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Regulating and supervising of wholesale energy markets. What's in it for the consumers?

Prof. dr. Saskia Lavrijssen & mr. Irina Bordei *

Abstract

This paper draws on the case law of the European Court of Justice to examine the current (im)possibilities of dealing with the supervision and regulation of the competition in the wholesale energy markets within the three different European regulatory frameworks, namely the Third Energy Package, REMIT and EU competition law. It contains a critical analysis of the potential of this complex interplay of rules- in itself a burden for the national energy authorities- to contribute to the key objective of the Third Energy Package's directives and regulations: the protection of energy consumers when concluding energy supply contracts.

JEL CODES K 21, K 22, K 23

Keywords: energy market, consumers' interests, competition law, regulation, remit, role NRAs

1. Introduction

In 2011, the Third Energy Package, (the 'Third Package') consisting of two directives and three regulations, entered into force.¹ By promoting further integration of the European energy market,

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these directives and regulations seek to ensure the freedom to choose one's own energy supplier for all consumers, both households and non-households, within the European Union. At the same time this package aims to create opportunities for economic growth and to promote cross-border trade. Eventually, the freedom of choice for all consumers should lead to more efficiency gains, more competitive prices and higher standards of service, as well as a secure and sustainable energy supply.² The main question that this article proposes to answer is: what is the significance of the provisions of the Third Package, in conjunction with the European competition rules and the recently adopted Regulation on Wholesale Energy Markets Integrity and Transparency³ (REMIT) for the monitoring and the regulation of competition on the wholesale energy markets. This article will particularly address the possibilities and the limitations of this complex interplay of the provisions of the three regulatory frameworks for the protection and the strengthening of the position of energy consumers when entering into energy supply contracts.

This contribution presumes that the interests of energy consumers are best achieved in competitive wholesale and retail energy markets. A competitive wholesale energy market, that is the market on which energy suppliers are purchasing energy, is a prerequisite for a well-functioning retail market⁴, that is the market in which energy is being delivered to end- consumers. Due to limited competition and liquidity in the wholesale markets (meaning that in such markets there are

¹ Third Package consists of: Directive 2009/72/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC [2009] OJ L211/55; Directive 2009/73/EC of the European Parliament and of the Council of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC [2009] OJ L211/94; 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 1228/2003 [2009] OJ L211/15; Regulation 715/2009 of the European Parliament and of the Council of 13 July 2009 on conditions for access to the natural gas transmission networks and repealing Regulation 1775/2005 [2009] OJ L211/36 and Regulation 713/2009 of the European Parliament and of the Council of 13 July 2009 establishing an Agency for Cooperation of Energy Regulators [2009] OJ L211/1.

² When this contribution refers to consumers, it refers to both consumers (households and small and medium-sized enterprises) and large consumers.

³ Regulation 1227/2011 Regulation of the European Parliament and of the Council of 25 October 2011 on wholesale energy market integrity and transparency [2011] OJ L326/1 (REMIT).

⁴ See for example Communication, "Inquiry pursuant to Article 17 of Regulation (EC) No 1/2003 into the European gas and electricity sectors (Final Report)", COM(2006)851 final and Communication, 'Prospects for the internal gas and electricity market', COM(2006)841 final.

insufficient trading opportunities) energy suppliers in the EU have limited, if any, possibilities to provide their final customers with competitive offers.⁵ As will be shown in paragraph 2 of this contribution, limited or distorted competition on the wholesale markets may also have adverse effects on the level of energy prices in the retail markets.⁶

The Third Package contains, among others, stricter rules regarding the unbundling of the transmission network from the production and supply activities, the independence and competences of the national regulatory authorities (hereinafter energy authorities), new transparency requirements for the market participants on the wholesale energy markets, the cooperation between the national energy authorities (through the Agency for the Cooperation of Energy Regulators (ACER) and the cooperation between transmission system operators within the European Networks of Transmission System Operators for Electricity and Gas (ENTSO-E and ENTSO-G). As it will be apparent from this contribution, the Third Package's rules are especially relevant for the supervision and regulation of the conditions and tariffs for access to cross-border networks for the import and export of electricity and gas. Although not specifically directed to consumers, these provisions are nevertheless affecting their position in an indirect manner. A harmonized application of the conditions concerning cross-border transmission of electricity and gas may foster the import and export of energy. This will result in enhanced competition on the wholesale energy markets, which will in the end benefit consumers.

According to the principle of EU law of the parallel application of European competition law and of sector specific energy directives and regulations (see paragraph 3), the European competition rules are also important for monitoring the wholesale energy markets. During the period in which the second generation of energy directives was in force, the European Commission took several high-profile (commitment) decisions concerning the enforcement of competition law, (Articles 101 and 102 TFEU) which sought to stimulate competition on different geographic wholesale energy markets.

⁵ See NMa, *Liquiditeitsrapport 2012. Groothandelsmarkten gas en elektriciteit*, July 2012, p. 2.

⁶ See for example COM(2006)851 and COM(2006)841 (4) above.

These competition decisions were taken on the background of the European Commission's proposals to revise the European energy directives. This article discusses some of these commitment decisions taken by the Commission on the basis of Article 9 of Regulation 1/2003 and that had far-reaching consequences for the structure of the markets involved.

The Council and the European Parliament adopted the REMIT in 2011, a regulation which is not a part of the Third Package. Nevertheless, REMIT is an important addition to the EU energy legislation, European competition rules and European financial legislation as it provides specific rules that intend to deter market abuse on the wholesale energy markets.⁷ According to REMIT, market abuse encompasses insider dealing and market manipulation. These are behaviors that undermine the integrity of the energy markets and which at the moment are not expressly prohibited on the most relevant energy markets (electricity and gas markets).⁸ Market manipulation on wholesale energy markets includes actions by individuals which are keeping prices at an artificial level that is not justified by the interplay between supply and demand factors such as actual availability of production, storage or transportation capacity and demand.⁹ The complementary role of REMIT in comparison to EU competition law stems from the fact that the current treaty provision regarding the abuse of a dominant position (Article 102 TFEU) is not applicable to trade practices which- due to the peculiarities of the energy sector in which they take place (electricity cannot be stored at industrial scale; it is produced at the moment it is being used)- are able to influence prices without necessary holding a dominant position. The relationship with the EU competition provisions and also

⁷ L. Nijman, "The impact of the new wave of financial regulation for European energy markets" (2012) 47 Energy Policy 468; J. Feldner and D. Thalhammer, "Energy, Section 3: EU industry sectors" (2013) The European Antitrust Review <http://www.globalcompetitionreview.com/reviews/47/sections/163/chapters/1824/energy/> [Accessed November 13, 2013].

⁸ See REMIT (3) above, Recital 7.

⁹ See REMIT (3) above, Recital 13 and art. 2. See also De Bruijne and Van Haersma Buma "De Verordening Marktintegriteit en Transparantie in de Energiesector" (REMIT); de groothandelsmarkten voor energie volledig in het vizier" (2012) 5 Nederlands Tijdschrift voor Energierecht 223, pp. 229-230.

financial legislation (market abuse in the sense of Directive 2003/6/EG)¹⁰ is further analysed in paragraph 6.

