

**THE ROLE OF THE EUROPEAN UNION’S COMPETITION RULES IN
SHAPING THE ELECTRIC ENERGY MARKETS IN EUROPE**

ARTICLE

LUIS ANÍBAL AVILÉS PAGÁN*

Introduction.....	86
I. The Regulation of Electric Public Utilities in the United States.....	87
A. 20 th Century Electric Energy Markets: State-Sanctioned Natural Monopolies.....	87
B. The Constitutional Basis	88
C. Public Service Obligations.....	89
D. Cost of Service Regulation.....	90
E. The Role of Antitrust Law in the Regulation of Public Utilities in the United States.....	91
II. The Regulation of Electric Public Utilities in European Law	93
A. The Framework of European Competition Law	93
B. Undertakings Exempted from the Rules of European Competition Law	94
C. Vertically-Integrated Electric Public Utilities as Providers of General Services of Economic Interest	96
D. The Regulation of the Electric Energy Sector under the Treaties.....	100
E. Competition Law and the Regulation of Electric Public Utilities Prior to the First Electricity Directive.....	102
E. Regulation of the Electric Energy Sector in Secondary Legislation.....	109
F. Competition Law Enforcement against Electric Public Utilities under the Regulatory Era.....	114
1. Article 101 TFEU; Generation.....	114
2. Article 102 TFEU; Generation.....	115
3. Article 102 TFEU; Transmission.....	116
4. Article 106 TFEU; Generation.....	116
Conclusion: The Future of the Role of Competition Law in the Regulation of Electric Public Utilities.....	117

* Associate Dean at the University of Puerto Rico Law School. Former President of the Governing Board of the Puerto Rico Electric Power Authority. I am grateful for the helpful comments on a previous version of this work by Professor Laurence Idot of Université Pantheon-Assas Paris II. I also greatly appreciate the comments on this version of the paper from my colleagues José Julián Álvarez González and Carlos Díaz Olivo and the edits suggested by my student assistant Héctor Sueiro Álvarez. Of course, any errors and omissions are my sole responsibility.

INTRODUCTION

IN THIS WORK, WE WILL EXPLORE THE ROLE OF COMPETITION RULES IN THE treaties leading to the European Union (E.U.) in shaping the regulation of the European electric energy markets. However, we will first offer a brief description of the creation and regulatory evolution of the interstate electricity markets in the United States (U.S.) and explore the intersection of the antitrust rules and the federal regulatory framework for such markets. This brief foray into the U.S. regulatory scheme will introduce the needed concepts and terminology which we will later use to analyze the European order.

Electric energy markets are defined by the interplay of several product markets defined along the phases of generation, transmission and distribution of electrical energy.¹ In most instances throughout the 20th century a single company or undertaking known as a *public utility* performed these functions. In competition literature these public utilities are referred to as vertically integrated utilities, for the supply chain of the end product (electricity) is owned by the same entity. The term *public utility* is not widely used in Europe; it is mostly used in the United States and the United Kingdom to describe private undertakings that: (1) provide essential services to the public, and (2) are subject to a scheme of pervasive government regulations. In European law these entities are referred to as undertakings providing *services of general economic interest*. For convenience, we will refer to undertakings providing services of general economic interest as *public utilities* throughout the rest of this work.

Part II of this work surveys the historical evolution of electric public utilities into state-sanctioned natural monopolies, and the regulatory framework under which these undertakings operated. The regulation of public utilities in the United States commenced following a case decided by the United States Supreme Court: *Munn v. Illinois*.² After the *Munn* decision both federal and state governments created regulatory agencies known as Public Service Commissions that imposed on public utilities obligations such as universal service and adopted the cost of the service regulation model. We will take a look at the role of the federal antitrust law in the regulation of public utilities and analyze the status of the regulated industries exemption to the application of the antitrust laws.

In Part III of this work, we will analyze in greater detail the regulation of electric public utilities, first under the competition framework established by the

¹ Generation is the manufacturing of alternate electric current by conversion of natural resources (coal, oil, solar energy) into electric power. Transmission refers to the controlled process of transmitting electric energy at high voltages (over 115,000 volts) through long distances via a complex electrical network. Distribution is the controlled process by which the high voltage energy is taken from the transmission network, stepped down to voltages suitable for consumption, and delivered to end customers.

² *Munn v. Illinois*, 94 U.S. 113 (1876).

treaties leading to the European Union, and then under the interaction of these competition rules and the regulatory regimes established by the several electricity directives issued by the Council. When the first competition rules were adopted under the Treaty of Rome,³ most vertically integrated electric public utilities in Europe operated as State monopolies of a commercial character. The treaties leading to the Treaty of Lisbon⁴ provide special rules regarding the application of the competition rules to such undertakings. On the one hand, the treaties prohibit the expansion of these monopolies by Member States. On the other hand, public utilities providing services of general economic interest subject to specific public service obligations by Member States might be exempted from the full application of antitrust rules. The European Commission monitored the application of these treaty provisions by bringing several cases against undertakings and Member States. During the era of the enlargement of the E.U., when it went from fifteen to twenty seven Member States, monitoring anticompetitive behavior of these undertakings by litigation alone became insufficient, and the Commission promoted a regulatory push that led to the first of the electricity directives. Under the regulatory framework of the electricity directives, the competition enforcement role of the Commission was redirected towards obtaining commitments and structural remedies against the anticompetitive behavior on the part of electric utilities. We conclude this study by offering an assessment on the future of competition law in the regulation of electric public utilities both in Europe and the United States.

I. THE REGULATION OF ELECTRIC PUBLIC UTILITIES IN THE UNITED STATES

A. 20th Century Electric Energy Markets: State-Sanctioned Natural Monopolies

The end of the 19th century saw the invention of the electric light bulb, the telephone, the widespread use of gas for home heating and the expansion of public transportation systems across the United States and Europe. While in the United States the exploitation of these technologies was achieved mostly by private enterprises, the history of such developments was different in Europe. European national states quickly recognized the importance of those new services and took upon themselves the development and exploitation of those services for the benefit of their citizens.⁵ For the greater part of the 20th century, until the advent of the liberalization movement at the beginning of the 1990's, the provi-

³ Treaty establishing the European Economic Community, Mar. 25, 1957, 298 U.N.T.S. 3 [hereinafter Treaty of Rome], available at http://ec.europa.eu/economy_finance/emu_history/documents/treaties/rometreaty2.pdf.

⁴ Treaty of Lisbon Amending the Treaty on European Union and the Treaty Establishing the European Communities, Dec. 13, 2007, 2007 O.J. (C 306) 1 [hereinafter Treaty of Lisbon].

⁵ Marshall E. Dimock, *British and American Utilities: A Comparison*, 1 U. CHI. L. REV. 265 (1933).

sion of utility services in Europe remained in the hands of national companies.⁶ The modern consensus on the meaning of the term *public utility* generally refers to those kinds of undertakings, publicly or privately-owned, which provide the public a good or service that, in the consensus of society, is considered of general or essential interest.⁷ Examples of public utilities include private and public undertakings in telecommunications; public waters; electricity generation, transmission and commercialization; and postal services.

Starting in the latter part of the 19th century, national governments allowed these public utilities to operate under a legal regime of exclusive rights within a defined territory. The general reason offered was that economies of scale did not make it economically feasible to build parallel networks for the provision of such public services. During the 20th century, public utilities that operated under that regulatory scheme yielded such market power that they rarely encountered competition.

Some public utilities operate as public-owned businesses in the form of revenue-producing monopolies. Most public utilities operate, however, as private-owned businesses to which the government affords certain exclusive rights. The most dominant public utilities are undertakings that build and operate exclusive or semi-exclusive distribution networks in order to provide their services.

Early American public utilities had several characteristics. First, they operated as private businesses that gave service to the public in the most general way. Second, given the high entry capital investment of such industries, they held legal or *de facto* monopoly or quasi-monopoly power. That is, they possessed the legal or market power to prevent competition for their services. Third, they tended to provide their services within fixed territories usually assigned by the government. Fourth, they had the duty of universal service: the duty to serve all members of the public for the service provided in a nondiscriminatory way. Fifth, they could charge the public tariffs or rates that had to be reasonable and commensurate with the services rendered. Finally, courts interpreted the reach of the legal monopoly of such public utilities narrowly, when that monopoly was faced with the creative destruction brought in by new market entrants that introduced innovative ways to provide the service.⁸

B. The Constitutional Basis

In the U.S., the power of States to regulate the private businesses we call public utilities commenced with a decision by the United States Supreme Court

⁶ See Directive 96/92, of the European Parliament and of the Council of 19 December 1996 concerning common rules for the internal market in electricity, 1996 O.J. (L 27) 20, [hereinafter First Electricity Directive], available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L1997:027:0020:0029:EN:PDF>.

⁷ See ELIOT JONES & TRUMAN C. BIGHAM, PRINCIPLES OF PUBLIC UTILITIES (1931); JOHN BAUER, EFFECTIVE REGULATION OF PUBLIC UTILITIES (1925).

⁸ See FRED BOSSELMAN ET AL., ENERGY, ECONOMICS AND THE ENVIRONMENT 46 (3rd ed. 2010).

in a case called *Munn v. Illinois*.⁹ The case was decided in the background of the end of the American Civil War and the passage of the 13th and 14th Amendments to the U.S. Constitution. The 13th Amendment prohibited the institution of slavery in the US.¹⁰ The 14th Amendment, among other things, prohibited states (as opposed to the federal government) to deprive their citizens of liberty and property without due process of law.¹¹ The case arose as the States asserted their power to regulate the prices of goods and services provided by private parties. *Munn* examined the constitutionality of an Illinois law that purported to establish a maximum price in the tariffs charged by owners and operators of grain elevators in the City of Chicago, Illinois. The plaintiffs in *Munn* asserted that the maximum price regulation was concomitant to the State of Illinois taking their private property (in what is now known as a regulatory taking), without the payment of just and prompt compensation.

Chief Justice Waite declared the Illinois statute constitutional and asserted the power of states to regulate the prices of businesses “affected with the public interest.”¹² *Munn* was a deeply divided opinion, and its legal reasoning was widely debated among legal commentators over the next half of the century.¹³ It nonetheless offered a solid foundation upon which States could regulate the prices of businesses “clothed with a public interest”¹⁴ to this date.

C. Public Service Obligations

Soon after the *Munn* opinion, the United States Congress established the Interstate Commerce Commission and entrusted it with regulatory power over interstate railroad tariffs. States reacted to *Munn* by creating public utility regulatory authorities now known as Public Service Commission (PSC). PSCs had the legislative mandate to regulate tariffs of those businesses that were classified as public utilities by state legislatures. State PSCs issued Certificates of Convenience and Necessity to public utilities as a condition of entry into the regulated market, and granted them exclusive franchises. They also regulated the utilities’s provision of universal service (that is, its nondiscriminatory duty to serve all customers) in their exclusive territories. Moreover, PSCs approved the utilities’ tariffs and rates to customers under the common law’s “just and reasonable” standards, mainly through the so-called *cost of service* rate regulation.

