and material damages up to an amount of (. . .) per cent of the total amount of the Contract.

8.93 The supplier's liability is excluded for minor fault. Gross negligence involves a conscious and voluntary disregard of the need to use reasonable care, which is likely to cause foreseeable grave injury or harm to persons, property, or both.

8.94 The second characteristic is the exclusion of indirect or consequential damages or losses. Direct damages in contract law are generally the difference between the value of the performance received and the value of the performance promised as measured by contract or market value. Indirect damages are those which are not a direct result of an act, but a consequence of the initial act.[42] Indirect damages and losses include, inter alia, the shutdown of production, production losses, and loss of revenues or profit.

- 'The supplier shall be liable to the Client for direct tangible or intangible losses resulting from a wrongful and intentional act or from gross and intolerable negligence, to the exclusion of any indirect losses, including those resulting from a shutdown of production, production losses, loss of revenue and profit and other financial damage.'
- 'The supplier liability pursuant to the execution of this contract is limited to a maximum amount of € . . . per event for tangible losses and personal injury.'
- 'Without prejudice to conditions fixed at §x, the liability of the parties shall be limited to paying compensation for direct material damage but under no circumstances for any indirect and subsequent damage, including but not excluding the loss of production, the loss of income or the loss of profit.'

[41] G Block, 'Hardship and Adaptation Clauses' (n 31).
[42] G Viney and P Jourdain, *The Conditions of the Liability* (3rd edn, Paris: LGDJ, 2006), 207.

8.95 It can be concluded that compensation is possible only for non-supplied energy or for the difference between the paid price of energy and the price of energy determined by the contract.

8.96 Finally, energy contracts include limited liability clauses and clauses which impose caps on compensation. It is important to highlight that, according to the nature of contract, a liability exemption clause is typically not effective as between the contract parties. This kind of clause destroys the object of the contract.

8.97 In the case of limitations or caps, the compensation cannot exceed some amount or a multiple of the monthly or annual invoice. Certain contracts contain caps formulated as a multiple of monthly or annual invoice, eg:

> The supplier liability pursuant to the execution of this contract is limited to a maximum amount of € . . . per event for tangible losses and personal injury and of € . . . per event for intangible losses.

8.98 With regard to liability to third parties, it is usually provided that the parties shall be liable to third parties for all damages, of whatever nature, resulting from the fulfilment of contractual obligations, eg:

> The client and the supplier shall bear, each to the extent of its interest, all liability for losses, of whatever nature, caused to third parties during the performance of this Contract.

8.99 It should also be remembered that liability clauses should be well-balanced and carefully drafted to reflect the risks run by each of the parties.

8.100 (i) **Force majeure:** The question of *force majeure* and its impact plays an important role in the application and analysis of energy contracts. Indeed, most of the contracts include *force majeure* clauses and will often specify the consequences of such incidents. For example:

- '"*Force majeure*" means any unforeseen event or circumstance, the occurrence of which is beyond the reasonable control of the affected Party, and which could not be avoided or prevented with due care and at reasonable expenses which have the effect of making impossible or unlawful for the affected Party

to perform all or any of its obligations hereunder. Force Majeure events shall include but shall not be limited to the following: . . .'.

- 'For the purposes of this contract, *force majeure* shall be taken to mean any event outside the control of the Party concerned, which could not reasonably be foreseen or, if foreseen, that could not be reasonably avoided and the consequences of which could not be overcome by the means which should be open to the Parties as prudent and reasonable operators, and which prevents the Party concerned from performing all or part of its obligations under this Contract. Cases of *force majeure*, when they fulfil the conditions set out above, shall include but not be limited to: . . .'.
- 'Consequences of *Force Majeure*
  All Natural Gas, the delivery or taking of which has been prevented by *force majeure*, shall, unless otherwise agreed, be deducted from the amounts required to be made available and taken under this Agreement'.

8.101 *Force majeure* clauses are often invoked in energy contracts, but because of their often rigid application conditions they are rarely accepted as valid by arbitral[43] or national jurisdictions.[44] However, these clauses are very useful in energy contracts in case of the occurrence of specific events independent of the will of parties.

8.102 *Force majeure* can be invoked in each relationship between the new players on the market. But, for the various actors on the energy market, the concept of *force majeure* has different meanings. Thus, the operator of an electricity transmission network has to manage his network by all means at his disposal. The operator of a gas transmission network should employ best endeavours to ensure the balance on his network. Indeed, the supply contracts usually provide that the liability of the supplier is excluded when the loss is caused by a network failure. Thus, the concept of *force majeure* is a concept with varying dimensions, depending upon the context.

8.103 On the one hand, a breakdown on the distribution network can be a cause of *force majeure* for the supplier, and not for the customer, if the latter is well covered by its supply contract. The same breakdown can also be a cause of *force majeure* for the distribution network operator, if this breakdown originated on the transmission network. An event can thus be a cause of *force majeure* for one actor and not for another. These different actors highlight the varying dimensions of this concept.

8.104 On the other hand, if the supplier encounters a case of *force majeure* that may have harmful repercussions for the customer, the supplier should give assistance to his customer. Even in a case of *force majeure*, the customer could be indemnified according to the contractual liability clause.

[43] Award n°2216, CCI, Rep of Awards of ICC (1974–1985), 224; or Award 2478, ICC, Rep of Awards of ICC (1974–1985), 233.

[44] G Block, 'Arbitration and Changes in the Energy Price' (n 30).

8.105 For those reasons, the contract no longer makes reference to the 'prudent and reasonable operator', but instead to a list of events which are considered *force majeure* cases.[45]

8.106 In the old single energy contract, the *force majeure* clause was typically drafted in the following way:

> The supplier and the consumer are totally or partially exempted from the supply or take-off obligation:
> - In cases of *force majeure* as defined in Article [. . .] of the Civil Code;
> - In the event of:
>   - breakdown of installations resulted from explosion, landslides, earthquakes, fire, floods, washouts, storms, outage of pipelines, equipment or machinery required for the transport of electricity;
>   - strikes, lock out, industrial disturbances, war;
>   - diminution or failure of, or interference with supply of raw materials and utilities.

8.107 These contracts also provide that (eg) 'the supplier is entitled to reduce and interrupt the supply for the renovation of transport networks. The party wishing to call upon the event of *force majeure* engages to make as soon as possible all reasonable efforts to restore the normal situation. The supplier must give notice to the client at least one week in advance, except in case of extreme urgency'.

8.108 In the new energy supply contracts, the events which prevent the supply are considered as *force majeure*. So, if one of these events affects the capacity of the operator to transport or distribute the energy to the delivery point, the suppliers will be discharged of their obligation to their eligible client (the 'back-to-back' idea). Also, the client should have the possibility to suspend his off-take obligation.