Before looking at the interaction between the above mentioned regulatory frameworks in respect to the protection of the energy consumers' position, the interaction between the wholesale and retail energy markets will be addressed.

2. The relationship between wholesale and retail markets

A competitive wholesale energy market¹¹ is essential for the protection of consumers' interests. Energy suppliers who supply gas or electricity to consumers on the consumer markets (retail markets) purchase their energy (partly) on the wholesale gas and electricity markets.¹² These are the markets where producers and traders offer energy to energy suppliers who then further sell the purchased energy to final customers. If the wholesale market is not sufficiently competitive, producers do not receive effective incentives to make attractive offers to the energy suppliers and as a result these suppliers are purchasing energy under less favorable conditions (higher prices, less flexible terms). If energy suppliers have to pay higher prices for the purchase of energy, they will pass these extra costs on to consumers.

A major obstacle to a competitive wholesale market is the vertical integration of production and supply activities with transport and distribution activities. The operator of an electricity network,

¹⁰ "Market abuse consists of insider dealing and market manipulation. The objective of legislation against insider dealing is the same as that of legislation against market manipulation: to ensure the integrity of Community financial markets and to enhance investor confidence in those markets." See recital 12 of Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse) [2003] OJ L 96/16.

¹¹ For an analysis of future regulatory matters and challenges in respect to Europe's wholesale electricity markets see CERRE, *Europe's wholesale electricity markets: future regulatory perspectives and challenges*, Policy Paper, 29 October 2013.

¹² Provided that supplier undertakings that are integrated with production undertakings, may (partially) purchase their energy on the basis of an internal contract with the affiliated producer.

which is part of a vertically integrated energy undertaking,¹³ has economic incentives to favour the affiliated supply or production undertaking, for example by discriminating when granting access to the electricity network to other undertakings. As a consequence, possible competitors are impeded from joining the wholesale market, which in turn means that there is less choice for the energy suppliers and subsequently for consumers. An integrated network operator also has fewer, if any, incentives to invest in the expansion of infrastructure since this would not be in the interest of the affiliated production and/or supply undertaking. When investments in infrastructure are low there is a greater risk that network congestion will develop. The (potential) congestion constitutes an entry barrier on the wholesale energy markets for both producers and traders, which means that suppliers have fewer purchase options than when sufficient transport capacity is available. Consequently consumers cannot (or hardly) benefit from competitive offers.

Another problem is that electricity and gas differ fundamentally from other traded goods as they are network based products. Furthermore, due to technical reasons, electricity cannot be stored or can only be stored at high costs. Although gas can be stored, in practice this can still prove problematic when, for example, in a certain geographic area a significant part of the storage location's capacity has been reserved to the dominant gas supplier.¹⁴ In such a situation the gas storage possibilities are limited. Therefore both gas and electricity are extremely sensitive to market abuse, especially in peak demand. This is the reason why the Commission considered that supervision of the participants on the wholesale gas and electricity markets needs to be tightened (see also paragraph 6).¹⁵

Furthermore, the sales on the wholesale electricity markets indicate that the production of electricity is highly concentrated. The analysis of the trade on electricity exchanges shows that on some of these producers have the possibility to exercise market power by, at times of peak demand,

¹³ See (1) above, art. 2(21) of Directive 2009/72.

¹⁴ See (1) above, recital 24 of Directive 2009/73. art. 15 and art. 33 of Directive 2009/73 contain stricter and clearer rules regarding the independence of and third party access to gas storage facilities.

¹⁵ See Proposal for a Directive of the European Parliament and of the Council amending Directive 2003/54/EC concerning common rules for the internal market in electricity, COM(2007)528 final, p. 8.

raising the prices above the price level which would apply under normal circumstances.¹⁶ At the same time it appears that on forward markets, which in general are less concentrated, electricity markets are dependent on few producers with strong positions due to an extended portfolio of available generating units. These large producers are able to withhold a part of their generating capacity in peak demand and this will determine an increase in prices.¹⁷ A major factor that causes these increases is the fact that the volume of existing interconnection capacity is not sufficient to promote cross-border trade flows. The result- limited liquidity and its negative consequences such as high price volatility, which in turn give rise to increased hedging costs¹⁸- is an entry barrier to electricity markets which leads to price increases on the wholesale markets. This will ultimately become part of the bill presented to the consumers.¹⁹ The Third Package aims to put an end to the above mentioned competition barriers by strengthening the unbundling rules and by increasing the transparency on the wholesale energy markets. In addition to this, REMIT is designed to counter the market abuse by market participants on the energy markets. As it will further be discussed in paragraph 4, the Commission had tried to achieve structural changes in the energy sector by enforcing general competition rules even before the implementation of the structural changes of the Third Package.

Before analysing the Commission's enforcement practice in the energy sector, the relation between competition law and sector-specific economic regulation will be addressed. This is needed in order to understand how the different rules (sector specific regulation and EU competition law) may interact after the implementation of the Third Package.

¹⁶ See DG Competition Report on Energy Sector Inquiry, SEC (2006)1724, pp. 124-125.
<http://ec.europa.eu/competition/sectors/energy/inquiry/index.html> [Accessed November 13, 2013];
Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of Regions COM(2012) 663 final, p. 3.; Commission Staff Working Document SWD(2012)368 final of 15 November 2012 accompanying the Communication 'Making the internal energy market work' (COM(2012)663 final), p. 42.

¹⁷ See COM(2006)851 (4) above, par. 2.1.16.

¹⁸ See COM(2007)528 (16) above, p. 151; "hedging" is a method used for dealing with price uncertainty it basically, involves taking equal and opposite positions in two different markets such as cash and futures markets.

¹⁹ See COM(2007)528 (16) above, par. 4.1.1. and 4.1.2.

3. The interplay between general competition law and economic regulation

3.1. De ex ante/ex post dichotomy

The distinction between general competition law and sector-specific regulation is in the literature often explained as follows:²⁰ competition law is applied ex post, which means that action under the EU competition rules is justified by the existence of certain forms of anti-competitive conduct of one or more undertakings,²¹ whereas sector-specific regulation is applied ex ante, namely before companies could cause any damage to competition and consumers. Under sector-specific legislation a national authority may set detailed specific requirements to regulate the behavior of undertakings in order to avoid competition problems.²² After the liberalization of the energy markets the transmission and distribution system operators have maintained a statutory monopoly with respect to the operation of the transport and distribution infrastructure which are both economically and technically difficult to duplicate.²³ Competition in the production and supply of energy can therefore only be achieved as new entrants can gain access to transport and distribution networks under transparent and non-discriminatory rates and conditions. In order to promote competition, the operators of the energy networks are subject to ex ante sector-specific regulation. They have to grant access to their networks in accordance with the legislation and at conditions and tariffs established by the energy authority. If disputes occur, the energy authority may determine the conditions and the tariffs under which a party may gain access to the transport network.