⁹ *Munn v. Illinois*, 94 U.S. 113 (1876).

¹⁰ U.S. CONST. amend. XIII.

¹¹ U.S. CONST. amend. XIV.

¹² *Munn*, 94 U.S. at 125-26.

¹³ See Breck P. McAllister, *Lord Hale and Business Affected with a Public Interest*, 43 HARV. L. REV. 759 (1930); Walton H. Hamilton, *Affectionation with Public Interest*, 39 YALE L. J. 1089 (1930).

¹⁴ *Munn*, 94 U.S. at 126.

D. Cost of Service Regulation

The *cost of service* rate regulation model was the government's attempt to correct the market defects associated with the *legal* or *natural* monopolies created when exclusive rights were granted to private or public undertakings that were not subject to the competitive forces of rival producers. Public utilities were granted exclusive territorial rights upon several justifications. First, allowing several parallel networks of transmission and distribution (hereinafter, distribution) would lead to economic waste. Second, it was argued that there were economies of scale in allowing only one network in charge of the distribution of the good (in our case, electricity). Finally, there were arguments calling for the protection of the immense amounts of capital laid down by investors in the initial setup of these networks of distribution. The network-as-natural-monopoly argument, however, does not explain the fact that most electric public utilities in the 20th century became vertically integrated undertakings, producing, transmitting, distributing and commercializing electricity.

Classic economic theory has well established that monopolies have the natural tendency to cut down the production of the good at hand and increase its price in order for the endeavor to become profitable.¹⁵ In order to avoid this natural behavior, governments that granted monopoly-type exclusive rights to these undertakings imposed upon them a series of public service obligations, most notably the obligation known as *universal service* or the *duty to serve* at reasonable prices. Public utilities had the positive duty to bring their goods and services to all members of the population that demanded such services within their exclusive territory, even if such delivery had to be incurred at an economic loss to the public utility. For example, the provision of electric service to remote areas of the territory entails the extension of the very costly distribution network, in order to serve perhaps a small population. Under a cost-benefit analysis, the costs associated with such remote service would not normally be incurred in by a regular private undertaking, for that investment would not be recouped within a reasonable time frame.

Under the *cost of service* regulatory model, the regulators would allow the public utility to recover the costs of providing the service and obtain a reasonable return on investment on their capital assets. Periodically, the public utilities had to demonstrate to government regulators their detailed costs of providing the service. In case of a shortfall, public utilities would petition a suitable rate of return on their capital to attract the capital required to continue providing their public service obligations. The petition is called the *revenue requirement*: the total amount the public utility needs to recover from its customers in order to cover its costs. Under the cost of service regulation scheme, the revenue requirement is represented by the following simple formula: $R = B * r + O$, where B is the utility base rate or investment in physical plant and other assets; r is the

¹⁵ See generally WILLIAM W. SHARKLEY, THE THEORY OF NATURAL MONOPOLY (1982).

utility's rate of return assigned by the regulators, and O is the utility's operating expenses, that vary with the utility's level of production (i.e., the costs of fuel). The economic idea behind the cost of service regulatory model is to mimic a competitive environment by obliging public utilities to produce their units of electricity (measured in kilowatts per hour or kW/hr) at the marginal cost just like a private firm, in a perfectly competitive environment, would.

Utilities passed their variable costs on to customers. They also passed the cost of their physical plant, including a reasonable rate or return on those assets to their investors. It is not difficult to see, for instance, that public utilities could increase their revenue requirement, and thus the tariffs paid by their captive customers, by overbuilding plant capacity tantamount to what could be considered economic waste. That is, under this model, public utilities could always assure their investors a regulator-sanctioned rate of return on their base rate. No matter how strong the level of government regulation is, public utilities have economic incentives to charge a price above the competitive level, produce less output than a competitive market would demand, and transfer wealth from consumers to themselves.¹⁶ As we will see in this work, the Public Service Commission regulatory model developed in the US in the 20th century may very well end up becoming the European model for the 21st century.¹⁷

E. The Role of Antitrust Law in the Regulation of Public Utilities in the United States

Despite the fact that public utilities regulated under the cost of service regulation do operate as natural or legal monopolies, their market behavior is still subject, to some extent, to antitrust laws. Both federal and state governments regulate the anticompetitive behavior of undertakings in the United States. In the federal sphere, the Sherman, Clayton and Hart-Scott-Rodino Acts regulate agreements in restraint of trade,¹⁸ monopolization and attempts to monopolize,¹⁹ and mergers of undertakings that tend to substantially lessen competition.²⁰ State laws on anticompetitive behavior of undertakings tend to follow the same regulatory pattern as those federal laws.²¹ The Federal Energy Regulatory Commission under the Federal Power Act (FPA) regulates interstate sales of electricity at the wholesale level in the US, as well as wholesale and interstate transmis-

¹⁶ See STEPHEN BREYER, REGULATION AND ITS REFORM 15-16 (1982).

¹⁷ See Directive 2009/72, of the European Parliament and of the Council of 13 July 2009 Concerning Common Rules for the Internal Market in Electricity and Repealing Directive 2003/54/EC, 2009 O.J. (L 211) 55, available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:211:005:5:0093:EN:PDF>.

¹⁸ Sherman Antitrust Act, 15 U.S.C.A. §§ 1-7 (West 2012).

¹⁹ *Id.* § 2.

²⁰ *Id.* § 3.

²¹ MASS. GEN. LAWS ANN. ch. 93, § 1 (West 2012); CAL. BUS. & PROF. CODE § 16720 (West 2012), CAL. BUS. & PROF. CODE § 16700 (West 2012); N.Y. GEN. BUS. LAW § 340 (McKinney 2012).

sion of electricity, and mergers in the electricity sector.²² However, although Subchapter II of the FPA contains an antitrust savings clause,²³ the application of the competition rules to public utilities in the United States who behave as natural monopolies is a story of exemption from the application of these rules.

For the most part of the 20th century, public utilities successfully avoided antitrust challenges to their otherwise anticompetitive behavior by invoking the regulated industries exemption. Under that claim, utilities argue that their market behavior is highly scrutinized by the pervasive regulatory scheme administered by the PSCs and that courts should defer to the expertise of the PSCs in administering the regulatory scheme and abstain from applying the federal antitrust laws.²⁴ Public utilities have also invoked, with success, the state action immunity doctrine to avoid the reach of federal antitrust laws,²⁵ provided that: (1) the public utility behavior fell within the clearly articulated state policy to displace competition with regulation, and (2) that behavior is monitored by the state.²⁶

The successful invocation by public utilities of the filed rate and state action doctrines, however, has not afforded them absolute immunity from federal antitrust laws, as the United States Supreme Court announced in *Otter Tail Power v. United States*.²⁷ *Otter Tail* was an investor-owned public utility that refused to deal in the wholesale of electricity market, in an attempt to maintain its dominant position in the market it operated. It claimed that the antitrust regulation did not apply to it because its wholesale market activities were highly regulated by the Federal Power Act. The Court held that, even though Section 202(b) of the Federal Power Act²⁸ gave the Federal Power Commission the authority to compel involuntary interconnections of power in the public interest to promote competition, the scheme of the Federal Power Act was not a “pervasive regulatory scheme for controlling the interstate distribution of power”²⁹ and, as such, *Otter Tail* was not exempt from the application of federal antitrust rules under the regulated industries exemption rationale. The holding in *Otter Tail* may be put in question by the Supreme Court’s later decision in *Verizon v. Trinko*.³⁰

The controversy in *Trinko* was a monopolization challenge in the context of a refuse-to-deal behavior by undertakings under the jurisdiction of the Telecommunications Act of 1996 (Telecomm Act).³¹ The Court held that Verizon

²² Federal Power Act, 16 U.S.C.A §§ 791a-825r (West 2012).

²³ “Sections 824i, 824j, 824l, 824m of this title, and this section, shall not be construed to modify, impair, or supersede the antitrust laws.” *Id.* § 824k(e)(2).

²⁴ See, e.g., Robert B. Von Mehren, *Antitrust Laws and Regulated Industries: The Doctrine of Primary Jurisdiction*, 67 HARV. L. REV. 929 (1954).

²⁵ *Parker v. Brown*, 317 U.S. 341, 350-52 (1943).

²⁶ *Cal. Retail Liquor Dealers Ass’n v. Midcal Aluminum, Inc.*, 445 U.S. 97, 105 (1980).

²⁷ *Otter v. U.S.*, 410 U.S. 366 (1973).

²⁸ 16 U.S.C.A. § 824a(b) (West 2012).

²⁹ *Otter*, 410 U.S. at 374.

³⁰ *Verizon v. Trinko*, 540 U.S. 398 (2004).

³¹ Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996).

could not raise the implied antitrust immunity defense by reason of the express antitrust savings clause in the Telecomm Act. However, Justice Scalia gave hope to the advocates of the regulated industries exemption when he said:

One factor of particular importance [to take into account] is the existence of a regulatory structure designed to deter and remedy anticompetitive harm. *Where such a structure exists, the additional benefit to competition provided by antitrust enforcement will tend to be small, and it will be less plausible that the antitrust laws contemplate such additional scrutiny.*³²

One may argue that the balancing analysis proposed by Scalia here may incline the balance in favor of FERC's own competition analysis for cases under its jurisdiction. The *Trinko* decision may have expanded again the scope of the regulated industries exemption, therefore reducing the potential impact of antitrust rules in shaping the market behavior of regulated industries in the United States. However, at least in one occasion after *Trinko*, the Federal Trade Commission and the US Department of Justice have asserted their concurrent jurisdiction over competition matters ruled by the FERC.³³ It remains to be seen whether the Federal Trade Commission will continue questioning competition decisions by the FERC and to what extent.

II. THE REGULATION OF ELECTRIC PUBLIC UTILITIES IN EUROPEAN LAW

A. The Framework of European Competition Law

The regulation of anticompetitive behavior by private undertakings in Europe is governed by the Treaty on the Functioning of the European Union (TFEU),³⁴ and follows the general scheme of the Sherman Act. Article 101 TFEU

³² *Verizon*, 540 U.S. at 412 (emphasis added).

³³ See Compliance & Enforcement Committee, *Committee Report: Report of The Compliance & Enforcement Committee*, 32 ENERGY L. J. 181, 226 (2011).