8.109 The black-out which occurred on 2 September 2004 across the networks of Luxembourg is an example of *force majeure*. The network of Luxembourg suffered an electrical breakdown 'imported from the RWE network in the western region of Rhineland-Palatinate' following a drop in production of wind farms in northern Germany. After describing the network configuration and the blackout steps, the report described actions taken by network operators and concluded that: '[r]egarding . . . the technical management of the blackout, there can be no reproach to our network operators. Instead, the officials of the dispatching of CEGEDEL acted in a professional way, made the right decisions and did not commit mistakes'.[46]

8.110 There are other examples of black-outs in Europe. On 4 November 2006, a large part of Western Europe experienced a black-out due to a massive power surge from thousands of turbines in Germany into the 'pan-European grid'. Also, on Sunday

[45] G Block, 'The *Force Majeure* in the Energy Contracts', *Europ'Energies*, May 2007, n° 60, p 10.

[46] Report of Grand Duchy of Luxembourg, Economic and external trade ministry, Black-out of 2 September 2004, Report presented by Mr Jeannot Krecké, 9 September 2004, at 2.

28 September 2003 the Italian power system faced its worst disruption in fifty years, which also affected parts of Switzerland. A total of 56 million people were affected by this blackout.[47] In these cases, the network operator and the supplier can invoke *force majeure*. To summarize, a *force majeure* event may be defined as:

> An event of external nature, that could not be foreseen or prevented; it renders performance of a contractual obligation impossible at all or for a certain time.[48]

8.111 Generally, the contracts provide a detailed description of the circumstances that can constitute a condition of *force majeure*. For example:

- The execution of the obligations under the Contract will be temporarily suspended for the duration of the event causing *force majeure* and/or emergency situation.
- The parties agree that the following situations will be considered as such type of events:
  - –a war, declared or not, a war threat, an invasion, an armed conflict, a blockade;
  - –a revolution, an insurrection . . . ;
  - –an explosion, a sabotage, terrorist actions, damages caused by criminal actions . . . ;
  - –a nuclear explosion . . . ;
  - –a natural disaster, including earthquakes, floods . . . ;
  - –serious accidents of individuals . . .

8.112 The list consists of three types of potential risks: natural risks, technical risks, and political events.

8.113 Usually, the occurrence of a qualifying *force majeure* event has important impacts upon the reciprocal obligations of contracting parties. The incidence of *force majeure* suspends the affected contractual obligations, except in the face of a contrary proposition of the contract.[49] Some network operators oblige customers to continue to pay at the fixed term, notwithstanding the *force majeure* situation. Also, the incidence of *force majeure* suspends the off-take obligation (under the 'back-to-back' clause).

8.114 A *force majeure* clause may specify a time frame for the suspension of a contract, beyond which the contract becomes terminable. Another question may be raised: in case of disruption of supply resulting from negligence or fault, can the client be supplied by other sources or can he or she sell his or her capacity reservations?

[47] Antti Silvast and Joe Kaplinsky, *Project UNDERSTAND White Paper on Security of European Electricity Distribution* at <http://www.understand.se/docs/White_Paper_EN.doc>.

[48] W Melis, '*Force majeure* and Hardship Clauses in International Commercial Contracts in View of the Practice of the ICC Court of Arbitration' (1984) 1 J Int'l Arb 213, 220–21.

[49] Mahmoud Reza Firoozmand, '*Force Majeure* Clause in Long-Term Petroleum Contracts: Key Issues' (2006) 24(3) *Drafting in Energy and Natural Resources Law* 435.

Or, reciprocally, can the supplier sell his non-delivered quantity to other clients? All of these aspects should be covered by the contract or at least a mechanism for addressing them should be provided.

8.115 **(j) Jurisdiction and dispute settlement:** Energy contracts contain generally classic clauses relating to jurisdiction and dispute settlement, eg:

> The law of [. . .] applies to the performance, validity and interpretation of this contract. Any dispute in respect of this contract which cannot be resolved by the parties themselves will be submitted to the jurisdiction of the national court.

8.116 In the energy sector, specific arbitration clauses are employed. The Parties can also appeal to new jurisdictional instances organized by the NRA for the settlement of disputes.[50] For example:

> The parties shall agree to try to settle by amicable means any dispute arising between them regarding the validity, interpretation or performance of the agreement.
>
> Should it prove impossible to settle the dispute amicably, a definitive ruling shall be made in accordance with the regulations of [. . .] by three arbitrators appointed in compliance with these regulations.

8.117 When the contract in question is not a 'regulated contract', the parties can choose the place of arbitration or jurisdiction.

8.118 For the rest, negotiated contracts and regulated contracts will also include particular clauses, including:

- the identity of the contracting parties;
- changing the designation of the access responsible and/or the designation of the supplier;
- the duration of the contract;
- the financial guarantees;
- the connection or access procedures, and designation of access responsibilities;
- fees, surcharges, taxes, and VAT payable by the customer;
- the provisions relating to the suspension and/or termination of the contract;
- the procedure for data protection;
- the liability of the parties (limitation of liability, warranty, obligation of limitation of damage, etc);
- the insurances;
- the additional provisions (amendment of general conditions, contacts and notification, transfer of obligations, continuity, etc).

8.119 **(k) Duration:** Long-term contracts have played and continue to play an important role in the construction and the development of the European energy markets.

[50] Eg Recitals 38, 42, and 54, Art 37(10) and Annex I, para 1(f) of the Third Electricity IEM Directive.

Such contracts show how conflicting principles could influence the position of the European institutions. On the one hand, long-term contracts are a cornerstone of the EU's security of supply,[51] supporting necessary investments for the development of electricity and/or gas grids as well as the building of new production units. On the other hand, such contracts may have foreclosure effects on the liberalized energy markets by impeding the access of new entrants or alternative operators to customers and/or to infrastructures such as interconnections.[52] Thus, balancing the three main objectives of EU energy policy (competition, environment, and security of supply) will prove challenging, both in general and on a case-by-case basis.

8.120 Long-term contracts in the liberalized energy markets must be assessed in the light of both the EU energy legislation and EU competition law, most of the scrutiny being provided under the latter.

(4) EU energy law and long-term contracts

8.121 The potential conflicts between security of supply and opening of the energy market are evident from the evolution of EU energy legislation regarding long-term contracts. The three major steps in this evolution are: (1) the Second Energy Package; (2) the results of the Energy Sector Inquiry carried out by the Commission's Competition Directorate General (DG COMP), published in the final report of 10 January 2007;[53] and (3) the Third Energy Package.