²⁰ P. Larouche and S. Lavrijssen, "EG-regulering van elektronische communicatie. Een kritische beschouwing van de onderliggende aannames van de EG-regelgeving betreffende elektronische communicatie" (2002) 7(8) SEW Tijdschrift voor Europees en economisch recht, 258, p. 259.

²¹ See Larouche and Lavrijssen (20) above, p. 259.

²² See Larouche and Lavrijssen (20) above, p. 259.

²³ According to European law, vertical integration of distribution networks is still allowed. See (1) above, art. 26 Directive 2009/72.

Although the distinction between competition law and sector-specific legislation is often being characterized by referring to the ex ante/ ex post dichotomy, in practice this distinction is less straightforward.²⁴ By issuing guidance on the substantive application of competition law in a particular sector, a competition authority could actively influence the manner in which companies behave in that particular sector.²⁵ Additionally, the Commission may also use its powers to accept commitments on the basis of EU competition law in such way that it may in effect proactively influence the structure of a particular sector (see paragraph 4).

3.2 The constitutional status of competition law

The Third Package's directives have the same goals as the EU competition rules. Protecting and promoting competition in order to protect consumers' interests- in the form of competitive prices, more choice and better quality products and services- is an essential goal of both legislative frameworks.²⁶

However, the objectives of the Third Package's directives go further than those of EU competition law. Their goal is to actively promote the internal market, the cross-border trade, achieve environment and climate targets, sustainability, universal service, energy efficiency, security of supply, competition and efficiency.²⁷ The Third Package's directives intend to protect and promote not only the consumers' competition interests, but also their non-competition interests.

²⁴ See also E.J. Dommering, N.A.N.M. van Eijk, J.J.M. Theeuwes, F.O.W. Vogelaar, *Toezicht en regulering in de telecommunicatiesector-Een analyse van sectorspecifiek en algemeen mededingingsrecht*, (University of Amsterdam, IVIR and SEO 2011), <http://www.ivir.nl/publicaties/overig/toezicht®ulering-telecommarkt.pdf>, [Accessed November 13, 2013].

²⁵ See Notice on the application of the competition rules to access agreements in the telecommunications sector. Framework, relevant markets and principles [1998] OJ C265/2.

²⁶ See also K. Csere, "The Controversies of the Consumer Welfare Standard" (2007) 3 Competition Law Review 121, p. 121. Among the objectives of competition law are the protection of the internal market and a competitive market structure. Eventually, both EU competition law and sector-specific regulation will have to be interpreted in the light of the objectives of the TEU (art. 3 TEU).

²⁷ See (1) above, art. 36 Directive 2009/72 and art. 40 Directive 2009/73.

Competition interests refer to protection and promotion of competition and market integration with the purpose of achieving reasonable energy prices and good services. Non-competition interests are primarily aimed at protecting and promoting other public interests than competition such as the interest of a clean environment.²⁸ The protection and promotion of both the competition and non-competition interests of consumers, be they households or non-households, can be seen as the ultimate goal of the Third Package's directives.²⁹

EU competition law has a constitutional status due to the anchoring of the competition rules in the Treaty on the Functioning of the European Union (Articles 101 and 102 TFEU) as primary norms of EU law.³⁰ The European Commission is responsible for the formulation of EU competition policy.³¹ In regard to the enforcement of the European competition law, the Commission and the NCAs have parallel powers and they must collaborate closely in order to ensure a consistent and effective application of the competition rules.³² National authorities (both competition and specific authorities) which implement EU law must ensure that they do not frustrate the effective application of the competition rules applicable to undertakings.³³ This means that national legislation and decisions which fall under the scope of EU law should in as much as possible be interpreted consistent with the EU competition rules.³⁴

²⁸ See S. Lavrijssen, "The Protection of non-competition interests: What role for competition authorities after Lisbon?" (2010) 5 European Law Review 634. In this article it is being argued that competition authorities should also take into account non-competition interests when exercising their powers. However, it is not up to the task of competition authorities to proactively promote these interests.

²⁹ See Lavrijssen (28) above.

³⁰ See P. Larouche, "Contrasting Legal Solutions and the Comparability of EU and US Experiences" in F. Levêque and H. Shelanski (eds.), *Antitrust and regulation in the EU and US: Legal and Economic Perspectives* (Cheltenham: Edward Elgar, 2007), chapter 3, pp. 76-100. See also G. Monti, "Managing the Intersection of Utilities Regulation and EC Competition Law" (2008) 2 Competition Law Review 121.

³¹ Art. 105 Treaty on the Functioning of the European Union 2008 O.J. C 115/47, (TFEU).

³² If the European Commission decides to investigate a case, then the national competition authorities do not have the power anymore to apply European competition law in the respective case. See art. 11(6) 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 [2002] OJ L1/1.

³³ *Consorzio Industrie Fiammiferi (CIF) v. Autorità Garante della Concorrenza e del Mercato* (C-198/01) [2003] E.C.R. I-8055, with annotation by K.J.M. Mortelmans (2003) 11 SEW 403.

³⁴ See (25) above.

The constitutional status of European competition law is the basis of the energy and other sector-specific directives' assumption that competition law and economic regulation apply together. It is settled case law of the Court of Justice that the application of competition law is not excluded if it appears that sector-specific legislation give leeway to undertakings to distort, to hinder or to limit competition through autonomous conduct.³⁵ The Commission followed this reasoning in the case of *Deutsche Telekom* (DT). DT was fined for abuse of dominance, despite the fact that its tariffs were approved by the Regulatory Authority for Telecommunications and Post (RegTP). The tariff regulation by RegTP could in fact not prevent that on the market for the supply of internet access services to end users competitors of DT came into a price squeeze. This was caused by an obvious disproportion between wholesale and end users tariffs for accessing the local network. Although RegTP fixed the wholesale tariffs for access to the network on the basis of (efficient) actual costs and non-discrimination principles, the end users' charges were partially fixed as maximum tariffs (analogue access and ISDN) and partially as not regulated tariffs (ASDL). This created leeway for DT to distort competition by charging high wholesale tariffs for access to its network to its competitors, which in turn were charging higher tariffs to end users. In this way these undertakings could not compete with DT anymore on the end users market, as DT could offer substantially lower prices for its internet services. According to the Commission, the German regulatory framework left DT with sufficient leeway to raise the end user tariffs for access to the network and to eliminate the price squeeze by asking the consent of RegTP to increase the end user tariffs. In appeal both the General Court and the Court of Justice confirmed the reasoning and decision of the Commission.³⁶

It should be noted that the Commission should exerts its competition law enforcing powers consistently across sectors, despite the differences that might exist between the various sectors. The energy and the telecommunication sectors differ in terms of the objectives which are being pursued

³⁵ See *Commission and Frankrijk v. Ladbroke Racing* (Joined Cases C-359/95 P and C-379/95 P) [1997] E.C.R. I-62225.