On February 22, 2010, in *United States v. KeySpan*, CA No. 10-cv-1415, the Department of Justice filed a complaint and stipulated judgment against the KeySpan Corporation for violations of section 1 of the Sherman Act, 15 U.S.C. § 1, *arising from facts that the FERC Office of Enforcement had concluded did not constitute market manipulation under the Federal Power Act*. KeySpan agreed to pay \$12 million for violating the antitrust laws by acquiring a financial interest in substantially all the output of a major competitor's generation through a financial swap with a financial services company that had the effect of restraining competition in the New York City electricity capacity market.

Id. (emphasis added).

³⁴ Consolidated Version of the Treaty of European Union, Sep. 5, 2008, 2008 O.J. (C 115) 13 [hereinafter TEU], available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2008:115:0013:0045:EN:PDF>; Consolidated Version of the Treaty on the Functioning of the European Union, Sep. 5, 2008, 2008 O.J. (C 115) 47 [hereinafter TFEU], available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2008:115:0047:0199:en:PDF>. The TEU and the TFEU are referred together hereinafter as the Treaties.

declares that agreements among undertakings that “may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the internal market”³⁵ are void³⁶ unless, in general, the agreement at stake “contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit.”³⁷

Article 102 TFEU prohibits “[a]ny abuse by one or more undertakings of a dominant position within the internal market or in a substantial part of it [...] as incompatible with the internal market in so far as it may affect trade between Member States.” Thus, Articles 101 and 102 TFEU are similar in structure to sections 1 and 2 of the Sherman Act, insofar as section 1 prohibits agreements in restraint of trade and section 2 prohibits monopolization and attempts at monopolization.

The Council, upon a proposal of the Commission and after consultation with the Parliament, may issue regulations and directives to implement these articles.³⁸ One such regulation is the Merger Control Regulation, aimed at “ensuring that competition in the internal market is not distorted.”³⁹ The Commission, in cooperation with the competition authorities of Member States, is the watchdog in charge of ensuring “the application of the principles laid down in Articles 101 and 102.”⁴⁰

B. Undertakings Exempted from the Rules of European Competition Law

Apart from the specific derogations for anticompetitive behavior under Article 101(3) TFEU, the Treaties afford special treatment to undertakings that enjoy exclusive or monopolistic rights under a Member State’s regulatory scheme. These include, most notably, state monopolies of a commercial character, public or private undertakings with special or exclusive rights granted by the Member State, and undertakings who provide general services of economic interest. As

³⁵ TFEU art. 101(1).

³⁶ *Id.* art. 101(2).

³⁷ *Id.* art. 101(3).

³⁸ *Id.* art. 103. Regulations and directives are defined as follows:

A regulation shall have general application. It shall be binding in its entirety and directly applicable in all Member States. A directive shall be binding, as to the result to be achieved, upon each Member State to which it is addressed, but shall leave to the national authorities the choice of form and methods.

Id. art. 288.

³⁹ Council Regulation 139/2004, On the Control of Concentrations Between Undertakings, art. 2, 2004 O. J. (L 24) 1 (EC).

⁴⁰ TFEU art. 105. We must also point out that cooperation to comply with the competition rules is also warranted by the principle of sincere cooperation of the TEU: “Pursuant to the principle of sincere cooperation, the Union and the Member States shall, in full mutual respect, assist each other in carrying out tasks which flow from the Treaties.” TEU art. 4(3).

we will see, these types of undertakings are not exempt from the competition rules of the Treaties: they just have to comply with a special set of rules provided for in the Treaties.

The Treaties recognize the prior existence of state monopolies of a commercial character. Many public utilities fall under this label. Article 37 of the TEU mandates Member States to adjust national monopolies of a commercial character run or controlled directly or indirectly by the Member State “so as to ensure that no discrimination regarding the conditions under which goods are procured and marketed exists between nationals of Member States.”⁴¹

We will consider the Treaties’s treatment of general services of economic interest in the next section, but first, we would like to mention briefly the other special situation where the Treaties provide an exception to the general application of the antitrust rules: the regulation of State aid. Article 107 of the TFEU declares economic protectionist measures favoring intra-state undertakings to be incompatible with the internal market.⁴² Article 107(2) lists State aid compatible with the internal market, such as aid provided to compensate the damage caused by natural disasters and Article 107(3) TFEU lists State aid which may be compatible with the internal market, such as “aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment.”⁴³ The Commission strictly monitors the State aid system for incompatibility with the internal market. It determines whether the State aid measure in fact or potentially distorts competition in such a way as to affect trade between Member States. In the next sections, we will explore the application of the Treaties’s competition rules to electric public utilities as implemented by both the Commission and the Court of Justice of the European Union (ECJ).

⁴¹ TEU art. 37(1). We must note that this article represents a specific application of the principle of non-discrimination of the TFEU, which states: “Within the scope of application of the Treaties, and without prejudice to any special provisions contained therein, any discrimination on grounds of nationality shall be prohibited.” TFEU art. 18.

⁴² Specifically, it states:

Save as otherwise provided in the Treaties, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market.

TFEU art. 107(1)

⁴³ *Id.* art. 107(3)(a).

C. Vertically-Integrated Electric Public Utilities as Providers of General Services of Economic Interest

European Law affords special treatment to undertakings that provide *services of general economic interest*. Article 14 of the Treaty on the Functioning of the European Union (TFEU) states very clearly that:

Without prejudice to Article 4 of the Treaty on European Union or to Articles 93, 106 and 107 of this Treaty, and *given the place occupied by services of general economic interest in the shared values of the Union as well as their role in promoting social and territorial cohesion*, the Union and the Member States, each within their respective powers and within the scope of application of the Treaties, shall take care that such services operate on the basis of principles and conditions, particularly economic and financial conditions, which enable them to fulfill their missions. The European Parliament and the Council, acting by means of regulations in accordance with the ordinary legislative procedure, shall establish these principles and set these conditions without prejudice to the competence of Member States, in compliance with the Treaties, to provide, to commission and to fund such services.⁴⁴

The TEU and the TFEU do not define the term *services of general economic interest*. Article 106(1) TFEU mentions “public undertakings and undertakings to which Member States grant special or exclusive rights,” while Article 106(2) TFEU speaks of “undertakings entrusted with the operation of services of general economic interest or having the character of a revenue-producing monopoly.”⁴⁵ Neither article defines these terms. Article 106 TFEU mandates that these types of undertakings “shall be subject to the rules contained in the Treaties, in particular to the rules of competition, insofar as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them.”⁴⁶ Moreover, Article 106(3) TFEU gives the Commission power to “ensure the application of the provisions of this Article and shall, where necessary, address appropriate directives or decisions to Member States.” Finally, the interpretation of Article 14 TEU is subject to Protocol 26, where the Member States reserved for themselves wide latitude in the interpretation and compliance with that Article.⁴⁷

⁴⁴ *Id.* art. 14 (emphasis added).

⁴⁵ *Id.* art. 106(2).

⁴⁶ *Id.* art. 106. See also Protocol (No. 26) on Services of General Interest, 2008 O.J. 115 (EC), available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:12008M/PRO/26:EN:HTML>.

⁴⁷ Protocol 26 consists of two articles that read as follows:

Article 1

The shared values of the Union in respect of services of general economic interest within the meaning of Article 14 of the Treaty on the Functioning of the European Union include in particular:

Since the Treaties do not define *services of general economic interest*, the European Commission (Commission) and the Court of Justice for the European Union (E.C.J.) have been left with the difficult task of providing legal meaning to this concept.⁴⁸ The Commission, in its Green Paper on Services of General Interest, explained that:

[T]here is broad agreement that the term refers to services of an economic nature which the Member States or the Community subject to specific public service obligations by virtue of a general interest criterion. The concept of services of general economic interest thus covers in particular certain services provided by the big network industries such as transport, postal services, energy and communications. However, the term also extends to any other economic activity subject to public service obligations.⁴⁹

In paragraph 14 of the *Corbeau* case,⁵⁰ the ECJ went further, in saying that Member States may grant undertakings providing services of general economic interests:

[E]xclusive rights which may hinder the application of the rules of the Treaty on competition in so far as restrictions on competition, or even the exclusion of all competition, by other economic operators are necessary to ensure the performance of the particular tasks assigned to the undertakings possessed of the exclusive rights.⁵¹

Regarding Belgium's postal monopoly, the ECJ held that "it cannot be disputed that the Régie des Postes is entrusted with a service of general economic interest consisting in the obligation to collect, carry and distribute mail on behalf of all users throughout the territory of the Member State concerned, at uniform tariffs and on similar quality conditions, irrespective of the specific situations or the

-
- the essential role and the wide discretion of national, regional and local authorities in providing, commissioning and organising services of general economic interest as closely as possible to the needs of the users;
 - the diversity between various services of general economic interest and the differences in the needs and preferences of users that may result from different geographical, social or cultural situations;
 - a high level of quality, safety and affordability, equal treatment and the promotion of universal access and of user rights.

Article 2

The provisions of the Treaties do not affect in any way the competence of Member States to provide, commission and organise non-economic services of general interest.

Id.

⁴⁸ See *Commission Green Paper on Services of General Interest*, COM (2003) 270 final (Jul. 21, 2003).

⁴⁹ *Id.* ¶ 17.

⁵⁰ Case C-320/91, *Roi v. Corbeau*, 1993 E.C.R. I-2533.

⁵¹ *Id.* ¶ 14.

degree of economic profitability of each individual operation.⁵² Thus, in *Corbeau*, the ECJ not only identified *universal service* as one of the public service obligations concomitant with the provision of general services of economic interest, but it also interpreted narrowly the extension of the monopoly rights to services outside the scope of the public service obligations entrusted by the Member State.

The question remained whether electricity producers and system operators were *services of general economic interest*. In the *Ijssecentrale* Decision,⁵³ the Commission, for the first time, took the position that both the electric power producers and the electric system administrator⁵⁴ provided *services of general economic interest* (in that case, the universal service). As such, the construction by the ECJ of Article 106 TFEU (former Article 86 EC) must apply to electric public utilities.⁵⁵ The political process leading to the First Electricity Directive in 1996⁵⁶ crystallized this position when, in Article 3(2) of that Directive, the Council stated:

[M]ember States may impose on undertakings operating in the electricity sector, in the general economic interest, *public service obligations which may relate to security, including security of supply, regularity, quality and price of supplies and to environmental protection*. Such obligations must be clearly defined, transpar-

⁵² *Id.* ¶ 15. The E.C.J. interpreted narrowly the monopoly rights afforded to the *Regie de Postes* and held that Mr. Corbeau could not be criminally liable for providing private mailbox services because these services were *dissociable* from the services of general economic interest entrusted to them.

⁵³ Commission Decision 91/50, Relating to a proceeding under Article 85 of the EEC Treaty, 1991 O.J. (L 028) 0032, available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31991D0050:EN:HTML>.