8.122 EU energy legislation regarding long-term contracts principally focuses on the internal gas market,[54] little attention having been given in the legislative texts to the electricity market.

8.123 (a) **The Second Energy Package:** Long-term contracts were addressed differently for the electricity and the gas markets in the Second Energy Package. For the electricity market, the Annex of Regulation 1228/2003/EC provided guidelines on the management and allocation of available transfer capacities of interconnections between national systems, specifying that:

- long-term contracts cannot be assigned priority access rights to an interconnection capacity if they are in breach of the competition rules (Articles 101 and 102 TFEU);

[51] See Chs 9 and 10 for general discussion of security of supply.

[52] H Nyssens and D Schnichels, 'Energy', in J Faull and A Nikpay (eds), *The EC Law of Competition* (2nd edn, OUP, 2007), ch 12, para 12.213.

[53] Communication from the Commission of 10 January 2007—Inquiry pursuant to Article 17 of Regulation (EC) No 1/2003 into the European gas and electricity sectors (final report) COM(2006) 851 final and DG Competition Report on Energy Sector Inquiry, 10 January 2007, SEC(2006) 1724, hereafter 'Energy Sector Inquiry'.

[54] For recent discussion, see K Talus, *Vertical Natural Gas Transportation Capacity, Upstream Commodity Contracts and EU Competition Law* (Alphen aan den Rijn: Kluwer Law International, 2011), ch 3.

- existing long-term contracts have no pre-emption rights at the time of their renewal.

8.124 For the gas market, long-term contracts were addressed directly by Directive 2003/55/EC. Their necessity to ensure the security of gas supply in the EU, as long as they were compatible with the objectives of the Directive and with the rules of the Treaty (particularly regarding competition) was highlighted in Recital 25:

> Long-term contracts will continue to be an important part of the gas supply of Member States and should be maintained as an option for gas supply undertakings in so far as they do not undermine the objectives of this Directive and are compatible with the Treaty, including competition rules. It is therefore necessary to take them into account in the planning of supply and transportation capacity of gas undertakings.

8.125 According to Article 18(3) of Directive 2003/55/EC, the 'provisions of this Directive shall not prevent the conclusion of long-term contracts in so far as they comply with Community competition rules'.

8.126 As already highlighted,[55] Article 32(1) of this Directive furthermore expressly maintained the validity of long-term gas contracts concluded before the liberalization of the internal market in natural gas in accordance with the Transit Directive.[56] No similar mechanism was provided for the electricity sector.

8.127 The preparatory documents which led to Directive 2003/55/EC provide evidence that the EU institutions were divided on these competition and security of supply concerns. In its first proposal for the directive, the Commission underlined that competition on the energy markets could be hindered by long-term energy contracts.[57] It also proposed (as previously discussed) to repeal the Transit Directive, regardless of the long-term transit contracts concluded within its framework.

8.128 In its first reading, the European Parliament recommended that regulatory authorities be entrusted with the competence to call into question long-term contracts.[58] This recommendation, although underlining the possible benefits of long-term contracts for security of supply, was justified by the possible barriers to competition due to such contracts.[59]

[55] See Ch 4, at paras 4.136 ff.

[56] Directive 91/296/EEC [1991] OJ L147/37.

[57] Proposal for a Directive of the European Parliament and of the Council amending Directives 96/92/EC and 98/30/EC concerning common rules for the internal market in electricity and natural gas, 13 March 2001, COM(2001) 125 final, 31.

[58] Report on the Proposal for a Directive of the European Parliament and of the Council amending Directives 96/92/EC and 98/30/EC Concerning Common Rules for the Internal Market in Electricity and Natural Gas, 1 March 2002, A5-0077/2002, 57.

[59] Report on the Proposal for a Directive of the European Parliament and of the Council amending Directives 96/92/EC and 98/30/EC Concerning Common Rules for the Internal Market in Electricity and Natural Gas, 1 March 2002, A5-0077/2002 (n 58), 58.

8.129 The Council departed from the positions of both the Commission and the European Parliament: it considered in its first reading that third party access had to take into account the specificity of long-term transit contracts concluded under the framework of the Transit Directive.[60] It accordingly underlined in its common position of 3 February 2003, that the Transit Directive 'should be repealed without prejudice to the continuity of the contracts concluded under the said Directive'.[61] Following this common position, the Commission declared to the European Parliament that the repeal of the Transit Directive 'shall not affect' the legal framework for future long-term gas contracts, considering their importance for Europe's security of supply.[62]

8.130 The European Parliament accordingly suggested, in its second reading, that the proposed new Gas Directive should clarify that the repeal of the Transit Directive should not call into question the conclusion of future long-term contracts considering their importance for the security of supply.[63] Although this suggestion was not followed, it expresses the position of the European Parliament and of the Council at the time of the adoption of the Second Energy Package to protect the essential role of long-term contracts in the security of supply.

8.131 (b) **Energy Sector Inquiry 2005 to 2007:** As a result of the slow progress in introducing competition into energy markets, in 2005 the Commission's Competition Directorate General (DG COMP) launched a sector inquiry into those markets. The final report of this inquiry was published on 10 January 2007.[64] The Energy Sector Inquiry final report highlighted the potential competition barriers raised by long-term energy contracts, both for the electricity and natural gas markets:

- such contracts hinder the access of new entrants to access upstream markets and hamper the level of liquidity on the electricity and gas markets;[65]

[60] 2394th Council Meeting—Energy/Industry, Brussels, 4 and 5 December 2001.

[61] Common position (EC) No 6/2003 adopted by the Council on 3 February 2003 with a view to the adoption of the Directive 2003/ . . . /EC of the European Parliament and of the Council of . . . concerning common rules for the internal market in natural gas and repealing Directive 98/30/EC, [2003] OJ C50/3, [2003] OJ C50/36 (4 March 2003), Recital 30.

[62] Communication from the Commission to the European Parliament concerning the common position of the Council on the adoption of a Directive of the European Parliament and of the Council concerning common rules for the internal market in electricity and repealing Directive 96/92/EC and concerning the common position of the Council on the adoption of a Directive of the European Parliament and of the Council concerning common rules for the internal market in natural gas and repealing Directive 98/30/EC, SEC/2003/0161 final, 7 February 2003.

[63] Recommendation for second reading on the common position adopted by the Council with a view to adopting a European Parliament and Council Directive on common rules for the internal market in natural gas and repealing Directive 98/30/EC, 28 April 2003, A5—0135/2003, 19 and 20: 'The repeal of Directive 91/296/EEC does not call into question the legal framework of long-term contracts, important to ensure European security of supply.'