³⁶ *Deutsche Telecom AG v. Commission* (T-271/03) [2008] E.C.R. II-477 and *Deutsche Telecom v. European Commission* (C-280/08P) [2010] E.C.R. 09555. See also *Telefónica en Telefónica de España v. Commission* (T-336/07) March 29, 2012.

therein and which are derived from their unique nature³⁷ as well in terms of their role in the geopolitical relations between the European Union and third countries. While sector specific characteristics may impact on the exact application of the provisions of competition law in each sector, the Commission has to respect the basic principles of competition law and the boundaries of the law when imposing remedies in a regulatory manner in both sectors. This reasoning confirms that the cases in the telecommunications sector are also relevant for the application of competition law in the energy sector.

3.3. Does competition law always have priority?

As the abovementioned case-law is also relevant for the energy sector, it follows that a regulated energy undertaking cannot rely on the approval of the specific national authority to justify anti-competitive tariffs. The Commission will carefully examine whether the concerned undertaking had the opportunity to display anti-competitive autonomous behavior and if yes, how has this been done. From the *Deutsche Telekom* case it appears that when regulation gives sufficient leeway for abuses and the regulatory authority has not yet acted to eliminate the distortion of competition, the regulated undertaking has an obligation to request from the regulatory authority an approval to increase the end user tariffs in order to stop the distortion of competition.³⁸ This obligation arises from the special responsibility which, according to the case law of the European Court of Justice the dominant undertakings, does not allow their conduct to impair genuine undistorted competition on the common market.³⁹ However, the question that arises is whether general competition law should always be given priority. Although the *Deutsche Telekom* case attributes a special status to

³⁷ Unlike the telecommunications sector, the energy sector is dependent on scarce and unbalanced distribution of natural resources which result in a higher risk of supply failure. That is why, besides the creation of a competitive market, other objectives such as ensuring the security of supply and minimising the dependence on imports from outside the Union are central to the energy policy (more about the security of supply versus competition in Monti (30) above, pp. 136-138). This is however not to say that one sector has less of a strategic nature than the other: both sectors are equally important for achieving European strategic goals such as smart and sustainable growth (Europe 2020).

³⁸ See Monti (30) above, p. 124.

³⁹ *Nederlandse Banden-Industrie-Michelin v. Commission* (Case 322/81) [1983] E.C.R. 3461, par. 57.

competition law, it has not gone so far as to recognize the priority of competition law above sector-specific regulation unconditionally and under all circumstances.

In *Deutsche Telekom* the Court of First Instance confirms that the objectives of sector-specific directives and general competition law differ.⁴⁰ This means that when protecting the interests of consumers in certain cases, a sector-specific authority, such as an energy authority, is able or a required to make other evaluations than a competition authority would do. For example, it is possible that an energy authority gives priority to climate and environmental goals rather than to the interest of competition, provided of course that the concerned authority is authorized to make such balancing within the framework of the Third Package's directives. According to Monti, the current approach of the European Commission and of the European Court of Justice to the relationship between competition law and sector-specific economic regulation, which has been confirmed in case-336/07, *Telefónica en Telefónica de España*, is too rigid. He suggests that the European Court of Justice should develop its case law in such a way as to give the possibility to set limits to the application of competition law. In such case European and national courts would have to decide on a case by case basis whether competition law should be applied in a situation in which the sector-specific authority has acted.⁴¹ When applying competition law the Commission and the national competition authorities would have to ensure that the legitimate policy choices of the sector-specific supervisory authorities are not hindered. Competition law should not be applied unabridged when such application would be contrary to the objectives of the sector-specific framework.⁴² The future will have to reveal how the case law on the relationship between competition law and economic regulation will evolve and what implications will this have for the application of the competition rules and the Third Package's directives and the protection of the competition and non-competition interests of consumers.

⁴⁰ See *Deutsche Telekom AG* (36) above, par. 113.

⁴¹ See Monti (30) above, p.122.

⁴² See Monti (30) above, p. 122 et seq.

4. High-profile competition decisions

4.1. Two landmark cases

While the second generation of energy directives could only partially harmonize the structure and the regulation of the energy market, the European Commission used competition law as a complementary tool to act against restrictions of competition which could arise due to gaps in the European energy regulatory framework. Therefore the Commission applied competition law in a regulatory manner⁴³ when in fact addressing the abuse of dominant position by the involved undertakings. This means that the Commission approved concentrations or accepted commitments of undertakings, under conditions which not only put an end to restrictive practices, but also lead to structural measures which enhanced competition in the energy sector. Whether this entangling of the sector specific regulation and the competition law is justified and the extent to which this is permitted will be examined further below.⁴⁴

However, both the *EON* and *RWE* cases are illustrative for the manner in which the Commission, by accepting far-reaching structural commitments, has actively promoted competition on the wholesale energy markets.⁴⁵

⁴³ Monti speaks of “regulatory manner” in Monti (30) above, p. 122.

⁴⁴ See further below the discussion in par. 4.2.

⁴⁵ For other examples see Decision relating to a proceeding under Article 102 of the Treaty on the Functioning of the European Union (33) above and Article 54 of the EEA Agreement (COMP/39.316- *Gaz de France*); Notice published pursuant to Article 27(4) of Council Regulation (EC) No 1/2003 (COMP/B-1/39.351- *Swedish Interconnector*) 2009] OJ C239/04; Decision relating to a proceeding under Article 102 of the Treaty on the Functioning of the European Union (‘TFEU’) and art. 54 of the EEA Agreement (COMP/39.315- *ENI*); Decision relating to a proceeding under Article 102 of the Treaty on the Functioning of the European Union and Article 54 of the EEA Agreement (COMP/39.386- *EDF*); Press release IP/03/1345, “Commission reaches breakthrough with Gazprom and ENI on territorial restrictions clause”. See also K. Talus, “Just what is the scope of the essential facilities doctrine in the energy sector? Third party access-friendly interpretation in the EU v. contractual freedom in the US” (2011) 48(5) *Common Market Law Review* 1571. For a discussion of the manner in which the Commission applied competition law in telecommunication sector see P. Larouche, *Competition Law and Regulation in European Telecommunications* (Oxford: Hart, 2003), chapter 3. In September 2012 Commission announced the opening of investigations procedures against Gazprom due to its concerns that Gazprom may abuse its dominant position in Central and Eastern Europe. For more details see http://europa.eu/rapid/press-release_IP-12-937_en.htm [Accessed November 13, 2013].

4.1.1. EON case

In the EON case the European Commission opened an investigation into the alleged abuse of a dominant position by EON on the German wholesale electricity market and the balancing market.⁴⁶

In a preliminary assessment the Commission found that EON, together with RWE and Vattenfall, had a collective dominant position⁴⁷ on the wholesale electricity market. This dominant position allowed EON to develop a certain strategy to withdraw generation capacity from the market in the short term in order to increase the wholesale tariffs.⁴⁸ The electricity price on short term markets is determined by an auctioning mechanism which in practice sets a single price for the wholesale market.⁴⁹ This price is equal to the last accepted offer in the process of matching the demand and the offer. The offers on the supply side reflect a merit order for the generation units.⁵⁰

First the relatively cheap base load plants (such as nuclear ones) are being dispatched and when demand so requires the more flexible, but also more expensive electricity plants such as gas-fired plants are also being switched on. In the electricity sector, most of the time the demand is non-elastic and in a situation of excess production, capacity electricity cannot be stored at the moment.⁵¹ Consequently, the withdrawal of generation capacity may drive prices up considerably, especially when demand is high and the most expensive plants have to be switched on to meet the demand. These price increases on the wholesale market are ultimately being passed on to end users through the tariffs they pay for the supply of energy.