⁵⁴ SEP, a system operator owned by the electric producers in the Netherlands, was entrusted by law:

To draw up a joint Electricity Plan; to operate (principally in the capacity of an owner) the 380/220 kV grid; to conclude agreements with foreign electricity undertakings concerning imports and exports and the use of international interconnections; to arrange the joint purchase of fuels for the purpose of generation; to pool energy and generation costs; [and] to make the best possible use of domestic electricity generation.

Id. ¶ 2(3).

⁵⁵ The Commission took the stance that a cooperation agreement among SEP and the public electric producers that owned it was “an infringement of Article 85(1) of the Treaty in so far as it has as its object or effect the restriction of imports by private industrial consumers and of exports of production outside the field of public supply, by distributors and private industrial consumers, including autogenerators.” *Id.* ¶ 54.

⁵⁶ Directive 96/92, of the European Parliament and of the Council of 19 December 1996 concerning common rules for the internal market in electricity, 1996 O.J. (L 27) 20, available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:1997:027:0020:0029:EN:PDF>.

ent, non-discriminatory and verifiable; they, and any revision thereof, shall be published and notified to the Commission by Member States without delay.⁵⁷

Thus, security of supply and environmental protection —competences reserved by Member States— are amongst the categories of public service obligations that may be used by Member States to exempt electric public utilities from the reach of the obligations set forth in the Directive. Furthermore, Article 3(3) of the Directive makes clear that:

[M]ember States may decide not to apply the provisions of Articles 5, 6 [giving Member States choice between and authorization and a tendering procedure for the construction of new generating capacity], 17, 18 [giving Member States choice between a negotiated and a “single buyer” method of third party access to the electrical system] and 21 [mandating Member States to allow direct electric line connections] insofar as the application of these provisions would obstruct the performance, in law or in fact, of the obligations imposed on electricity undertakings in the general economic interest *and insofar as the development of trade would not be affected to such an extent as would be contrary to the interests of the Community*. The interests of the Community include, *inter alia*, competition with regard to eligible customers [wholesale, final customers in electricity and distribution companies].⁵⁸

Moreover, Article 24 of the Directive allows Member States to take safeguard measures (*i.e.*, close down to competition) in the “event of a sudden crisis in the energy market and where the physical safety or security of persons, apparatus or installations or system integrity is threatened.”⁵⁹ The message of the First Electricity Directive to the Commission was clear: the liberalization of the electric sector of the economy will be achieved by legislation and will fall in the hands of the Member States. The impetus gained by the Commission during the deregulation of the telecommunications sector era had to cede to the principle of subsidiarity.⁶⁰

⁵⁷ Directive 2003/54, of the European Parliament and the Council of 26 June 2003 concerning common rules for internal market in electricity and repealing Directive 96/92/EC, art. 3.2, 2003 O.J. (L 176) 37 (emphasis added).

⁵⁸ *Id.* art. 3.8.

⁵⁹ *Id.* art. 24.

⁶⁰ The Treaty of European Union states:

Under the principle of subsidiarity, in areas which do not fall within its exclusive competence, the Union shall act only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States, either at central level or at regional and local level, but can rather, by reason of the scale or effects of the proposed action, be better achieved at Union level.

The institutions of the Union shall apply the principle of subsidiarity as laid down in the Protocol on the application of the principles of subsidiarity and proportionality. National Parliaments ensure compliance with the principle of subsidiarity in accordance with the procedure set out in that Protocol.

TEU art. 5(3); *See also* TAKIS TRIDIMAS, *THE GENERAL PRINCIPLES OF EU LAW* (2nd ed. 2006).

At present, electric public utilities and their monopolistic behavior are not only protected by the Treaties, but also by European legislation. Since the Treaty of Rome, the European Union has been known for its strong competition policy. Why did the Founders permit the apparent contradiction of allowing revenue-producing monopolies that provide services of general economic interest to exist within the EU's strong competition policy? In other words, one must question ultimately why the EU, which since its inception aimed at creating an internal market based on a "highly competitive social market economy,"⁶¹ allows for special treatment of undertakings that are the antithesis of competition: monopolies.

D. The Regulation of the Electric Energy Sector under the Treaties

It is interesting to note that founding treaties of the now European Union dealt with the subject of energy, namely coal (Carbon and Steel Community) and atomic energy (Euratom). However, the electric energy market was not mentioned and was relegated to the precepts of the common market under the Treaty of Rome. Despite early case law establishing the fact that electricity was a good and not a service,⁶² the electric markets in Europe were, and still are controlled by isolated monopolies with high import and export restrictions on the free flow of electricity. We must remember that Article 90(3) of the Treaty of Rome (now Article 106(3) TFEU)⁶³ gave the Commission the power to ensure that providers of general services of economic interest complied with the rules of competition of the Community's common market by issuing Directives and Decisions addressed to the Member States.⁶⁴

A true internal market entails a true internal market in energy, for energy is an essential input in the production process. A fractured and price-differentiated

⁶¹ TEU art. 3(3).

⁶² Case 6/64, *Costa v. ENEL*, 1964 E.C.R. 585. available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:61964CJ0006:EN:PDF>.

⁶³ TFEU art. 106(3).

⁶⁴ Treaty of Rome art. 90 reads as follows:

1. In the case of public undertakings and undertakings to which Member States grant special or exclusive rights, Member States shall neither enact nor maintain in force any measure contrary to the rules contained in this Treaty, in particular to those rules provided for in Article 7 and Articles 85 to 94.

2. Undertakings entrusted with the operation of services of general economic interest or having the character of a revenue-producing monopoly shall be subject to the rules contained in this Treaty, in particular to the rules on competition, in so far as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them. The development of trade must not be affected to such an extent as would be contrary to the interests of the Community.

3. The Commission shall ensure the application of the provisions of this Article and shall, where necessary, address appropriate directives or decisions to Member States.

Id.

access to the flow of electric energy will not permit producing firms to compete effectively against each other in terms of price, and that, in and of itself, produces a *détente* in the free movement of goods. In other words, similar products manufactured with radically different energy costs will not make it into the shelves of retailers in Member States that can produce these products at lower energy costs.

As we will see, up until the 1990s, the Commission was at best timid in applying the competition rules to the electric energy sector of the economy. Member States, under their sovereign powers, have defended the traditional monopolistic structure of their electric energy sector citing the strategic relevance of such sector in the welfare and social cohesion of their population. During the same time span, the Commission nonetheless tested the limits of monopolistic powers in other services of general economic interest such as telecommunications.⁶⁵ The ECJ also made important pronouncements regarding the interaction and compatibility of monopolistic services of general economic interest, and the pro-competition rules aimed at achieving the Community's internal market.⁶⁶

In the 1990s, the Commission took aim against the electric market sector by way of Decisions against Member States, and by a haphazard process that culminated in the promulgation of Directive 92/96, the first internal energy market directive.⁶⁷ The second electric market directive followed in 2003⁶⁸ and the third electric market directive made its debut 2009.⁶⁹ Later, we will see the effects of the Electricity Directives in the Commission's efforts to apply the competition rules to electric public utilities. In the meantime, the energy sector found its way into the Treaty of Lisbon⁷⁰ by the addition of a new Energy title into the TFEU.

The Treaty of Lisbon explicitly acknowledged the energy sector of the economy for the first time in the evolution of the Treaties. First, Article 4(2)(i) TFEU made explicit the assumed fact that energy was a shared competence between the EU and the Member States.⁷¹ Second, the TFEU introduced the new Title XXI on energy that added Article 194 to the Treaty. Article 194 TFEU gives power to

⁶⁵ See *Commission Green Paper on the Development of the Common Market for Telecommunications Services and Equipment*, COM (87) 290 final (Jun. 30, 1987); Commission Directive 90/388 EC on competition in the markets for telecommunication services, 1990 O.J. (L 192) 10.

⁶⁶ PETER CAMERON, *COMPETITION IN ENERGY MARKETS* 473 (2nd ed. 2007); See, also, Case C-18/88, *RTT v. GB*, 1991 E.C.R. I-5973 (granting of exclusive ancillary rights to public telephone monopoly); Case C-320/91, *Roi v. Corbeau*, 1993 E.C.R. I-2533.

⁶⁷ Directive 96/92, of the European Parliament and of the Council of 19 December 1996 concerning common rules for the internal market in electricity, 1996 O.J. (L 27) 20, available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:1997:027:0020:0029:EN:PDF>.

⁶⁸ Directive 2009/72, of the European Parliament and of the Council of 13 July 2009 Concerning Common Rules for the Internal Market in Electricity and Repealing Directive 2003/54/EC, 2009 O.J. (L 211) 55, available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:211:0055:0093:EN:PDF>.

⁶⁹ *Id.*

⁷⁰ Treaty of Lisbon Amending the Treaty on European Union and the Treaty Establishing the European Communities, Dec. 13, 2007, 2007 O.J. (C 306) 1.

⁷¹ TFEU art. 4(2)(i).

the Parliament and Council, in accordance with the ordinary legislative procedure, to introduce legislation (Regulations or Directives) in order to: “(a) ensure the functioning of the energy market; (b) ensure security of energy supply in the Union; (c) promote energy efficiency and energy saving and the development of new and renewable forms of energy; and (d) promote the interconnection of energy networks.”⁷² Thus, the Treaty of Lisbon gave the energy sector an express legal basis to legislate, aside from the internal market legal basis of Article 114 TFEU.

Interestingly, such legislative power does not take away from the powers of the Commission to issue Directives and Decisions to Member States, in accordance with Article 106(3) TFEU. It remains uncertain whether the Commission (acting alone) will ever use again the legal basis provided in Article 106(3) TFEU, given the fact that the new Article 194 TFEU comes with the democratic blessing of the ordinary legislative procedure and expressly deals with the interconnection of networks, which until then had been the sole reign of the Commission in its administration of the competition rules of Articles 101 *et seq.*

Moreover, the Treaty of Lisbon gives the EU certain responsibilities in several areas related to the energy sector. Article 122 TFEU gives the Council (by qualified majority voting) the power to take emergency action if there is a severe disruption in the supply of fuel necessary to fulfill the energy needs of Member States. Article 170 TFEU mandates the EU to “contribute to the establishment and development of trans-European networks in the areas of transport, telecommunications and energy infrastructures.”⁷³ Finally, Article 192(2)(c) TFEU gives the Council, acting unanimously, the power to adopt “measures significantly affecting a Member State’s choice between different energy sources and the general structure of its energy supply.”⁷⁴

E. Competition Law and the Regulation of Electric Public Utilities Prior to the First Electricity Directive

The fact that the energy sector is now expressly regulated in both the TFEU and the Electricity Directives does not mean that energy was outside the reach of the original treaties, as some have argued in the past. The regulation of the electric sector started when the ECJ defined electric energy as a good subject to the Treaty’s provision on the free movement of goods. In *Costa v. ENEL*,⁷⁵ the ECJ found certain aspects of an Italian law nationalizing the electric energy sector to be incompatible with the principles of the Treaty of Rome. The case is mostly known for the introduction of the concept of *direct effect* into community law. However, the ECJ also found that the Italian law violated the rights of establish-

⁷² TFEU art. 194.