[64] Communication from the Commission, Inquiry into the European Gas and Electricity Sectors (Final Report), SEC(2006) 1724, COM(2006) 851 final, 10 January 2007 (hereafter, 'Sector Inquiry: Final Report').

[65] Sector Inquiry: Final Report (n 64), 6, point 20.

- long-term contracts hamper the access to interconnections;[66]
- long-term contracts have the effect of tying customers (usually) to incumbent operators;[67]
- long-term contracts may have foreclosure effects.[68]

8.132 In parallel to the Energy Sector Inquiry Final Report, the Commission's regulatory proposals (for the Third Energy Package) to address the shortcomings of the energy markets were presented to the Council and to the European Parliament in its communication on 'Prospects for the Internal Gas and Electricity Market'.[69] The Commission pointed to long-term contracts as one of the main deficiencies of the internal energy markets.[70] The Commission's proposals thus focused on long-term gas transmission and downstream contracts. First, the importance of long-term contracts for the EU security of supply was stressed; then, the Commission aimed to develop the guidelines provided by Regulation 1775/2005/EC regarding congestion management and to increase the scrutiny of long-term contracts:

> The Commission has repeatedly acknowledged the role of long-term contracts between external producers (i.e. upstream) and companies supplying customers in the European Union. These long-term contracts reflect the need for upfront investments to be undertaken and have an important role to play as regards access to cost-effective energy inputs. However, such agreements are often extended downstream and serve to foreclose the downstream market via priority transmission contracts and disproportionately long term supply contracts with either local suppliers or directly with final customers. This often results in market foreclosure within the European Union.
>
> The gas Regulation already imposes strict use-it-or-lose-it conditions regarding transmission contracts. This includes contracts which were concluded under Directive 91/296/EEC on the transit of natural gas through grids. These requirements, when combined with additional investment in gas networks, may help overcome the current blockages to meaningful competition. Further development of use-it-or-lose-it guidelines would also help competition develop more rapidly. The Commission will strictly monitor compliance with the requirements of Regulation (EC) No 1775/2005. It will further develop the guidelines under the Regulation. It also considers that any regulatory decisions relating to such contracts should be subject to Commission scrutiny . . . [71]

8.133 The Report of the European Parliament on the Commission's Communication stressed the need for long-term contracts, particularly in the gas sector, to ensure

[66] Sector Inquiry: Final Report, (n 64), 6 and 7, point 23.

[67] Sector Inquiry: Final Report, (n 64), 8, points 31 and 32.

[68] Sector Inquiry: Final Report, (n 64), 12 and 13, points 46 and 48.

[69] Communication from the Commission to the Council and the European Parliament, 'Prospects for the Internal Gas and Electricity Market', COM(2006) 841 final, 10 January 2007 (hereafter, 'Communication: Prospects (2006)').

[70] Communication: Prospects (2006) (n 69), 6.

[71] Communication: Prospects (2006) (n 69), 16.

security of supply and it entrusted the Commission with providing clear guidance regarding such contracts, so as to reduce uncertainty:[72]

> The European Parliament . . .
>
> 26. Recognises that upstream long-term contracts, in particular in the gas sector, are necessary to provide a positive investment climate, contribute significantly to security of supply and do not harm the integration of the internal energy market, provided that new entrants are not excluded;
>
> 27. Believes that balanced, effective application of the 'use-it-or-lose-it' principle must be ensured so that new entrants may access the networks where capacity is not utilised;
>
> 28. Believes downstream bilateral long-term contracts allow, as long as they do not take up a significant percentage of the market and do not prevent customers from switching suppliers, energy-intensive industries to negotiate more competitive and stable energy prices with the supplier of their choice and should therefore be allowed, assuming that they are properly supervised by the relevant authorities, and as long as they do not create additional costs for the networks, to close the market to new entrants or hamper market development;
>
> 29. Requests the Commission to propose a definition of what constitutes a high energy user; also requests the Commission to give special consideration to high energy users in the EU that are competing in the global economy;
>
> 30. Asks the Commission to provide clear guidance on downstream bilateral long-term contracts in order to reduce uncertainty in the market and to move towards standardization of contracts;
>
> 31. Recalls that energy generation, transmission, storage and distribution facilities are critical infrastructures the safety and security of which must be fully preserved and ensured under all circumstances . . .

8.134 **(c) The Third Energy Package:** Long-term contracts are addressed for both the electricity and the gas markets in the new Third IEM Directives concerning common rules for the internal energy market, namely Directives 2009/72/EC (Elec) and 2009/73/EC (Gas).

8.135 Most of the emphasis is upon the gas market, under the Third Gas IEM Directive 2009/73/EC. This Directive reaffirms the possibility of concluding long-term contracts as long as they are compatible with the competition rules[73] and also compels NRAs to respect long-term contracts as long as they are compatible with European competition rules:

> The regulatory authority shall have the following duties: . . .
> (1) respecting contractual freedom with regard to interruptible supply contracts as well as with regard to long-term contracts provided that they are compatible with Community law and consistent with Community policies.[74]

[72] Report of the European Parliament on 'Prospects for the Internal Gas and Electricity Market' (2007/20089(INI)), 26 June 2007, A6-0249/2007, 10, paras 26–31.

[73] Art 32(3) of the Third Gas IEM Directive 2009/73/EC: '[t]he provisions of this Directive shall not prevent the conclusion of long-term contracts in so far as they comply with [EU] competition rules.'

[74] Art 41(1)(l) of Directive 2009/73/EC.

A similar duty was imposed upon NRAs for the electricity market.[75] Besides this provision, long-term contracts in the electricity market are not further addressed in the Third Energy Package. **8.136**

It follows from the provisions of the Third Energy Package regarding long-term contracts that such contracts are acceptable as long as they comply with EU competition rules. Such limited acceptance of long-term contracts is evident from the preparatory work of the Third Energy Package. In its first proposals for the new directives, dated 19 September 2007, the Commission underlined—for both the electricity[76] and gas[77] markets—that: **8.137**

> . . . downstream bilateral supply agreements provide an opportunity to energy intensive industries to obtain more predictable prices. However, such agreements risk foreclosing the downstream market by preventing consumers from switching and thus limiting competition.

The Commission also announced that it would provide guidance about the compliance of downstream bilateral long-term supply agreements with EU competition law. **8.138**

The risks of long-term contracts for competition were also underlined by the European Economic and Social Committee in its opinion of 22 April 2008:[78] **8.139**

> *Identifying downstream bilateral long-term supply agreements that comply with EU competition law.* The degree of competition on retail markets is very limited. The cumulative effect of long-term contracts, open-ended contracts, contracts with tacit renewal clauses and long termination periods could be a substantial barrier to competition. Contractual obligations binding industrial end users and producers (incumbent companies) in the long term differ from country to country. However, there is growing demand for more competitive supply, from companies other than the incumbent companies.