⁴⁶ Decision relating to a proceeding under Article 82 of the EC Treaty and Article 54 of the EEA Agreement (COMP/39.388- *German Electricity Wholesale Market* and COMP/39.389- *German Electricity Balancing Market*).

⁴⁷ See *Compagnie Maritime Belge Transports and Others v. Commission* (joined cases C-395/96 P and C-396/96 P) [2000] E.C.R. I-01365 and Communication on Guidance on the Commission's Enforcement Priorities in Applying Article 82 EC Treaty to Abusive Exclusionary Conduct by Dominant Undertakings, COM (2008)832 final.

⁴⁸ See (46) above, par. 28-40.

⁴⁹ See (46) above, par. 35.

⁵⁰ See (46) above, par. 35.

⁵¹ On balancing markets, the demand can be more elastic. Large market participants on the demand side are at times ready to even shift their demand, against remuneration.

In addition to the withdrawal of capacity, the Commission was also concerned with the fact that EON had developed a strategy to deter actual and potential competitors to enter the wholesale market by concluding long-term supply contracts and by offering competitors participations in the power plants of EON.⁵² According to the Commission, this strategy regarding the production facilities was directly connected to the price strategy of EON and it would have enabled EON to maintain a price level on the wholesale markets that under normal competitive circumstances would not have been possible. Since prices on the wholesale market substantially influence prices on the retail market, EON's strategy to deter investments by third parties had not only harmed the traders, but also the end users.⁵³

The Commission was also concerned with the fact that EON had also abused its dominant position on the balancing market. This is the market in which the national grid operator purchases electricity in order to maintain the right balance in the grid and not for further sale. The abuse would have consisted of systematically buying balancing capacity against high costs from the affiliated production company. Furthermore, EON would have also prevented the import of balancing capacity from other EU Member States to its own balancing area. In this manner EON would have actually favoured its own production affiliate and passed on the high purchase costs to end users by including these costs in the network tariffs.⁵⁴

In order to meet the allegations of the Commission EON offered to take structural measures.⁵⁵ First, the company offered to divest a large part (approximately 5,000 MW) of its production capacity in order to eliminate the anti-competitive conduct on the wholesale market and to avoid future abuse of a dominant position. Secondly, EON offered to also divest its transmission system business. In this way, favouring its own power plants would be brought to an end and incentives for future discrimination would be eliminated. EON also committed to sell its transmission

⁵² See (46) above, par. 41-44.

⁵³ See (46) above, par. 44.

⁵⁴ See (46) above, par. 51-52.

⁵⁵ See (46) above, par. 6.

system business to a buyer which had no interests in the production and supply of electricity (the unbundling requirement). The Commission accepted these measures within the commitments and made them binding by including them in a commitment decision taken in accordance with article 9 of Regulation 1/2003.⁵⁶ It further argued that the measures were suitable and necessary to effectively put an end to the identified competition problems. The identified practices were so entangled with the production portfolio of EON, the structure of EON and the German electricity market that any behavioural remedies such as price regulation, transparency and access obligations would not have been effective. They would have implied that the conduct of EON would have had to be controlled every hour or even every quarter of an hour, which in practice would have been difficult to attain. Furthermore these regulatory measures would not have eliminated the risk of reoccurrence. The Commission considered the commitments sufficient to put an end to the concerns it identified in its preliminary assessment.⁵⁷

4.1.2. RWE-case

In the RWE case⁵⁸ the European Commission came to the preliminary conclusion that RWE had a dominant position on the German gas transmission market within its network area. The Commission's concerns were that RWE abused its dominant position by refusing to offer gas transmission services to third parties and by reserving network capacity mainly for the transportation of its own gas. As a result, third parties could only make limited use of the transmission capacity of the network, which in turn meant that they could not compete on the wholesale and retail gas market.⁵⁹ The Commission was also concerned with the fact that RWE abused its dominant position by adopting a strategy which focused on squeezing competitors' downstream gas supply margins

⁵⁶ See (32) above, Council Regulation 1/2003.

⁵⁷ See (32) above, Council Regulation 1/2003, art. 9(1).

⁵⁸ Decision relating to a proceeding under Article 82 of the EC Treaty and Article 54 of the EEA Agreement (COMP/39.402- *RWE Gas Foreclosure*).

⁵⁹ See (58) above, par. 22-28.

(‘price squeeze’).⁶⁰ According to this strategy, RWE kept its transmission tariffs at an artificial level, which meant that its competitors could not effectively compete on the downstream gas supply market or were deterred from entering the market.⁶¹ End users were ultimately the ones affected by these practices as they were confronted with limited or even no possibilities to choose an energy supplier and as a result could not profit from competitive prices. Although it could not agree with the Commission’s assessment, RWE has offered to adopt structural measures in order to eliminate the identified competition problems. RWE suggested divesting its German gas transmission system business to a suitable purchaser that would no longer raise competition issues. Just as in the EON case the Commission considered these measures to be suitable and necessary to eliminate the identified competition problems. Only the divestment of its gas transmission activities would effectively eliminate any incentives to continue favouring certain (affiliated) companies.⁶² The Commission made the commitments legally binding by adopting a commitments decision on the basis of article 9 of Regulation 1/2003.

4.2. Impact on consumers

From a consumer’s perspective the Commission’s commitments decisions could, at least in respect of the short-term effects, be welcomed. The elimination of the structural competition restrictions on the wholesale energy market can enhance competition on these markets, which means that energy suppliers have more possibilities to purchase energy under competitive conditions and to pass any gains on to consumers.

From a long-term perspective, however, these enforcement practices of the Commission are prone to criticism.⁶³ First of all, the question arises whether the economic efficiency of the accepted

⁶⁰ See (58) above, par. 29-36.

⁶¹ RWE was temporary exempted from the regulation of network tariffs because it requested such an exemption. Its request was in the end rejected by the German energy authority.

⁶² See (58) above, par. 48-53.

⁶³ For a critical analysis of the manner in which the Commission applied competition law in the energy sector, but also for an analysis of the advantages and disadvantages of Virtual Power Plants as structural measures see

structural measures could be sufficiently supported in a competition procedure. The measures imposed in the above discussed cases are far-reaching. This requires that the Commission has a good understanding of the costs and benefits of these structural measures in the light of the latest market developments.⁶⁴ Due to the contentious nature of the commitments procedure, the commitment decisions, which are already somewhat ill motivated, lack a proper cost and benefit analysis. From an economic perspective, there is thus a risk that in the long-term, the effects of these decisions will not necessarily be favourable for consumers.