⁷³ TFEU art. 170.

⁷⁴ TFEU art. 192(2)(c).

⁷⁵ Case 6/64, *Costa v. ENEL*, 1964 E.C.R. 585.

ment and the free movement of goods, thus assuming that electricity was a good susceptible to the rules on the free movement of goods.

Given the fact that *Costa v. ENEL* had not ruled expressly that electricity was a good, some Member States insisted that the electric sector was not subject to the Treaty. In the *Almelo* case,⁷⁶ the ECJ restated the legal status of electricity as a good. Notwithstanding, Italy continued to claim that electricity was a *service* and not a *good* in order to take electricity outside the scope of Articles 28-31 EEC, which regulates the free movement of goods.⁷⁷ Their argument was that electricity is an effect coming from a process, that it has no substance, that it cannot be stored and that it has no economic existence in and of itself and it is a service that is used by others in their processes. As such, it is more a service than a good. In fact, the engineering literature refers to the sale of electricity as a service. The ECJ rejected that argument, citing *Almelo* with approval. Thus, electricity is a good under European Law subject to the rules on the free movement of goods.

Costa v. ENEL also provided the ECJ's first interpretation of Member States duties regarding their state monopolies of a commercial character under Article 37 of the Treaty of Rome. The Italian nationalizing law at stake in *Costa v. ENEL* was a new measure creating a monopoly of a commercial character, which was prohibited by Article 37(1) of the Treaty of Rome. However, the ECJ ruled that the Article "does not prohibit the creation of any State monopolies, but merely those of a 'commercial character', and then only in so far as they tend to introduce the cases of discrimination [regarding the conditions under which goods are procured and marketed between nationals of Member States]."⁷⁸ Since the electric transmission networks of Member States are interconnected with networks in other Member States, the preconditions for the potential discrimination in the purchase and sale of electricity by ENEL were in place, and therefore, the Italian measure was found to be incompatible with the Treaty of Rome. Moreover, in the 1976 *Manghera* case, the ECJ took the firm position that after 1969, national monopolies of a commercial character had to be adjusted to eliminate the exclusive right to import from other Members States.⁷⁹

Thus, Member States can grant exclusive rights to undertakings of a commercial nature, provided they comply with Articles 37 and 106 TFEU. Article

⁷⁶ Case C-393/92, *Municipality of Almelo v. NV Energiebedrijf Ijsselmij*, 1994 E.C.R. I-1485. The Court stated: "In Community law, and indeed in the national laws of the Member States, it is accepted that electricity constitutes a good within the meaning of Article 30 of the Treaty. Electricity is thus regarded as a good under the Community's tariff nomenclature (code CN 27.16)." *Id.* ¶ 28. Furthermore, in the judgment in *Case 6/64, Costa v. ENEL*, 1964 E.C.R. 1141, the Court accepted that electricity may fall within the scope of Article 37 of the Treaty.

⁷⁷ Case C-158/94, *Commission v. Italy*, 1997 E.C.R. I-5789, available at <http://curia.europa.eu/juris/showPdf.jsf?text=&docid=43428&pageIndex=0&doclang=EN&mode=lst&dir=&occ=first&part=1&cid=4152996>.

⁷⁸ *Id.* at 5800.

⁷⁹ Case 59/75, *Pubblico Ministero v. Flavia Manghera*, 1976 E.C.R. 91 (concerning the exclusive import rights by the State monopoly on manufactured tobacco), available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:61975CJ0059:EN:PDF>.

106(1) implicitly recognizes the rights of Member States to grant such exclusive rights to undertakings and Article 37 mandates Member States not to adopt or maintain any measures with regards to such undertakings that are contrary to the provisions of the Treaty, including rules relating to discrimination on the grounds of nationality and the rules of competition.

However, Article 106(2) TFEU provides a possible exemption to the general rule of Article 106(1) TFEU. It provides that the rules of competition shall be applied to undertakings with exclusive rights that provide services of general economic interest “in so far as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them.”⁸⁰ As we shall see, one such rule is the universal service obligation or the duty to serve all customers within a geographic area. Undertakings have invoked this derogation when accused of infringement of Articles 34, 35 and 37 TFEU on the free movement of goods.

Thus, up to the 1970s, the ECJ had ruled that: (1) electricity was a good for purposes of the Treaty, and that (2) Member States could not create new monopolies in electricity with exclusive rights as to the importation and exportation of energy, since that would be contrary to the Treaty’s principles on the free movement of goods.

Electric utilities that operate as for-profit monopolies are characterized by a series of exclusive rights. These rights can be categorized as follows:

- 1) Exclusive rights to import and export electricity from their exclusive geographic territory of operation. (These rights have raised issues regarding the free movement of goods.)
- 2) Exclusive rights for the transmission and distribution of electricity within their exclusive geographic territory. (These rights may raise issues of barriers of entry and abuse of a dominant position under Article 102 TFEU.)
- 3) Exclusive rights to produce electricity in their exclusive territory. (These rights may raise issues of rights of establishment for undertakings wishing to introduce new generation of electricity under Article 56 TFEU.)
- 4) Exclusive access to their transmission and distribution networks. (These rights may raise issues of the free movement of goods, barriers of entry, and abuse of a dominant position under Article 102 TFEU.)
- 5) Other exclusive rights such as exclusive marketing rights.

These exclusive rights may raise issues under Articles 37, 101 and 102 TFEU which may need to be derogated under the provisions of Article 106(2) TFEU by proving that the exclusive right is necessary to comply with the public service obligations. In the electricity sector, the Commission and the ECJ have not tested how

80 TFEU art. 106(2), available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2010:083:0047:0200:en:PDF>.

compatible with the Treaties are both the exclusive rights for the transmission and distribution of electricity within a geographic territory, and the exclusive territorial rights to produce electricity. There is perhaps a two-fold reason for this lack of action. First, the Commission may simply be following the principle of subsidiarity of Article 5(3) TEU.⁸¹ Second, the Commission may have taken the position that intra State production and management of electricity does not have cross-border implications. This latter position would be clearly erroneous, electric networks in the European Continent are interconnected and electric flows do not respect legal boundaries. The handling of the electric network by France does have an effect in the transmission and distribution of electric energy in the neighboring Member States, at least along the borders. In fact, the European Council recognized this when it issued the precursor to Regulation 714/2009 “on conditions for access to the network for cross-border exchanges in electricity.”⁸² Under these premises, the Commission could invoke infringement actions against Member States pursuant to 106(3) TFEU, against exclusive rights in the electric production and transmission at the intra border level. That has not happened. The Commission, however, has concentrated its efforts on attacking exclusive rights that tend to create import and export monopolies and cases where electric utilities restrict access to their network by third parties.

To what extent are such exclusive rights necessary to maintaining public service obligations, such as universal service, is a question that went unexplored by the Commission and the ECJ until the 1990s.

In *Almelo*, a regional, non-exclusive electricity distributor prohibited local electricity distributors from importing electricity generated by third party producers, by means of an exclusive purchasing clause. The importance of this case is that the public authorities were not involved in the controversy; the parties were just a regional distributor holding a dominant position in the market and the local distributors. However, the regional distributor was operating under certain exclusive rights granted by the public authorities and invoked a derogation under Article 90(2) EC [now 106(2) TFEU] arguing that the exclusive purchasing clause was necessary to comply with its public service obligations.

The ECJ held that the rules of competition and the free movements of goods are applicable to the electric sector utilities and that the exclusive rights granted to such utilities are only justified if they are indispensable to guarantee the utilities’ compliance with the public service obligations imposed by the Member State. The ECJ said, in paragraphs 49 and 50 of the opinion, the following:

49 Restrictions on competition from other economic operators must be allowed *in so far as they are necessary* in order to enable the undertaking entrusted with

81 TEU art. 5(3).

82 Regulation 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 O.J. (L 51) 112, available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:211:0015:0035:EN:PDF>.

such a task of general interest to perform it. In that regard, it is necessary to take into consideration the economic conditions in which the undertaking operates, in particular the costs which it has to bear and the legislation, particularly concerning the environment, to which it is subject.

50 It is for the national court to consider whether an exclusive purchasing clause prohibiting local distributors from importing electricity is necessary in order to enable the regional distributor to perform its task of general interest.⁸³

The ECJ introduced in *Almelo* a necessity test for public utilities to invoke the derogation of Article 106(2) TFEU. After *Almelo*, public utilities must prove that there is a necessary connection between the exclusive rights granted and the costs associated with the service in order to escape from the competition rules of the Treaties.

In *Commission v. Netherlands* (the Dutch case),⁸⁴ the Commission argued the illegality under the Treaty of the Dutch Electric Law of 1989. The Law gave an undertaking named SEP, as coordinator of electric production, the monopoly power over the importation of electricity. The Netherlands denied that SEP constituted a monopoly for purposes of Article 37 EC, given the fact that it was a coordinator for production. The ECJ, citing *Banchero*, rejected that contention:

20 It is clear, however, from the case-law of the Court that Article 37 of the Treaty applies to situations in which the national authorities are in a position to control, direct or appreciably influence trade between Member States through a body established for that purpose or a delegated monopoly (Case C-387/93 *Banchero* [1995] ECR I-4663, paragraph 26, and case-law cited). *By their nature, exclusive import rights give rise to such a situation.*⁸⁵

The ECJ found that this monopoly right was discriminatory and contrary to Article 37 EEC, since the exclusive right hinders the free movement principles inasmuch as all the electricity was channeled through only one enterprise. The Commission argued that the derogation provided by Article 90(2) EEC could only be applicable if SEP showed that, without the exclusive right, acting under the forces of competition, the undertaking would face dire economic conditions. The ECJ did not accept this argument. It held that SEP just had to prove that it would not be able to comply with its public service obligations without the exclusive rights and that the exemption provided by Article 90(2) EEC would not adversely affect the inter-Community electricity trade.

⁸³ Case C-393/92, *Municipality of Almelo v. NV Energiebedrijf Ijsselmij*, 1994 E.C.R. I-1485, 1488.

⁸⁴ Case C-157/94, *Commission v. Netherlands*, 1997 E.C.R. I-5699, available at <http://curia.europa.eu/juris/showPdf.jsf?text=&docid=99692&pageIndex=0&doclang=EN&mode=lst&dir=&occ=first&part=1&cid=4153179>.