[75] Art 37(1)(l) of Directive 2009/72/EC.

[76] Proposal for a Directive of the European Parliament and of the Council amending Directive 2003/54/EC Concerning Common Rules for the Internal Market in Electricity, COM(2007) 528 final, 19 September 2007, 18.

[77] Proposal for a Directive of the European Parliament and of the Council amending Directive 2003/55/EC Concerning Common Rules for the Internal Market in Natural Gas, COM(2007) 529 final, 19 September 2007 (n 76), 18.

[78] Opinion of the European Economic and Social Committee on the 'Proposal for a Directive of the European Parliament and of the Council amending Directive 2003/54/EC Concerning Common Rules for the Internal Market in Electricity', 'Proposal for a Directive of the European Parliament and of the Council amending Directive 2003/55/EC Concerning Common Rules for the Internal Market in Natural Gas', 'Proposal for a Regulation of the European Parliament and of the Council Establishing an Agency for the Cooperation of Energy Regulators', 'Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EC) No 1228/2003 on Conditions for Access to the Network for Cross-Border Exchanges in Electricity', and 'Proposal for a Regulation of the European Parliament and of the Council Amending Regulation (EC) No 1775/2005 on Conditions for Access to the Network for Cross-Border Exchanges in Natural Gas', 2008/C 211/06, 22 April 2008, [2008] OJ C 211/30, 19 August 2008, point 7.12.

8.140 Departing from the Commission and the European Economic and Social Committee, in its first reading, the European Parliament recommended giving national regulatory authorities the duty to promote long-term contracts, where they 'contribute to the improvement of the energy production and distribution and, at the same time, allow consumers to share the resulting benefits, provided that such agreements can contribute to an optimal level of investment in the energy sector'.[79]

8.141 This recommendation was not followed by the Commission, which considered that even if long-term contracts were 'acceptable', they should not be 'encouraged', given the foreclosure risks which they posed for the opening of the market.[80]

8.142 **(d) Conclusion on EU energy legislation and long-term contracts:** Long-term contracts illustrate the evolution of EU energy law before the conflicting principles of security of supply and the opening of the energy market. While at the time of the adoption of the Second Energy Package and in the context of the Energy Sector Inquiry, long-term contracts were highlighted as amongst the main deficiencies of the liberalized electricity and gas markets, the position towards such contracts has warmed in the recent years, in the face of the increase of prices on the liberalized electricity and gas markets in the absence of the stabilizing effect of long-term contracts.

8.143 The examination and assessment of long-term contracts within the liberalized electricity and gas markets was instead left to the application of the European competition rules: long-term contracts are accepted as long as they are compatible with European competition rules (or, indeed, with the national competition law, where no cross-border trade effects could be shown).

8.144 The compatibility of long-term contracts with EU competition law is thoroughly scrutinized by the Commission's Competition Directorate General (DG COMP).

[79] For electricity, see the position of the European Parliament adopted at first reading on 18 June 2008 with the view to the adoption of Directive 2008/ . . . /EC of the European Parliament and of the Council amending Directive 2003/54/EC concerning common rules for the internal market of electricity, TA(2008)0294, proposed new Art 22c(1)(n); for gas, see the position of the European Parliament adopted at first reading on 9 July 2008 with the view to the adoption of Directive 2008/ . . . /EC of the European Parliament and of the Council amending Directive 2003/55/EC Concerning Common Rules for the Internal Market of Natural Gas, TA(2008)0347, proposed new Art 24c(1)(l).

[80] For electricity, see Communication from the Commission to the European Parliament concerning the common position of the Council on the adoption of a Directive of the European Parliament and of the Council repealing Directive 2003/54/EC concerning common rules for the internal market in electricity, 12 January 2009, COM(2008) 906 final, 6, point 3.4.1; for gas, see Communication from the Commission to the European Parliament concerning the common position of the Council on the adoption of a Directive of the European Parliament and of the Council repealing Directive 2003/55/EC concerning common rules for the internal market in natural gas, 12 January 2009, COM(2008) 907 final, 6, point 3.4.1: 'Long-term contracts are acceptable provided they comply with competition rules, but they will not be encouraged as they have a potential foreclosing effect on the market.'

In the Commission's decisional practice, a distinction appears to be drawn between: (i) long-term contracts linked to an investment; and (ii) long-term supply contracts *stricto sensu*, that is to say not linked to any investment.

(5) Long-term contracts linked to an investment

8.145 Contracts of 15 years' duration have been accepted in the past when they concerned contracts linked to an investment, usually in new electricity production units. Five cases dealt with by the DG COMP are particularly relevant: *Scottish Nuclear*, *Electricidade de Portugal/Pego*, *REN/Turbogás*,[81] *Synergen*, and *Distrigaz*.[82]

8.146 In the *Scottish Nuclear* case, a contract had been concluded between Scottish Power, Hydro Electric, and Scottish Nuclear for an initial duration of 30 years ('the Nuclear Energy Agreement'). By this agreement, Scottish Power and Hydro Electric were bound, through a TOP clause, to acquire most of the electricity produced by Scottish Nuclear at its production units at Hunterston and Torness. The Commission reduced the duration of this agreement to 15 years, considering that this shorter duration was sufficient to allow the necessary return on investment as well as the competitiveness of Scottish Nuclear:

> The agreement, which was originally to apply for a period equivalent to the remaining lifetime of the nuclear power stations, i.e. 30 years, has, at the Commission's request, been limited to 15 years. This period of validity provides the stability and guarantee necessary for long-term planning and allows the necessary adjustments to be made to the new situation after a reasonable start-up period. However, this period seems necessary to allow Scottish Nuclear to attain full profitability and become competitive.[83]

8.147 The *Electricidade de Portugal/Pego* case[84] concerned a 28-year contract for the sale of the entire electricity output produced by a coal-fired power plant to the incumbent Portuguese electricity operator, EDP. The plant was in construction at the time of the case. The Commission refused to accept that duration, considering that, during that time, no electricity produced by the power plant in project could be delivered to consumers other than EDP either in Portugal or in other Member States. The duration of the contract was accordingly reduced to 15 years. A first option system was authorized for the remaining thirteen years in order to allow producers to sell to third parties where there was excess capacity not required by the grid.

[81] PD Cameron, *Competition in Energy Markets: Law and Regulation in the European Union* (2nd edn, Oxford: OUP, 2007), 331 and 332.

