

Law

Energy

Brussels talks tough on countries that fail to offer power choice

Those failing to comply with obligations get written warning, write **John Pheasant** and **George Metaxas**

IN A generally expected move, the European Commission has opened a new legal front in the energy sector.

On April 4, it sent 28 'letters of formal notice' to 17 European Union member states (Austria, Belgium, the Czech Republic, Germany, Estonia, Spain, Finland, France, Greece, Ireland, Italy, Lithuania, Latvia, Poland, Sweden, Slovakia and the UK) alleging various failures to comply with obligations to liberalise their electricity and gas markets.

The commission will also launch proceedings before the European Court of Justice against Spain and Luxembourg for their failure to notify national implementation measures to the commission; and the energy laws of Portugal and Sweden are also reported to be under close commission scrutiny.

This is the latest commission move in an escalating political conflict and a public test of its power to make a serious difference in the EU energy industry landscape. It is also part of a multi-front conflict between the commission and at least some member states, which has accelerated significantly and very publicly in the last few months.

High energy prices and Europe's energy dependence have added some urgency and political credit to the commission's initiatives in the energy sector, and the obvious first targets are the continuing delays in the effective implementation of EU rules for the liberalisation of energy and gas markets.

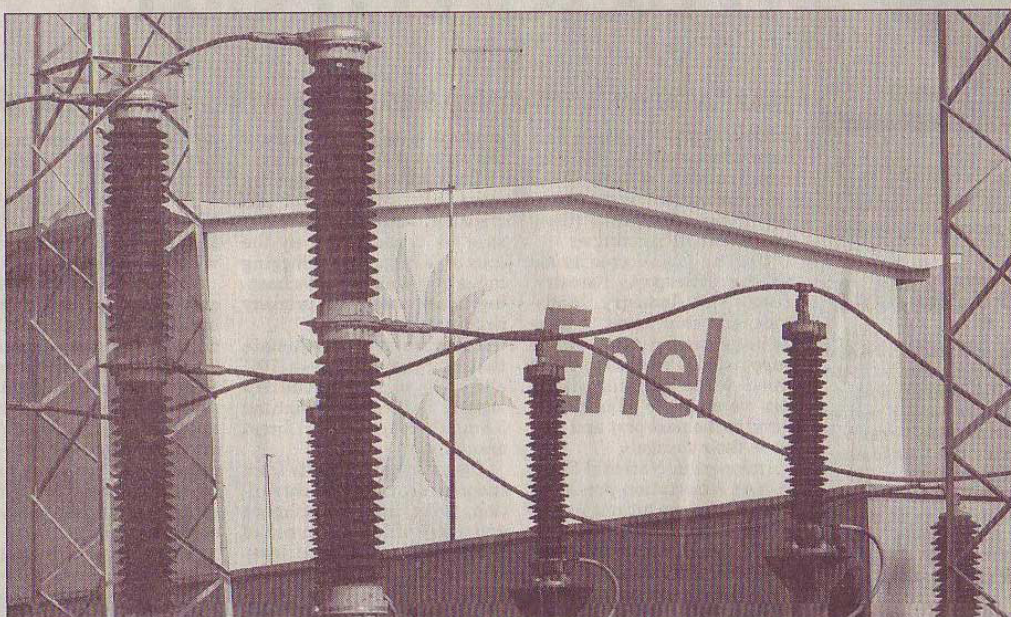
Adding oil to the fire, two major energy deals, currently under regulatory scrutiny, have only highlighted the sector's reluctance to follow basic Internal Market rules. The first concerns the Gas de France merger with Suez, which has been hastily supported by the French government as a pre-emptive defensive move against the Italian Enel's bid for GdF.

The second is Gas Natural's and E.ON's competing bids for Endesa, and the Spanish government's open support for Gas Natural.

In both cases, the commission is threatening to step in against the two governments' open display of "economic patriotism" in the energy sector, against fundamental EU requirements of non-discrimination between EU companies.

The prelude to the current energy conflict was the commission's launching of a major inquiry in the energy sector in June 2005.

The commission sent some 3,000 detailed questionnaires to gas and electricity producers, distributors, major consumers and other players to identify continuing barriers to a



Under scrutiny: Enel, operator of this hydroelectric plant near Rome, is bidding for GdF.

Bloomberg

genuinely open and competitive EU-wide energy market, by relying on comprehensive data instead of fragmented evidence.