⁸⁵ Case C-387/93, *Banchero*, 1995 E.C.R. I-4663, available at <http://curia.europa.eu/juris/showPdf.jsf?text=&docid=99220&pageIndex=0&doclang=EN&mode=lst&dir=&occ=first&part=1&cid=3788699> (emphasis added).

In the *EDF/GDF* case,⁸⁶ the Commission argued that the French electricity and gas monopolies were contrary to the Treaty and that they could not be justified under Article 90(2) EC. The French monopolies prevented producers in other Member States from selling their production to customers in France other than EDF and GDF. They also prevented customers in France from choosing providers of such goods from other Member States. As such, the Commission argued, the import monopolies were contrary to Article 28 EC, as measures having an effect equivalent to quantitative restrictions on imports, and the exclusive import rights were discriminatory *vis-a-vis* producers in other Member States under Article 31 EC. The ECJ held that:

40 The existence of exclusive import rights in a Member State deprives economic operators in other Member States of the opportunity to offer their products to consumers of their choice in the Member State concerned, regardless of the conditions which they encounter in their Member State of origin or in other Member States.⁸⁷

However, it found that they constituted violations of Article 37 EC, and thus the analysis under the free movement of goods provisions was not warranted:

41 Since the maintenance of the exclusive import and export rights at issue is therefore contrary to Article 37 of the Treaty, it is unnecessary to consider whether they are contrary to Articles 30 and 34 or, consequently, whether they might possibly be justified under Article 36 of the Treaty.⁸⁸

The French government argued that these privileges were necessary in order to cover consumer demand at a competitive price without discriminating among different types of customers and to comply with its environmental commitments and regional policies. The ECJ decided in favor of France and allowed it to derogate on the basis of Article 90(2) EEC. Similarly to the *Dutch case*, the ECJ ruled that:

59 It must therefore be concluded that, for the Treaty rules not to be applicable to an undertaking entrusted with a service of general economic interest under Article 90(2) of the Treaty, it is sufficient that the application of those rules obstruct the performance, in law or in fact, of the special obligations incumbent upon that undertaking. It is not necessary that the survival of the undertaking itself be threatened.⁸⁹

The Commission lost the *Dutch* and *EDF/GDF* cases, as well as others brought on similar grounds against Italy⁹⁰ and Spain.⁹¹ In all cases, the ECJ found that the

⁸⁶ Case C-159/94, *Commission v. France*, 1997 E.C.R. I-5815, available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:61994CJ0159:EN:PDF>.

⁸⁷ *Id.*

⁸⁸ *Id.*

⁸⁹ *Id.*

⁹⁰ Case C-158/94, *Commission v. Italy*, 1997 E.C.R. I-5789, available at <http://curia.europa.eu/juris>

Commission offered insufficient proof that the Article 90(2) EC defense raised by the Member States was meritless. Nonetheless, despite the Commission's lost battles, the ECJ clearly held that the exclusive import rights of electric utilities run against the principles of free movement of goods and can only be permitted in the European order if properly justified under the exemption provided by Article 106(2) of the TFEU.⁹²

With regards to network access, there is no doubt that in order to achieve a liberalized internal market in electric energy there must be open access to the electric transmission network. The transmission network is the infrastructure necessary for the sale of electricity. For new market entrants in the electric sector, it would be an insurmountable barrier of entry to not be allowed to wheel their produced power unto existing networks. As such, in an open internal market for energy, electric transmission networks must become common carriers or essential facilities.⁹³ Vertically integrated electric utilities currently enjoy a dominant position with respect to the access to their networks. A network operator cannot deny access to the network to those willing to pay a reasonable toll for network access upon the following conditions: 1) there is technical capacity to access the same, 2) the construction of a parallel transmission line is economically unfeasible, and 3) the network operator can plan the dispatch of energy in the network adequately.

In the *Bronner* case,⁹⁴ the ECJ laid down the principles on what has become the Court's take on the essential facilities doctrine. There, in a typical "refuse to deal" case, Mr. Bonner, the owner of a small circulation newspaper in Austria wanted paid access to the distribution network of Mediaprint, a major newspa-

/showPdf.jsf?text=&docid=43428&pageIndex=0&doclang=EN&mode=lst&dir=&occ=first&part=1&cid=3792236.

⁹¹ See Case C-160/94, *Commission v. Spain*, 1997 E.C.R. I-5851, available at <http://curia.europa.eu/juris/showPdf.jsf?text=&docid=43430&pageIndex=0&doclang=EN&mode=lst&dir=&occ=first&part=1&cid=3792276>.

⁹² Article 86(2) states:

Undertakings entrusted with the operation of services of general economic interest or having the character of a revenue-producing monopoly shall be subject to the rules contained in the Treaties, in particular to the rules on competition, in so far as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them. The development of trade must not be affected to such an extent as would be contrary to the interests of the Union.

TFEU art. 86(2), available at <http://eur-lex.europa.eu/LexUriServ/site/en/oj/2006/ce321/ce32120061229en00010331.pdf>.

⁹³ See also Sebastien Evvard, *Essential Facilities in the European Union: Bronner and Beyond*, 10 COLUM. J. EUR. L. 491 (2004), available at <http://www.jonesday.com/files/Publication/e2d79ea9-8440-49e6-a879-c834f4bob557/Presentation/PublicationAttachment/9cf89b02-295b-43cf-8a00-3cbea13a85bf/Article%20essential%20of%20facilities.pdf>; Phillip Areeda, *Essential Facilities: An Epithet in Need of Limiting Principles*, 58 ANTITRUST L.J. 841 (1989).

⁹⁴ Case C-7/97, *Oscar Bronner GmbH & Co. KG v. Mediaprint Zeitungs- und Zeitschriftenverlag GmbH & Co. KG*, 1998 E.C.R. I-7791, available at <http://curia.europa.eu/juris/showPdf.jsf?text=&docid=43749&pageIndex=0&doclang=EN&mode=lst&dir=&occ=first&part=1&cid=3793635>.

per conglomerate that claimed its distribution network was an essential facility. Mr. Bonner argued that Mediaprint's refusal to deal was an abuse of a dominant position within the meaning of Article 86 EC (now Article 102 TFEU). In paragraph 41 of the case, the ECJ held that:

[I]n order to plead the existence of an abuse within the meaning of Article 86 of the Treaty in a situation such as that which forms the subject-matter of the first question, not only that the refusal of the service comprised in home delivery be likely to eliminate all competition in the daily newspaper market on the part of the person requesting the service and that such refusal be incapable of being objectively justified, *but also that the service in itself be indispensable to carrying on that person's business, inasmuch as there is no actual or potential substitute in existence for that home-delivery scheme.*⁹⁵

The ECJ went on to hold that Mediaprint's home-delivery distribution network was not indispensable in order for Mr. Bronner to achieve his market objectives.

We do not see how the essential facilities logic of the ECJ in *Bronner* cannot be applied with added force in the case of access to electric transmission networks given the unique nature of those networks. In contrast, the Commission has applied the essential facilities doctrine without blinking to the gas pipeline industry.⁹⁶

E. Regulation of the Electric Energy Sector in Secondary Legislation

In parallel with the infringement cases against Member States that were just discussed, the Commission commenced an ill-fated process to issue a directive to require the removal of import-export monopolies in the electric and gas industries under the legal basis provided by Article 86(3) EC (now 106(3) TFEU). We must remember that directives issued under Article 86(3) EC did not require the legal participation of the Council or the Parliament. Under major pressure from Member States, the Commission abandoned its attempt to regulate the electricity and gas markets under the route provided by Article 83(3) EC.⁹⁷ In 1996, however, the European institutions got together and approved the first common rules in the internal energy market contained in Council Directive 96/92.⁹⁸ In fact, the Council has adopted a total of five Directives in the electrici-

⁹⁵ *Id.* ¶ 41, at 1-7831 (emphasis added).

⁹⁶ See EUROPEAN COMMISSION, XXIIIRD REPORT ON COMPETITION POLICY 141-43 (1993) (discussing the *Disma* case, the Commission concluded that oil and gas pipelines can be considered essential facilities).

⁹⁷ PETER CAMERON, COMPETITION IN ENERGY MARKETS 470-71 (2nd ed. 2007).

⁹⁸ Directive 96/92, of the European Parliament and of the Council of 19 December 1996 concerning common rules for the internal market in electricity, 1996 O.J. (L 27) 20, available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:1997:027:0020:0029:EN:PDF>.

ty sector: one on the transparency of prices for electricity,⁹⁹ one on inter-State transit of electricity,¹⁰⁰ one on the common rules for the internal energy market, one for the full liberalization of the electricity markets,¹⁰¹ and a final one concerning the common rules for the internal market in electricity that repealed the previous Directives.¹⁰²

Commencing with the First Electricity Directive in 1996, the pro-competition objectives of the Treaties moved away from the scattered application of the competition rules by the Commission to the realm of regulation by the EU institutions. *Vis-à-vis* the Member States, the Commission's role went back to the traditional role of ensuring the correct transposition and application of the Directives and its role was redirected to the enforcement of the competition rules against private or state-owned undertakings against their *cartelization* activities, abuse of dominant position behavior and market power concentration checks via the Merger Regulation.

Despite the fact that both the First and Second Electricity Directives have been repealed, it is worth reviewing their approach to the pro-competition or *liberalization* objectives for the electric energy markets. As we discussed earlier, the First Electricity Directive sent the message to the Commission that public utilities providing services of general economic interest had to be given special treatment under the rules of Article 106 TFEU.

The First Electricity Directive attempted to establish measures aimed at the different product markets controlled by vertically-integrated public utilities: power generation, power transmission at the high voltage electric network, and power distribution to the end customer. To that effect, the Directive mandated account unbundling:

Integrated electricity undertakings shall, in their internal accounting, keep separate accounts for their generation, transmission and distribution activities, and, where appropriate, consolidated accounts for other, non-electricity activities, as they would be required to do if the activities in question were carried out by separate undertakings, with a view to avoiding discrimination, cross-subsidization and distortion of competition.¹⁰³

99 Directive 90/377, of the European Parliament and of the Council of 29 June 1990 concerning a Community procedure to improve the transparency of gas and electricity prices charged to industrial end-users, 1990 O.J. (L 185) 16, available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=C-ELEX:31990L0377:en:HTML>.

100 Council Directive 90/547, of the European Parliament and of the Council of 29 October 1990 on the transit of electricity through transmission grids, 1990 O.J. (L 313) 30, available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:1990:313:0030:0033:EN:PDF>.

101 Directive 2009/72, of the European Parliament and of the Council of 13 July 2009 Concerning Common Rules for the Internal Market in Electricity and Repealing Directive 2003/54/EC, 2009 O.J. (L 211) 55, available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:211:0055:0093:EN:PDF>.

102 *Id.*

103 Council Directive 96/92, art. 14(3), 1996 O.J. (L 27) 20 (EEC).

The main idea behind *account unbundling* was to account for the proper and real costs of providing services in these different product markets with the hope of establishing a market price for each of these services.