Hancher and De Hautecloque, for example, are of the opinion that the answer to the question of whether the divestment of production capacity has positive effects on competition depends on the manner in which the capacity is being auctioned (auction design), the duration of the contract and the investment climate. They also consider that there is only little empirical evidence as to the effects of such interventions.⁶⁵ Imposing such measures thus requires a careful consideration of the costs and benefits which these interventions would entail; such a broad consideration is lacking in the commitments decisions of the Commission.

Notwithstanding the foregoing it should be noted that from a legal point of view, the Commission is not required to comply with extensive motivation requirements when making a commitment decision and only has to live up to a moderate proportionality test.⁶⁶ Unlike the imposition of structural measures when completing an infringement procedure leading to a decision, according to article 7 of Regulation 1/2003, in a commitment procedure the parties offer the structural measures themselves.⁶⁷ This had led the Court of Justice to consider in the *Alrosa*-case that

L. Hancher and A. De Hautecloque, "Manufacturing the EU Energy Markets: The Current Dynamics of Regulatory Practices" (2010) 3 Competition and Regulation of Network Industries 307, p. 307.

⁶⁴ It should be noted that there are good economic grounds for unbundling of transmission networks. See M. Pollitt, "The Arguments for and Against Ownership Unbundling of Transmission Networks" (2008) 36(2) Energy Policy 704.

⁶⁵ See Hancher and De Hautecloque (63) above.

⁶⁶ See also the conclusion of AG-Kokott in *Commission v Alrosa* (C-441/-07P), [2010] E.C.R. I-05949, par. 26. See also *The Queen / Ministry of Agriculture, Fisheries and Food, ex parte FEDESA e.a.* (C-331/88) [1990] E.C.R. I-4023, par. 13.

⁶⁷ See Monti (30) above, pp. 142-143.

the proportionality test performed by the Commission in the context of article 9 of Regulation 1/2003 is limited to verifying whether these commitments address the identified concerns and that the involved undertakings have not offered less onerous commitments which would be equally suited to address those concerns adequately. When performing this verification the Commission has to take into account the interests of third parties. Judicial review extends only to assessing whether the assessment of the Commission is manifestly incorrect.⁶⁸

Within certain limits, the *Alrosa* judgement substantially endorses the approach of the Commission regarding the application of competition law in a regulatory manner when taking commitments decisions. Although the Commission could use this sort of decision as a flexible instrument to swiftly and effectively address the shortcomings of the regulatory framework as shown above, this approach has its limits.⁶⁹

When the parties involved agree, the Commission could impose obligations which otherwise, for example via article 7 of Regulation 1/2003, would be difficult to enforce because of a stricter proportionality test and more demanding motivation requirements.⁷⁰ In this manner the Commission can extend its discretion and impose its own vision on how the market should develop, whereas for the parties involved their own interests (such as preventing reputational damage) will constitute decisive factors. There is an inherent risk in this process that these commitments ultimately will not benefit consumers. In fact, they could even have anti-competitive effects.⁷¹

From this perspective it could be argued that it is desirable to extensively analyse and weigh both the short-term and long-term interests of consumers against each other when taking such far

⁶⁸ *Alrosa* [2010] E.C.R. I-05949, par. 41-50.

⁶⁹ M. Messina and J-C A Ho, "Re-establishing the Orthodoxy of Commitment Decisions under Article 9 of Regulation 1/2003: Comment on Commission v *Alrosa*" (2011) 5 *European Law Review* 737, p. 748. See also M. Sadowska and B. Willems, "Power Markets Shaped by Antitrust" (2013), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2187765 [Accessed November 13, 2013].

⁷⁰ H. Schweitzer, "Commitment Decisions in the EU and in the Member States: function and risks of a new instrument of competition law enforcement within a federal enforcement regime", July 2012, p. 3, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2101630 [Accessed November 13, 2013].

⁷¹ See Schweitzer (70) above, p. 3.

reaching decisions. This can be better achieved within the context of a regulatory procedure of an energy authority that adopts ex ante rules on the basis of transparent consultations than in procedures for the enforcement of competition law.

The latter procedures primarily aim to protect the right of defense of the undertakings under investigation rather than effectuating a broad examination of the interests of the different stakeholders involved and of the effects of a certain measure. As will be discussed below, after the entry into force of the Third energy Package the national energy authorities have to be attributed the power to impose structural regulatory measures on energy companies. This will give these authorities more instruments to proactively take regulatory steps against competition problems in the wholesale market.

5. The Third Package and the supervision and regulation of the wholesale energy markets

5.1. Enhanced European cooperation

In the Third Package there are no provisions requiring that the national energy authorities have the power to directly influence the manner in which competition on the wholesale energy markets could or should develop, e.g. by setting wholesale prices. National energy authorities do not have the power to ex ante set the prices and conditions for trading on the wholesale energy markets. However, the Third Package's directives and regulations do lead to a number of structural changes which may influence competition on the wholesale energy markets significantly. In addition to the stringent requirements for unbundling transmission network operators from the production and supply of energy⁷², there are also structural cooperation requirements for the European Commission, the national energy authorities, ACER and the transmission systems operators in regulating the cross-

⁷² C. Jones, *EU Energy Law. The Internal Energy Market*, (Leuven: Claeys & Casteels, 2006), vol. I, pp. 96-100.

border transport of energy. These parties must cooperate with each other at all levels (national, European, transnational) in order to promote the cross-border energy trade.⁷³

ACER is assisting the national energy authorities in exercising their regulatory tasks at the European level and coordinates their actions.⁷⁴ An important task of ACER is to assess the European network codes, which are drafted by the ENTSOs and can be made legally binding by a decision of the European Commission.⁷⁵ When exercising their duties, the energy authorities are also required to coordinate their work and to cooperate with ACER in cross-border situations. At the same time, whenever necessary they must also work together with the national energy authorities from other Member States and are required to comply with and implement the binding decisions of ACER and the Commission.⁷⁶ Furthermore the initiatives of regional cooperation between transmission system operators received a formal basis in the Third Package. Within the framework of ENTSOs⁷⁷ they have to promote the adoption of operational arrangements in order to guarantee an optimal operation of the network. Better integration of regional markets could lead to an intensification of trade as a result of which the wholesale energy markets could become more competitive and liquid. The idea is that the gradual integration of the regional markets will ultimately result in a fully integrated European energy market. As a result of enhanced cooperation at all levels, the technical and economic conditions under which the cross-border transport of energy takes place can be better agreed upon between transmission system operators, national energy authorities, the European Commission and ACER. This will foster cross-border trade and contribute to competition on wholesale energy markets.

⁷³ See Hancher and De Hautecloque (63) above, p. 307.

⁷⁴ See (1) above, art. 1 Regulation 713/2009.

⁷⁵ See (1) above, art. 36(a) and (1) above, art. 38(1) Directive 2009/72 and (1) above, art. 40(a) and art. 42(1) Directive 2009/73.