The commission published its initial findings in November 2005 and a detailed, preliminary report on February 16 of this year.

Essentially, this confirmed the commission's initial findings of five main barriers to a fully functioning internal energy market, namely:

- Market concentration: the incumbents still dominate their home markets, and new entrants strongly depend on them for key services.

- Vertical foreclosure: new entrants cannot enter the gas market because of long term supply contracts between gas producers and incumbent importers, and the latter's control of gas infrastructure. In the electricity sector, supply and network companies maintain strong links, and the required unbundling between transmission networks and the production/supply side does not seem to function properly.

- Lack of market integration: both gas and electricity markets remain essentially segmented along national borders, and cross-border trade is still very limited.

- Lack of transparency on the technical availability of capacity, interconnectors, access to networks and other essential information.

- Price formation: this is also non-transparent and partly artificial as a result of indexation and similar mechanisms. For example, gas

prices are artificially linked to those of oil products and have followed their rise.

The energy sector inquiry is based on EC competition rules and is driven primarily by the commission's competition unit.

Typically, such sector inquiries may culminate in remedies addressed against individual energy companies rather than member states.

However, because the problems here seem to be structural and beyond case-by-case repair, competition commissioner Neelie Kroes has also threatened imposing full structural unbundling, i.e. separation, on the ownership level, of supply and retail energy businesses from monopoly infrastructures such as the transmission grid.

So what do the commission's 28 letters of formal notice add to this picture? Put simply, Ms Kroes is after companies, while Andris Piebalgs — the commissioner in charge of energy — is after the member states themselves.

In other words, while Ms Kroes' efforts are directed primarily — although not exclusively — against the energy players' violation of rules they are supposed to follow, the letters of formal notice are directed against member states' failure to adopt or enforce these rules in the first place.

The two commission initiatives correspond to two parallel sets of EU rules: antitrust and

harmonisation. Their aims and effects overlap extensively, but the remedies and procedures for their enforcement are quite different.

The commission's letters of formal notice are not identical, since they address different problems in each of the 17 countries concerned.

In general, these problems are closely linked to essential features of the EU regime now in place for the liberalisation of the energy and gas markets, and are described briefly below.

- There is a persistence of regulated prices, especially for the benefit of certain customers. Such regulated prices impede the development of a normal market mechanism and are an obstacle in the path of new market entrants.

- Under the current EU regime, electricity and gas transmission system operators on the one hand and distribution system operators on the other must be legally unbundled (although they can remain under common ownership) and must be managed separately to ensure they are independent of each other. A number of member states have apparently failed to satisfy this requirement.

- Third parties are supposed to have access to electricity and gas networks under non-discriminatory and transparent terms. Again, this is still not the case in several member states.

- Eligible energy customers are still

unduly deprived of a free choice of supplier.

- The energy regulatory authorities set up by member states in line with their EU obligations have not always been given the necessary tariff-setting for access to networks.

- Preferential access conditions in long-term electricity or gas supply contracts keep new entrants out of the market.

- Member states have failed to meet obligations relating to public service notification and electricity origin indications.

The way ahead will be difficult and relatively slow. The formal notice is only the first step in EU infringement proceedings against a member state. Typically, member states are given two months to reply.

The next step is a 'reasoned opinion' by the commission and, if the member state in question still fails to meet its obligations by the specified deadline, the commission refers the case to the European Court of Justice. The remaining procedure can then take years and the ultimate threat against the member state concerned is a fine by the European Court of Justice, which is often too little, too late.

A more effective remedy in this and similar cases could be actions for damages by private parties, such as new market entrants, against a member state which has failed to meet its obligations. The commission's initiation of infringement proceedings would provide such actions with strong legal support, and EU law includes sufficiently clear precedents allowing such actions. Until now, such types of private action have been rare and their prospects of success depend largely on the ability of the national courts to deal speedily with them.

It may be unrealistic to expect too much too quickly from the commission's combined recent initiatives in the electricity and gas sectors. Nevertheless, it has a legally clear-cut case and a mass of fresh information to support it; the fronts it has opened are too many to ignore and the energy industry is regarded as having been a serious laggard in the move to liberalisation as compared, for example, with telecoms.

It all adds up to a solid starting point that is bound to lead to tangible results, even if the initial rhetoric and legal threats are trimmed down in the process.

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Enel's chief executive officer Fulvio Conti, top; European commissioner Piebalgs, centre, and Kroes, bottom.

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