On the power generation market, the Directive mandated national rules regarding the procurement of new power generation. Member States had the choice of establishing an *authorization* process (similar to what in the United States is known as *integrated resource planning*) or a *tendering* process in order to promote the bid by third-party power producers for the new generation.¹⁰⁴ The Directive also asked Member States to provide nondiscriminatory third party access to their systems via the implementation of a negotiated or *single buyer* model. It also recognized the *autoproducer* and the independent producer of electricity, and mandated the removal of obstacles to the installation of direct electric lines; that is, electric lines that were not interconnected to the network.¹⁰⁵ Finally, the Directive introduced the concept of *system operator*, which was to be “responsible for operating, ensuring the maintenance of, and, if necessary, developing the transmission system in a given area and its interconnectors with other systems, in order to guarantee security of supply.”¹⁰⁶ Member States could name the system operator or could allow vertically integrated public utilities to continue owning and operating them under certain *Chinese Wall* and independent management criteria.

The Second Electricity Directive went a step further and required that system operators become separate legal entities from the vertically integrated public utility. The public utility could still own the shares of the system operator, but for all relevant purposes, the system operator had to operate under separate management and in accordance with detailed obligations set forth in the Directive.¹⁰⁷ For the most part, the Second Electricity Directive kept the same structure as the First Electricity Directive: derogations for undertakings with public service obligations, the procurement of new generation capacity, the unbundling of account obligations, etc. Regarding third-party access obligations, the Directive mandated:

[T]he implementation of a system of third party access to the transmission and distribution systems based on published tariffs, applicable to all eligible customers and applied objectively and without discrimination between system users.

¹⁰⁴ *Id.* arts. 5-6.

¹⁰⁵ *Id.* art. 21.

¹⁰⁶ *Id.* art. 7(1).

¹⁰⁷ Article 10(1) establishes:

Where the transmission system operator is part of a vertically integrated undertaking, it shall be independent at least in terms of its legal form, organisation and decision making from other activities not relating to transmission. These rules shall not create an obligation to separate the ownership of assets of the transmission system from the vertically integrated undertaking.

Id. art. 10(1).

Member States shall ensure that these tariffs, or the methodologies underlying their calculation, are approved prior to their entry into force . . . and that these tariffs and the Methodologies . . . are published prior to their entry into force.¹⁰⁸

The confection and publication of toll tariffs in accordance with procedures guaranteeing the transparency requirements set forth in the Directive is the responsibility of one or more national regulatory authorities designated by the Member States.

These authorities must be independent of the electricity sector and have a duty to monitor competition issues inasmuch as they “at least [should] be responsible for ensuring non-discrimination, effective competition and the efficient functioning of the market, monitoring, in particular: . . . (h) the level of transparency and competition.”¹⁰⁹ The energy national regulatory authority has jurisdiction over functions normally falling in the national competition authorities. For instance, in Spain, the *Comisión Nacional de Energía* shares the monitoring of competition rules with the national competition authority. Although it falls outside the scope of this paper, it would be interesting to study the cooperation of the national energy regulatory body and competition authorities regarding the monitoring of competition in national markets.

Not long after the issuance of the Second Electricity Directive, the Commission launched an inquiry into the energy sector in Europe, pursuant to the powers afforded to it by Article 17 of Regulation 1/2003.¹¹⁰ Article 17 empowers the Commission to launch these sector inquiries “where the trend of trade between Member States, the rigidity of prices or other circumstances suggest that competition may be restricted or distorted within the common market.” The Commission adopted the final report on October 2007.¹¹¹

The results of the inquiry were dismal for the promoters of the liberalization process:

However, while progress has been made, the objectives of market opening have not yet been achieved. Despite the liberalisation of the internal energy market, barriers to free competition remain. Significant rises in gas and electricity wholesale prices that cannot be fully explained by higher primary fuel costs and environmental obligations, persistent complaints about entry barriers and limited possibilities to exercise customer choice¹¹²

¹⁰⁸ Council Directive 96/92, art. 20(1), 1996 O.J. (L 27) 20 (EEC).

¹⁰⁹ Directive 2003/54, of the European Parliament and the Council of 26 June 2003 concerning common rules for internal market in electricity and repealing Directive 96/92/EC, art. 3.2, 2003 O.J. (L 176) 37.

¹¹⁰ Council Regulation 1/2003, of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty, 2003 O.J. (L 1) 1.

¹¹¹ Communication from the Commission Inquiry pursuant to Article 17 of Regulation (EC) No. 1/2003 into the European gas and electricity sectors (Final Report), COM (2006) 851 final (Oct. 1 2007), available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2006:0851:FIN:EN:PDF>.

¹¹² *Id.* ¶ 2.

The inquiry encountered serious issues of market concentration (where energy markets remain national markets); vertical foreclosure issues given the inadequate unbundling of network and supply of vertically-integrated public utilities; issues with the lack of market integration, including lack of regulatory oversight for cross border issues; lack of transparency regarding network information; lack of trust in the price formation mechanisms of the market; lack of customer choice and competition in the end-customer or downstream markets; balancing markets that were very concentrated and dominated by incumbent operations; and lack of third party access to the liquefied natural gas (LNG) terminals.

The Commission took the position that in order to remedy these market defects, “it is essential to apply both competition and regulatory-based remedies. Competition law enforcement can make a significant contribution, but cannot by itself open markets and resolve all the shortcomings identified by the Sector Inquiry . . .”¹¹³ and, therefore, called for additional regulatory remedies. The regulatory remedies suggested by the Commission are spelled out in the Third Electricity Directive.¹¹⁴ This Directive picks up on the themes of the previous two directives but now calls for full ownership unbundling¹¹⁵ of the network assets of vertically integrated utilities; for the independence of national energy regulators from the national governments; and, following the successful model of Regulation 1/2003, it calls for the creation of the Agency for the Cooperation of Energy Regulators.¹¹⁶ The Third Electricity Directive had to be transposed into the national law of Member States by March 3, 2001. As of June 21, 2012, Ireland and Slovenia had not notified the Commission of their respective national measures achieving the transposition of the Directive.¹¹⁷ Failure by Member States to transpose or to correctly transpose directives subjects them to an infringement procedure under Article 258 TFEU. It remains to be seen whether this cooperative regulatory model will offer the needed momentum for the still illusory formation of an internal energy market in Europe.

¹¹³ *Id.* ¶ 40.

¹¹⁴ See Directive 2009/72, of the European Parliament and of the Council of 13 July 2009 Concerning Common Rules for the Internal Market in Electricity and Repealing Directive 2003/54/EC, 2009 O.J. (L 211) 55, available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:211:0055:0093:EN:PDF>.

¹¹⁵ Although it still allows Member States the option to adopt the Independent System Operator Model (network assets in a separate legal entity operated by a party designated by the Member State) and the Independent Transmission Operator Model (network assets still part of the vertically-integrated utility subject by strict regulation by the national energy regulator).

¹¹⁶ Regulation 713/2009, of the European Parliament and of the Council of 13 July 2009 establishing an Agency for the Cooperation of Energy Regulators, 2009 O.J. (L 211) 1.

¹¹⁷ Press Release, Internal energy market: national legislation in 3 Member States is still not fully in line with EU rules, European Commission (Jun. 21, 2012), available at http://europa.eu/rapid/press-release_IP-12-639_en.htm.

F. Competition Law Enforcement against Electric Public Utilities under the Regulatory Era

Both Article 106(3) TFEU and Regulation 1/2003 empower the Commission to investigate and issue decisions against named persons regarding compliance with the competition rules of the Treaties. The Commission has also used the State-aid rules to monitor State aid to electric public utilities regarding, for example, compensation for the stranded costs associated with the unbundling of vertically-integrated utilities.¹¹⁸ It has also used the Merger Regulation to monitor market concentration issues regarding proposed mergers by electric public utilities.¹¹⁹

The Commission in recent years has developed the practice of joining national regulators in performing unannounced visits to undertakings suspected of violating competition rules. For instance, in February 2012 the Commission inspected power exchange undertakings in several Member States under the suspicion of Article 101 TFEU violations.¹²⁰ In March 2009, they also visited Electricité de France (EDF) under suspicion of abuses of its dominant position under Article 102 TFEU, in particular, actions taken by EDF to raise the wholesale price of electricity. These investigations remain open and may lead the Commission to open formal proceedings against the undertaking pursuant to Regulation 1/2003.¹²¹ Once these formal proceedings are notified, the undertaking may offer commitments to the Commission under a *nolo contendere* approach similar to the one used by the Federal Trade Commission in antitrust enforcement. Next, we will briefly consider some of the Commission's probing of anticompetitive market practices by electricity undertakings in recent years.

1. Article 101 TFEU; Generation

In May 2010, the Commission opened proceedings against the French nuclear company Areva SA and the German company Siemens AG.¹²² These companies had entered into a joint venture in 2001 for the development of nuclear electricity generation. The joint venture ended in 2009. Upon termination, the joint venture agreement had an 11-year non-compete and confidentiality agreement, which the Commission alleged violated Article 101 TFEU. Through commit-

¹¹⁸ See, e.g., *SA.18989 Stranded costs compensations in Poland*, EUROPEAN COMMISSION, http://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=3_SA_18989 (last visited Jan. 25, 2013).

¹¹⁹ See, e.g., *Case M.3440 ENI / EDP / GDP (4064)*, EUROPEAN COMMISSION, http://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=2_M_3440 (last visited Jan. 25, 2013).

¹²⁰ European Commission, *Antitrust: Commission confirms unannounced inspections in the electricity sector*, http://europa.eu/rapid/press-release_MEMO-12-78_en.pdf (Memorandum 12/78 of February 7, 2012).

¹²¹ Council Regulation 1/2003, of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty, 2003 O.J. (L 1) 1.

¹²² *Case COMP/B1/39.736 — Siemens/Areva*, EUROPEAN COMMISSION, http://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=1_39736 (last visited Jan. 25, 2013).

ments, the Commission obtained a reduction of the non-compete to 3 years for the core products and eliminated the non-compete in the non-core products of the joint venture.