[82] Adrien de Hauteclocque, 'EC Antitrust Enforcement in the Aftermath of the Energy Sector Inquiry: a Focus on Long-Term Supply Contracts in Electricity and Gas', in B Delvaux, M Hunt, and K Talus (eds), *EU Energy Law and Policy Issues* (Rixensart (Belgium): Euroconfidentiel, 2008), 106.

[83] Commission Decision 91/329/EEC of 30 April 1991, para 40.

[84] Case No IV/34.598, [1993] OJ C265/3.

8.148 In the *REN/Turbogás* case,[85] a power purchase agreement of 25 years had been concluded to supply the Portuguese system manager and operator of the national grid with the electricity from a combined cycle gas turbine power station. The contract was reduced to 15 years' duration by the Commission.[86]

8.149 More recently, in the *Synergen* case,[87] the Commission accepted an exclusive gas supply contract of 15 years between Statoil and Synergen in the frame of the construction and operation of a gas power plant belonging to Synergen. The Commission considered that the Irish gas market was still dominated by the incumbent gas supplier BGE and that the fifteen-year contract would ensure Statoil's long-term presence in the Irish gas market. The special price formulae offered by Statoil for its gas were also taken into account by the Commission, considering that they would not have been offered in the absence of long-term exclusivity.[88]

8.150 Finally, the *Distrigaz* case[89] is also noteworthy. In this case, the Commission required Distrigaz to commit to limit its new downstream gas supply contracts with industrial users and electricity producers to five years. This commitment, however, was not extended to contracts concluded with electricity producers buying gas for new installations exceeding 10 MW:[90]

> The proposed commitments specifically do not apply to gas supply agreements with customers which are for the supply of gas for new investment in electricity generation capacity of over 10 MW. Such agreements are subject to a case-by-case basis appreciation taking into account that the investment might not go ahead, unless greater predictability of prices and possibly increased security of supply is guaranteed for the investor.

8.151 The need to take into account investments in the assessment of long-term contracts is supported by the Guidelines on the application of Article 101(3) TFEU (previously Article 81(3) EC).[91] The application of Article 101(3), allowing for possible exemptions for otherwise anti-competitive agreements from the prohibition of Article 101(1), needs to 'take into account the initial sunk investments made by any of the parties and the time needed and the restraints required to commit and recoup an efficiency enhancing investment'. The Commission considers that:

> Article [101] cannot be applied without taking due account of such *ex ante* investment. The risk facing the parties and the sunk investment that must be committed to implement the agreement can thus lead to the agreement falling outside Article

[85] [1996] OJ C118/7, (1996) 4 CMLR 881. See also J Ratliff, 'Major Events in EC Competition Law 1996: Part 2' (1997) 8(3) ICCLR 75, 82 ff.
[86] Ratliff, 'Major Events' (n 85), 82ff.
[87] Commission Press Release, IP/02/792, 31 May 2002.
[88] XXXIInd Report on Competition Policy 2002, Commission, 192–193.
[89] Commission Decision of 11 October 2007, case COMP/B-1/37966, *Distrigaz*.
[90] Commission Decision, *Distrigaz* (n 89), para 37.
[91] Communication from the Commission, Notice, Guidelines on the application of Article 81(3) of the Treaty, [2004] OJ C101/8.

> [101](1) or fulfilling the conditions of Article [101](3), as the case may be, for the period of time required to recoup the investment.[92]

8.152 The recently updated Guidelines of the Commission on vertical restraints[93] are also relevant:

> In the case of a relationship-specific investment made by the supplier . . . a non-compete or quantity forcing agreement for the period of depreciation of the investment will in general fulfil the conditions of Article 101(3) . . . A relationship-specific investment could, for instance, be the installation or adaptation of equipment by the supplier when this equipment can be used afterwards only to produce components for a particular buyer. General or market-specific investments in (extra) capacity are normally not relationship-specific investments. However, where a supplier creates new capacity specifically linked to the operations of a particular buyer, for instance a company producing metal cans which creates new capacity to produce cans on the premises of or next to the canning facility of a food producer, this new capacity may only be economically viable when producing for this particular customer, in which case the investment would be considered to be relationship-specific. [94]

8.153 From those cases, one may deduce that a 15-year duration may appear to be a 'standard' term for contracts linked to investments, thereby securing investors' long-term commitments.[95]

(6) Long-term contracts *stricto sensu*, not linked to an investment

8.154 In the absence of investment in new infrastructure, the duration of energy contracts seems generally to be limited to five years where the beneficiary of the contracts is in a dominant position on the relevant market. This tendency is supported by the recent cases *Distrigaz*[96] and *EDF—Long-term contracts France*.[97]

8.155 In the *Distrigaz* case, contracts of beyond five years' duration had been concluded by Distrigaz with large customers on the Belgian gas market. After having noted the dominant position of Distrigaz on the market for the supply of gas to large customers in Belgium, the Commission underlined that 'with very few exceptions, customers only have one gas supplier and therefore competition in the gas supply market only takes place when a contract expires and a new contract is concluded'.[98] The Commission accordingly considered that the long-term contracts concluded

[92] Guidelines on the Application of Article 81(3) of the Treaty, para 44.
[93] Commission, Guidelines on Vertical Restraints, [2010] OJ C130/01.
[94] Commission, Guidelines on Vertical Restraints, [2010] OJ C130/01, para 146. One can easily see how such arguments might be applied to new electricity generation or gas pipeline capacity in some circumstances.
[95] Cameron (n 81), 332.
[96] Commission Decision, *Distrigaz* (n 89).
[97] Decision of the Commission of 17 March 2010, Case COMP/39.386, *EDF—Long-term contracts France*.
[98] Commission Decision, *Distrigaz* (n 89), 2, para 2.

by Distrigaz had a potential foreclosure effect since they 'would prevent customers from switching supplier and would thereby limit the scope for other gas suppliers to conclude contracts with customers and so foreclose the access to the market'.[99]

8.156 The potential foreclosure effect of Distrigaz's long-term contracts was assessed on the basis of the proportion of the relevant market tied by existing contracts on 1 January 2005 for various dates in the future.[100] It appeared that the proportion of the market already tied to Distrigaz under the contracts in force on 1 January 2005 was between 50 and 60 per cent in the six months from their conclusion and between 20 and 30 per cent in the three years following their conclusion. On this basis, the Commission considered that 'the contracts concluded by Distrigaz significantly foreclosed the relevant market in a way that could constitute an abuse of its dominant position'.[101]

8.157 To address this concern, Distrigaz committed to limit its new contracts with industrial users and electricity producers to five years, except where the gas was to supply new installations exceeding 10 MW, as has been highlighted previously. For existing customers with contracts whose duration was five years or more, Distrigaz committed to grant them a unilateral termination right with prior notice and without indemnity.[102]

8.158 The case *EDF—Long-term contracts France*[103] occurred in the context of the constitution of a purchase consortium, Exceltium. In this case, the Commission considered that EDF may have abused its dominant position on the market for the supply of large industrial customers by concluding contracts hindering access to this market, in particular given the duration of those contracts. To address the issues raised by the Commission, EDF committed to not conclude any new contracts with large industrial customers which had a duration beyond five years.