⁷⁶ See (1) above, art. 37(1)(d) Directive 2009/72 and (1) above, art. 41(1)(d) Directive 2009/73.

⁷⁷ See also par. 1.

5.2 Transparency

5.2.1 Transparency and information requirements

The Third Package's directives also contain new provisions on information and transparency obligations for various participants in the energy sector, which are also relevant for the wholesale energy markets. These provisions aim to promote the transparency and liquidity of wholesale markets which in turn will stimulate the entrance of new market participants. These provisions are also enabling the Commission, the national energy authorities and the competition authorities to identify competition barriers and forms of market abuse (see paragraph 6) on the wholesale markets, as well as to initiate enforcement actions when necessary.

The Third Package's directives require that the national energy authorities are granted the power to request information from electricity undertakings. Among others, this information may relate to explanations for any refusal to grant third-party access and the measures needed to reinforce the network.⁷⁸ Furthermore, the transparency and information requirements for supply undertakings are tightened since Member States must require these undertakings to register and keep the relevant data relating to all transactions in electricity supply contracts and electricity derivatives with wholesale customers and transmission system operators for a period of at least five years.⁷⁹ This data includes details on the characteristics of the relevant transactions such as duration, delivery and settlement rules, the quantity, the dates and times of execution and the transaction prices and means of identifying the wholesale customer concerned, as well as specified details of all unsettled electricity supply contracts and electricity derivatives.⁸⁰ At the same time national energy authorities are granted the power to make this information available to market participants, except for commercially sensitive information on individual market players

⁷⁸ See (1) above, art. 37(4)(c) Directive 2009/72. See also Art. 41(4)(c) Directive 2009/73.

⁷⁹ See (1) above, art. 40 Directive 2009/72.

⁸⁰ See (1) above, art. 40(2) Directive 2009/72.

or individual transactions.⁸¹ According to paragraph 4 of article 40 of Directive 2009/72/EC, the Commission has the power to adopt guidelines regarding the methods and arrangements for record keeping in order to ensure a uniform implementation of the information and transparency obligations.⁸² This is a situation in which energy authorities cooperate with each other and also with other (European) authorities. Before such guidelines are adopted, the Commission will consult ACER and ESMA. The competent authorities in the financial and energy markets will have to cooperate in order to get an accurate overview of the situation in the concerned markets.⁸³

5.3 Strengthening the role of the independent energy authority

5.3.1 Political independence and powers

In addition to the extended transparency and information requirements for energy companies regarding their transactions on the wholesale energy market, the supervision and regulation of the wholesale and retail markets is also sharpened in an indirect manner by a reinforcement of the position and the powers of the national energy authorities. The Third Package's directives do not only strengthen the political independence of the energy authorities, but they also introduce a further harmonization of the powers and the objectives of these authorities.⁸⁴ The independence of the energy authorities is a necessary prerequisite for the authorities to exercise their powers effectively and contribute to the creation of a competitive market.⁸⁵ Furthermore, given the substantial influence of the energy authorities on ACER via the Board of Regulators, the

⁸¹ See (1) above, art. 40(3) Directive 2009/72. For a similar provision for the gas sector see (1) above, art. 44(3) Directive 2009/73.

⁸² See (1) above, art. 44 Directive 2009/73 for a similar provision.

⁸³ See (1) above, Recital 40 of Directive 2009/72.

⁸⁴ See S. Lavrijssen and A. Ottow, "Independent Supervisory Authorities: A Fragile Concept" (2012) 39(4) Legal Issues of Economic Integration 419.

⁸⁵ See Lavrijssen and Ottow (84) above, p. 437.

independence principle is one of the safeguards preventing problems at national level to be transferred to the European level and vice versa.⁸⁶

Article 37 of Directive 2009/72/EC and Article 41 of Directive 2009/73/EC give an overview of the powers that have to be granted to the energy authorities.⁸⁷ These powers correspond to the duties these authorities have in accordance with the directives.⁸⁸ The directives explicitly provide that Member States have to ensure that energy authorities are granted the powers which should enable them to perform the tasks entrusted to them in an efficient and timely manner.⁸⁹ The powers of the energy authorities and their relevance for the functioning of the wholesale energy markets and ultimately for the position of consumer will be looked at in more detail below.

5.3.2. Analysis of the powers of the energy authorities

The powers of the energy authorities can be roughly divided into four categories⁹⁰:

- 1) The power to regulate the connection and access to the transmission and distribution networks, including fixing transmission or distribution tariffs or their methodologies, fixing tariffs for balancing services or their methodologies and determining the technical conditions for access to networks: These powers are also found in the previous energy directives. However, according to the second generation of energy directives, Member States could still require the national authorities to present these tariffs or their methodologies to a relevant authority (for example a ministry) which was supposed to take the relevant decision. According to the Third Package's directive, this is not allowed anymore as the tariffs and their methodologies have to be determined autonomously by the national energy authorities. This

⁸⁶ See Lavrijsse and Ottow (84) above, p. 440.

⁸⁷ See (1) above, art. 37(4) Directive 2009/72 and art. 41(4) Directive 2009/73.

⁸⁸ See (1) above, art. 37(1) Directive 2009/72 and art. 41(1) Directive 2009/73.

⁸⁹ See (1) above, art. 37(4) Directive 2009/72 and art. 41(4) Directive 2009/73.

⁹⁰ Lavrijssen and Bordei, "ACER: Demystifying the European Energy Supervisor from a Consumer Perspective" (2012) 10(5) Oil, Gas & Energy Law Intelligence, pp. 22-24.

prevents foreign parties from being in a disadvantaged position when requiring network access or when offering capacity for balancing services.

- 2) The power to monitor the compliance of the market participants with the requirements of the Third Package's directives and regulations and monitoring the markets and the market participants: These powers existed already on the basis of the Second Package's directives, but they were not sufficiently specific. The Third Package's directives specify that national energy authorities monitor the level of transparency, including the wholesale prices, and ensure the compliance of the energy undertakings with the transparency obligations.⁹¹
- 3) Enforcement powers: The Third Package's directives specifically elaborate on those enforcement powers which should be granted to the national energy authorities, including the power to issue binding decisions on electricity undertakings, to carry out investigations, to request information or to impose penalties.⁹²
- 4) The power to settle disputes in network access issues. This power existed already in the second generation of energy directives.
- 5) The power to impose any necessary and proportionate measures to promote effective competition.

This last mentioned power is new and directly relevant for promoting competition on the wholesale markets. It entails the possibility of the energy authorities to carry out investigations into the functioning of the energy market.⁹³ On the basis of these investigations it can be decided to

⁹¹ See (1) above, art. 37(1)(i) Directive 2009/72.

⁹² See (1) above, art. 37(4)(a), (b), (c) and (d) Directive 2009/72.