2. Article 102 TFEU; Generation

In July 2007, the Commission commenced formal proceedings against Electrabel of Belgium and EDF of France for abuse of their dominant position under Article 102 TFEU.¹²³ Both undertakings used long-term exclusive purchase obligations in their supply contracts with industrial clients. The effect of such long-term purchase obligations was to foreclose competition in the downstream retail markets because these contracts close up the future demand to new retail market entrants. In the EDF case, the Commission adopted a Decision accepting EDF's commitments, including one to modify its supply contracts in order to ensure that at least sixty percent of the tied industrial demand returned to the market on a yearly basis.¹²⁴

In 2008, the Commission, after a series of inspections, issued a preliminary assessment of the German wholesale and balancing electricity markets and identified practices by the E.On group in violation of Article 102 TFEU. E.On was abusing its dominant position by intentionally withholding the dispatch of available generating capacity, thus creating false scarcity in order to drive up the prices of wholesale electricity. In addition, E.On offered long-term supply contracts, or participation in their generating plants, to potential competitors, thus discouraging the buildup of new generation capacity. Moreover, the Commission found that E.On's transmission system operator systematically favored the use of E.On's generating affiliates to provide "balancing electricity"¹²⁵ into its network, passing the costs of such balancing energy to end customers, and preventing third party producers from selling their balancing electricity into E.On's transmission network. E.On did not accept the Commission's preliminary findings, but soon offered a set of commitments that would effectively restructure the German electricity markets forever.¹²⁶ E.On proposed to divest itself of more than 20% of the generation assets it owned (in excess of 5000 MW). In addition, E.On proposed the divestiture of its whole transmission network business to a third

¹²³ European Commission, *Antitrust: Commission initiates formal proceedings against Electrabel and EDF for suspected foreclosure of the Belgian and French electricity markets*, http://europa.eu/rapid/press-release_MEMO-07-313_en.pdf (Memorandum 07/313 of July 26, 2007).

¹²⁴ European Commission, *Antitrust: EDF commitments to open French electricity market to competition made legally binding*, http://europa.eu/rapid/press-release_ip-10-290_en.pdf.

¹²⁵ On an engineering note, high voltage electricity transmission requires the injection of so-called reactive power or balancing energy in order to properly manage the power load of the transmission lines.

¹²⁶ European Commission, *of 26 XI 2008 relating to a proceeding under Article 82 of the EC Treaty and Article 54 of the EEA Agreement (Cases COMP/B-1/39.388 - German Electricity Wholesale Market and COMP/B-1/39.389 - German Electricity Balancing Market)*, http://ec.europa.eu/competition/antitrust/cases/dec_docs/39388/39388_2796_3.pdf.

party not controlled by E.On in order to avoid the balancing electricity market transactions ridden with conflict of interest. The Commission achieved, for the first time in the electricity regulatory era, a structural remedy that led to ownership unbundling, which was to become the preferred method of unbundling in the yet to come Third Electricity Directive.

The structural remedies in the E.On case may become the norm and not the exception. In July 2011, the Commission opened proceedings against CEZ A.S., the incumbent vertically integrated electric utility in the Czech Republic, alleging violations of Article 102 TFEU. CEZ was incurring in capacity hoarding¹²⁷ of its transmission network in an effort to prevent the entry of third parties into the wholesale market of electricity. In July 2012, CEZ proposed a series of commitments, including the divestiture of part of its generation assets.¹²⁸

3. Article 102 TFEU; Transmission

In the transmission side, the Commission opened proceedings in 2009 against Svenska Kraftnät (SvK), the Swedish national Transmission System Operator.¹²⁹ Sweden's hydroelectric production in the northern part of the country is mostly consumed in the densely populated southern part. Neighboring countries bided for such inexpensive hydroelectric power, but did not receive much. SvK alleged limited interconnector capacity when denying energy block dispatches to neighboring countries. The Commission alleged that SvK abused its dominant position under Article 102 TFEU by limiting the export capacity of its border interconnectors in order to relieve internal network congestion.¹³⁰ The result was to create a market segmentation that favored internal customers compared to the customers from the inter-connected Member States. The Commission accepted SvK's commitment to: (1) restructure the electric grid into at least two bidding zones, and (2) to build additional transmission capacity in order to address the illegal use of the interconnectors.

4. Article 106 TFEU; Generation

Despite the issuance of several Decisions against undertakings in the electric energy sector during recent years, the Commission had not instituted any major infringement actions against Member States for noncompliance with the competition rules. In the only Article 106(3) TFEU Decision against a Member State in

¹²⁷ Capacity hoarding is the withholding of transmission capacity through excessive capacity reservations in order to prevent or hinder competition.

¹²⁸ Press Release, European Commission, Antitrust: Commission market tests commitments proposed by CEZ concerning Czech electricity market (July 10, 2012).

¹²⁹ Commission Decision 2010/C 142, relating to a proceeding under Article 102 of the Treaty on the Functioning of the European Union and Article 54 of the EEA Agreement, 2010 O. J. (C 142) 28.

¹³⁰ Congestion occurs when the physical assets of the network is not sufficient to withstand the demanded capacity for transmission. Such a situation may require the construction of additional transmission lines, and related facilities.

recent years, the Commission found that the semi-exclusive rights for the extraction of lignite - used in the generation of electric energy - that Greece gave to Public Power Corporation (PPC), the state-owned electric public utility, infringed Article 86 EC (106 TFEU) and 82 EC (102 TFEU).¹³¹ Lignite-based power generation was the most inexpensive in Greece and constituted over sixty percent of the generation in Greece at that point in time.¹³² The Commission concluded that:

[B]y granting and maintaining in force quasi-monopolistic rights giving the public undertaking PPC privileged access to lignite exploitation, and accordingly to lignite-based electricity, the Hellenic Republic assured PPC a privileged access to the cheapest available fuel for electricity production, which gave this company the possibility to maintain a dominant position in the wholesale electricity market at a level close to monopoly by excluding or hindering market entry by newcomers.¹³³

It is interesting to note that Greece did not rely on an Article 106(2) derogation to justify the national measures granting semi-exclusive lignite extraction rights to PPC.¹³⁴ In 2009, the Greek government proposed commitments that included the tender of forty percent of the lignite deposits to third parties in order to address the main points of the 2008 Decision. The Commission accepted such commitments.¹³⁵ However, in 2011 the Greek government requested a modification of the 2009 Decision and the Commission is still evaluating the proposed amended commitments.

CONCLUSION: THE FUTURE OF THE ROLE OF COMPETITION LAW IN THE REGULATION OF ELECTRIC PUBLIC UTILITIES

In this work, we have surveyed the roles of antitrust and other competition rules in the deregulation of wholesale energy markets in the United States and the liberalization of energy markets in the European Union. In both cases, the aim of regulators and competition enforcement agencies has been to break up the electricity sector from the monopolistic claw of the vertically integrated public utility model. From the beginnings of the electric energy industry, both the United States and European countries subsidized the generation, transmission and distribution of electric energy by giving these undertakings exclusive rights in exchange for the high costs of capital needed to maximize the enjoyment of

¹³¹ Commission Decision 2008/C 93, relating to a proceeding under article 86(3) of the EC Treaty on the maintaining in force by the Hellenic Republic of rights in favor of Public Power Corporation S.A. for extraction of lignite, 2008 O. J. (C 93) 3.

¹³² *Id.* ¶ 187.

¹³³ *Id.* ¶ 132.2.

¹³⁴ *Id.* ¶ 240.

¹³⁵ Press Release, European Commission, Antitrust: Commission Accepts Commitments by Greece to Ensure Fair Access to Greek Lignite Deposits (Aug. 6, 2009).

electric energy by their respective populations. The natural monopoly undertakings subsidized by these countries took away high surpluses from their clients, offered deficient service, underinvested in innovation and, in general, abused their dominant position in the same markets these countries helped to create. The deregulation or liberalization movements acted on the premise that, by regulating the unbundling of these vertically-integrated public utilities, the surpluses captured by these undertakings under the natural monopoly economic model would be returned to clients in the form of lower costs of electricity.

In terms of lowering the costs to the end user, the results have been mixed.¹³⁶ In terms of bringing innovation to the electric energy markets, the results have been positive.¹³⁷ Competition at the generation level has increased as a result of these regulatory reforms. Competition at the transmission and distribution level is a different story. Electric networks are very complex engineering feats that follow the path of the electron and not the path of legal rules. The networks now in place were technically designed to cover the needs of national electric markets and not interconnected markets. True competition at the transmission and distribution level requires major redesigns of the electric networks, and the capital costs of this redesign may be insurmountable. We do not see how these new electrical grids will be built without major influxes of capital by the governments.

We read the last sentence of Article 14 TFEU: “The European Parliament and the Council, acting by means of regulations in accordance with the ordinary legislative procedure, shall establish these principles and set these conditions without prejudice to the competence of Member States, in compliance with the Treaties, to provide, to commission and to fund such services”¹³⁸ as giving the European Union a mandate to not only legislate, but to provide financial assistance in the ultimate formation of the internal energy market. For instance, any observer of the industry knows that the physical unbundling of vertically integrated utilities creates *stranded costs* such as the carrying costs of those assets that are not necessary to keep the redundancy of closed transmission networks. Who should pay for those stranded costs, Member States (as it is currently done)¹³⁹ or the EU at large? By which mechanisms should these be paid for? These are questions of a legal, or even constitutional, nature. Antitrust structural remedies may not be enough to answer them. Questions such as whether or not investments taken by undertakings in implementing the Electricity Directives, and approved by na-

¹³⁶ See Tyson Slocum, *The Failure of Electricity Deregulation: History Status and Needed Reforms*, http://www.ftc.gov/bcp/workshops/energymarkets/background/slocum_dereg.pdf.

¹³⁷ See LYNNE KIESLING, *DEREGULATION, INNOVATION AND MARKET LIBERALIZATION: ELECTRICITY REGULATION IN A CONTINUALLY EVOLVING ENVIRONMENT* (2008).

¹³⁸ TFEU art. 14.

¹³⁹ See European Commission, *Commission Communication Relating to the Methodology for Analysing State Aid Linked to Stranded Costs*, http://ec.europa.eu/competition/state_aid/legislation/stranded_costs_en.pdf.

tional regulators, should receive antitrust immunity will not be answered unless the Commission brings actions to the *patena* of the General Court and the ECJ.

Much has been written about the differences and similarities between the European and American approaches to antitrust and competition issues.¹⁴⁰ However, we believe that when it comes to regulation and antitrust enforcement, both the EU and the US can learn from their respective experiences in opening up electricity markets to competition. The US should consider studying the cooperative approach of Regulation 1/2003 and tightening up the enforcement approaches of the FERC and the FTC. The EU should regulate the wholesale and cross-border sale of electricity, and harmonize the rules regarding competitive access to the transmission network via Regulations and not Directives. Considerations of the subsidiarity principle set apart; Member States should reassess the current status of regulations and realize that the Commission's activism of the 1990s and a EU-wide solution might be necessary to bring legal coherence to the legislative goal of truly creating an internal energy market. For, without a true internal energy market, there is no real internal market.

¹⁴⁰ See, e.g., FRANCOIS LEVEQUE & HOWARD SHELANSKI, ANTITRUST AND REGULATION IN THE EU AND US: LEGAL AND ECONOMIC PERSPECTIVES (2009).