8.159 **(a) Take-or-pay clauses:** According to a take-or-pay (TOP) clause, a client commits to pay an amount equal to a determined volume of energy (contractual yearly quantity), irrespective of its off-take at the agreed price.[104] The volume not taken

[99] Commission Decision, *Distrigaz* (n 89), 2, para 2.
[100] Commission Decision, *Distrigaz* (n 89), 7, para 23.
[101] Commission Decision, *Distrigaz* (n 89), 7, para 24.
[102] Commission Decision, *Distrigaz* (n 89), 7 and 8, para 27.
[103] Commission Decision, *EDF—Long-term contracts France* (n 97).
[104] G Block, 'Arbitration and Changes in Energy Prices' (n 30); G Block, 'Les clauses take-or-pay dans les ventes d'énergie' [2007] *Europ'Energies* 12; G Block et al, 'Le consommateur industriel', in *Le nouveau marché de l'énergie, Partie III*, subsection 7: 'les clauses liées à la quantité: clauses take-or-pay, take-and-pay et certaines variantes contractuelles', (Louvain-la-Neuve, Anthémis, 2007), 263; P Griffin, 'Take-or-pay contracts in liberalized markets' (1999) 15(10) *Natural Gas* 8; P Hodges, '"Take-or-pay" and "send-or-pay"—a perspective on recent litigation' [1997] OGLTR 469; H Davey, '"Take-or-pay" and "send-or-pay": a legal review and long-term prognosis' [1997] OGLTR 419; E Marseglin, 'Take-or-pay litigation—the producer's perspective' (1987–1988) 6 OGLTR 125.

is subject to a TOP penalty agreed by the parties in the power purchase agreement (PPA) or supply contract. A TOP clause could be drafted as follows:

> If during a Contractual year, the Buyer takes off a quantity of natural gas from the Seller inferior to the yearly contracted quantity, he shall pay the Seller for the quantities below the yearly contracted quantity after deduction of the quantities not made available by the Seller or not taken off by the Buyer for reasons of *force majeure* or for reasons of planned or unplanned maintenance, at the agreed Penalty, calculated in accordance with Article . . .

8.160 The objective of such clauses is to ensure that producers and/or suppliers receive a steady and reliable cash flow to allow them to invest in production and network facilities. Risks related to prices and volumes are shared between producers and suppliers, on the one hand, and consumers (mainly industrials), on the other hand: the contract price is determined according to subscribed volumes, irrespective of its off-take.

8.161 TOP clauses first appeared in the gas sector, due in part to the complexity of the supply chain (from upstream natural gas fields to downstream customers' off-take points) as well as the need to invest in production and network facilities. Nowadays, TOP clauses have been extended to the electricity sector, notably for electricity produced from natural gas or by new entrants, so as to establish the necessary client portfolio for the conclusion of upstream supply contracts.

8.162 TOP clauses may have a deterrent effect: they may restrain the access of alternative producers/suppliers to customers bound by TOP clauses. Such risks of deterrent effect were underlined by DG COMP during the public consultation launched under the framework of the Energy Sector Inquiry:

> Regarding the take-or-pay obligations, which constitute a characteristic feature of upstream long-term contracts, one vertically integrated gas market player argued that such flexibility is a necessary part of their long-term contracts since it takes into account the volume risk taken by them as a buyer and provides them with an alternative source of flexibility to balance their portfolio. Contrary to this view, entrants noted that take-or-pay obligations effectively internalize the role of wholesale markets in managing price and volume risks with the harmful consequence of impeding the development of more effective and efficient wholesale markets. They argued that liquid wholesale markets would obviate the need for such flexibility since the market could then be used to hedge the price exposures and provide flexibility to match customers' and suppliers' evolving requirements.[105]

8.163 TOP clauses are accordingly under close scrutiny with regard to the EU competition rules. The first element of scrutiny is the duration of TOP clauses: the criteria taken into account by DG COMP were highlighted at paras 8.145 ff in the discussion of the duration of power purchase agreements and supply contracts.

[105] DG Competition Report on Energy Sector Inquiry—Second phase (public consultation), 10 January 2007, SEC(2006) 1724, para 639.

8.164 The second element in the scrutiny of TOP clauses is their flexibility. The importance of such flexibility was underlined in the first phase of the report on the Energy Sector Inquiry of 10 January 2007:[106]

> (121) Long-term contracts generally offer buyers a substantial degree of flexibility in terms of off-take. Incumbents can use this contractual arrangement to provide ready-made flexibility. They can also, despite take-or-pay obligations, avoid buying more gas than they need, which limits their need to buy and sell on hubs . . .
>
> (125) The exact nature of flexibility provisions varies greatly between import contracts and between regions . . . Many contracts establish an 'annual contractual quantity' but allow the buyer to take a defined percentage less or more than this over the course of a year. Many contracts also specify monthly or daily maximum or minimum quantities . . .
>
> (127) These contracts typically provide specific rules for the situation where the buyer does not take the whole of the gas required in a given year. In these circumstances, the buyer may be able to defer delivery by one or more years, or delivery obligations might be averaged over a number of years. Alternatively, the buyer might be required to pay for gas not taken.
>
> (128) It is, however, extremely rare for suppliers to pay for gas not taken . . .
>
> (130) By far the most common scenario is that flexibility inherent in long-term contracts has been sufficient, so that take-or-pay provisions have not been used.

8.165 Three mechanisms are generally used to provide flexibility to TOP clauses. The first of these mechanisms is the possibility for the buyer of energy to be supplied for part of its needs in electricity and/or gas by an alternative supplier. A TOP clause provided by an energy producer and/or supplier in a dominant position on the relevant market and covering, on an exclusive basis, the entire need of a customer, is indeed likely to be considered as foreclosing the access of other producers and/or suppliers, notably new entrants, to the customer concerned. In the above-mentioned *EDF—Long-term contracts France* case,[107] EDF's customers were bound by exclusive volume clauses covering all their needs. The Commission considered that such TOP clauses could lead to an abuse of dominant position.[108] EDF accordingly committed to give the option to its customers of choosing between an exclusive offer and a non-exclusive offer, so as to allow them to access supplies from other suppliers in an effective manner.[109]

8.166 The second mechanism allowing flexibility in TOP clauses is the provision for compensation when the relevant volumes are not taken by the buyer: this compensation comes in the form of 'carry forward' or 'carry backward' clauses. A 'carry forward' clause postpones a TOP penalty to one or several future contractual years.

[106] DG Competition Report on Energy Sector Inquiry—First phase (Gas), 10 January 2007, SEC(2006) 1724.

[107] See Commission Decision, *EDF—Long-term contracts France* (n 97).

[108] Commission Decision, *EDF—Long-term contracts France* (n 97), paras 30–35.

[109] Commission Decision, *EDF—Long-term contracts France* (n 97), paras 82–86.

The penalty may have to be paid immediately or may constitute a down-payment for postponed volumes, regardless of the price to be agreed for future years. Such a clause could be drafted as follows:

> Where the yearly consumption is inferior to the yearly contractual quantity for a year (N), such difference does not lead to payment provided that in the following year (N+1), the Buyer consumes a quantity at least equal to the yearly contractual quantity surcharged with this difference.

8.167 A 'carry backward' clause has the reverse effect: the buyer is entitled to cover a deficit in the pending year (N) by relying upon an excess from previous years (eg N-1). Such clauses are rarer in practice and are usually limited to a return on the previous year only.

8.168 The third mechanism of flexibility in TOP clauses is the 'resale clause'. Such a clause allows the customer to resell the quantities it has bought but does not in fact need. The condition regarding off-take is accordingly fulfilled. Such resale can be realized with the assistance of the trading platform of the seller, with or without a trading fee. Such clause could be drafted as follows:

> The Supplier will use his best endeavours to sell on behalf of the Buyer the off-take below the contractually agreed volume. Any profit or loss will be passed on to the Buyer and no trading fee will be applied.

8.169 **(b) Destination clauses:** Historically, natural gas supply contracts have often contained a clause which, either explicitly or by its effect,[110] aims to ensure that the gas supplied is only sold to consumers within a given territorial area (typically a given Member State), known under the general heading of 'destination clauses'. For example: 'the natural gas supplied under this contact shall only be used in [. . .] and shall not be re-exported'. Such clauses were to be found in various contracts concluded by Russian (Gazprom),[111] Algerian (Sonotrach),[112] and Norwegian gas producers.[113] These clauses aimed to restrict the importer to marketing within their national territory and restricted competition between such importers for the sale of such gas to end users. They also reinforced the pre-existing division of the EU into national, or

[110] eg via: 'profit-splitting' mechanisms which require the importer to pass on a share of the profits generated from any sales outside of the importer's traditional market; and customer or use restrictions, such as requiring the purchaser to use the gas only for its own purposes. See L Kjølbye, 'Vertical agreements', in C Jones (gen ed), *EU Energy Law, Volume II: EU Competition Law and Energy Markets* (3rd edn, Leuven: Claeys & Casteels, 2011), Part 3, ch 3, 271–276 for discussion.

[111] See the various Commission Press Releases concerning ENI/SNAM (IP/03/1345, 6 October 2003), OMV (IP/05/195, 17 February 2005), Ruhrgas (IP/05/710, 10 June 2005); Gasunie's contract with Gazprom was also investigated and found to involve no territorial restrictions (see H Nyssens et al, 'The Territorial Restrictions Case in the Gas Sector: A State of Play' (2004) 1 *Competition Policy Newsletter* 48, at 51).

[112] See Nyssens et al (n 111), at 51 and Commission Press Release IP/07/1074 (11 July 2007).

[113] See the settlement in the *GFU* case with regard to Norwegian gas supplies from Statoil and Norsk Hydro, where a promise not to include such clauses was made: M Lindroos et al, 'Liberalization of European Gas Markets—Commission Settles GFU Case with Norwegian Gas Producers' (2002) 3 *Competition Policy Newsletter* 50, at 51.

at least territorially restricted, vertically organized markets, and may also have prevented competitive pressure on gas prices charged by suppliers to different importers, thus allowing producers to differentiate their prices per buyer (and therefore territory) due to the inability of importers to engage in price arbitrage inter se.

8.170 Such territorial restrictions in these 'vertical' supply contracts (within the meaning of EU competition law's policy concerning vertical restraints in relations between parties operating at different levels of the value/supply chain) amount to a hard-core restriction under Article 4(b) of the Vertical Agreements Block Exemption Regulation 330/2010/EU.[114] This would deprive those contracts of the benefit of that exemption as a matter of course, and are also highly unlikely to be exempted under Article 101(3) TFEU. The Commission's approach to these contracts was to investigate, then invite the producers to remove such clauses from all *new* gas supply contracts—which they duly did. Pre-existing contracts containing such clauses, meanwhile, were not immediately or formally[115] condemned: instead, the parties were given the opportunity to remove the offending clause(s) and to amend their contracts in the light of that removal. This preserved the integrity of the underlying long-term contracts involved and gave the parties a chance to adapt those contracts to the new situation, finding a 'commercial solution for the competition problem' identified.[116] As Commissioner Monti said at the time:

> [D]uring the initial delicate transition phase from monopolised to liberalised energy markets, the focus should lie, [on] some occasions, on [the] Commission's interventions improving effectively the market structure, rather than on formal procedures imposing fines.[117]

8.171 However, now that the basic principles have been clarified by this series of settlements, the Commission will be unlikely to operate so informally or leniently in future, especially since the advent of the Third Package legislation has accelerated the pace of that liberalization. Certainly, the Commission's more recent competition law practice in the energy sector suggests a trend towards the use of competition law as an accompaniment to the regulatory regime laid down in the Directives, often with far-reaching consequences.[118]

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[114] [2010] OJ L102/1 (20 April 2010).

[115] The exception was the pair of cases involving Gaz de France and Italian importers: Case COMP/38.662 *GDF/ENEL* and *EDF/ENI* (26 October 2004), which both led to the adoption of formal Decisions by the Commission, with a view to clarifying the position for other market players in the future (see, eg, Press Release IP/04/1310, 26 October 2004): no fines were imposed. Note that these cases also involved gas transport and service, as well as supply, contracts.

[116] M Monti, 'Applying EU Competition Law to the Newly Liberalized Energy Markets', World Forum on Energy Regulation (Rome, 6 October 2003).

[117] M Monti, 'Applying EU Competition Law to the Newly Liberalized Energy Markets' (n 116).

[118] See, eg, the discussion concerning competition law and ownership unbundling at paras 3.125 ff.

Part III

'ENERGY SECURITY' AND 'SECURITY OF SUPPLY'