⁹³ See (1) above, art. 37(4)(b) Directive 2009/72 and art. 41(4)(b) Directive 2009/73.

impose the necessary and proportionate (structural) measures to promote effective competition and the good functioning of the market. This power is defined broadly and leaves the national energy authorities the possibility to draw specific or general binding measures promoting competition without having to prove the existence of an abuse of a dominant position in accordance with article 102 TFEU or the existence of a cartel situation according to article 101 TFEU. Therefore, in contrast to the competition authorities, who can only act ex post when articles 101 or 102 TFEU are breached, the energy authorities can act ex ante to prevent possible competition problems and to promote a healthy market structure. The preamble of Directive 2009/72/EC, for example, indicates that the national energy authorities could create virtual power plants through the establishment of release programmes whereby electricity undertakings could be obliged to sell or to make a certain part of their generation capacity available for a specific period of time to interested suppliers.⁹⁴

The power to proactively impose structural measures is far reaching and can be used by the energy authorities to limit or to break market concentrations on the wholesale energy markets, which in the end will promote competition in the interest of consumers. Given the nature of this power, it is not likely that the energy authorities will make use of it easily. They will most likely resort to it in last instance, when the combination of the provisions concerning unbundling, cooperation and transparency will not lead to the desired effect of more competition and market concentrations on the wholesale market will persist.

With the exception of the above described power to impose structural measures, most of the new powers of the energy authorities arising from the Third Package are not directly related to the wholesale energy markets. However, these powers could promote fair access to the wholesale markets, as a result of which effective competition between producers can be stimulated; that in the end can translate into more competitive consumer prices.

⁹⁴ See (1) above, recital 37 of Directive 2009/72.

6. REMIT

6.1. Scope and objectives

In addition to the transparency requirements of the Third Package's directives, the so called REMIT regulation has major implications for the monitoring of the wholesale energy markets.⁹⁵ It functions as a complement to the existing financial legislation⁹⁶ and the European competition rules. Two terms, "insider trading" and "market manipulation" are being introduced in respect to the wholesale energy markets. If these types of market abuse occur in one Member State, wholesale energy prices across borders can be affected (see also paragraph 1).⁹⁷ Through market manipulation prices on the wholesale energy markets, which are determinant for the costs of both households and non-households could be held at an artificial level.⁹⁸ If such practices cannot be effectively addressed, they may increase the volatility of energy prices and may lead to higher energy prices in general.⁹⁹

The Regulation applies to trading in wholesale energy products and it covers both commodity and derivative markets.¹⁰⁰ Articles 3 (Prohibition of insider trading) and 5 (Prohibition of market manipulation) of the Regulation do not apply to wholesale energy products which are financial instruments and to which Article 9 of Directive 2003/6/EC (Market Abuse Directive (MAD)) applies. This Directive aims to counteract market abuse on financial markets. REMIT is without prejudice to

⁹⁵ See REMIT (3) above.

⁹⁶ See (10) above and Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC [2004] OJ L145/1.

⁹⁷ For an explanation of these terms see (10) above.

⁹⁸ See par. 1 of this article.

⁹⁹ See par. 1 of this article.

¹⁰⁰ Derivatives markets are financial markets in which derivatives (securities which prices are derived from an underlying asset) are being traded.

Directives 2003/6/EC and 2004/39/EC, as well as to the application of European competition law to practices which fall within its scope.¹⁰¹

As already emphasized in the introduction, the complementary role of REMIT is determined by the limited scope of the financial and competition legislation. Directive 2003/6/EC¹⁰² is only partially applicable to the energy markets because it is specifically designed for financial markets. This Directive applies to financial instruments which are admitted for trading on a regulated market. However, physical energy market products (such as spot market products) are not covered by Directive 2003/6/EC and the energy derivatives markets products are covered only if they are admitted to trading on a regulated market.¹⁰³

Directive 2004/39/EC on markets in financial instruments (MiFID)¹⁰⁴ is applicable on commodity derivatives.¹⁰⁵ The objectives of this Directive namely financial stability and investor protection seem to be less relevant for the energy market since energy derivatives are typically not investment products, but are primarily used as hedging instruments for mitigating price risks of

¹⁰¹ See REMIT (3) above, art. 1(2).

¹⁰² At this moment there are two proposals awaiting to be adopted and which are meant to update the MAD: Proposal for a Regulation of the European Parliament and of the Council on insider dealing and market manipulation (market abuse) COM(2011) 651 final and Proposal for a Directive of the European Parliament and of the Council on criminal sanctions for insider dealing and market manipulation, COM(2011) 654 final. On 10 September 2013 the European Parliament voted to formally endorse the political agreement on a Regulation on insider dealing and market manipulation (market abuse) subject to alignment with the final political agreement on MiFID II (see below fn. 104) and revisions by legal linguists and revisers. See http://europa.eu/rapid/press-release_MEMO-13-774_en.htm?locale=en [Accessed November 13, 2013].

¹⁰³ 'Impact Assessment accompanying Proposal for a Regulation of the European Parliament and of the Council on energy market integrity and transparency', SEC(2010) 1510 final, pp. 12-13. According to Proposal for a Regulation of the European Parliament and of the Council on market abuse, "the Regulation extends the scope of the market abuse framework applying to any financial instrument admitted to trading on a MTF or an OTF, as well as to any related financial instruments traded OTC which can have an effect on the covered underlying market." See Proposal for a Regulation of the European Parliament and of the Council on market abuse, pp. 6-7. Accessible at <http://register.consilium.europa.eu/pdf/en/13/st11/st11384.en13.pdf> [Accessed November 13, 2013].

¹⁰⁴ MiFID is currently also being reviewed: see Proposal for a Regulation of the European Parliament and of the Council on markets in financial instruments and amending Regulation [EMIR] on OTC derivatives, central counterparties and trade repositories, COM(2011) 652 final and Proposal for a Directive of the European Parliament and of the Council on markets in financial instruments repealing Directive 2004/39/EC of the European, COM (2011) 656 final.

¹⁰⁵ According to the Impact Assessment REMIT (103) above, there are only relatively high level transparency obligations with regard to exchanges listing commodity derivatives as part of their basic organizational requirements to ensure fair and orderly trading (see p. 9).

energy market participants.¹⁰⁶ Furthermore, MiFID does not cover the spot market and physically settled OTC transactions, which are non-standardized.¹⁰⁷

Article 102 TFEU applies only to a limited extent to market abuse in the energy sector. Its application requires the existence of a dominant position. However, market abuse is not always linked to a dominant position.¹⁰⁸ Examples of such manipulation practices are practices that are either trade based, such as orders entered at the end of the auction to influence the closing prices and 'window dressing' deals between two parties to ensure a certain level of prices or information based, such as disseminating misleading information.¹⁰⁹

The scope of REMIT is currently being defined, among others by the legislation regarding the regulation of financial markets.¹¹⁰ However, according to ACER, what falls under the scope of REMIT will have to be amended accordingly when the new legislation on financial regulation¹¹¹ enters into force. Under the influence of this new financial regulation the term 'market manipulation' in the energy sector will need to be further filled in.¹¹²

In ACER's second edition of the Guidelines regarding the application of REMIT, it was made clear that ACER will adopt and amend its future guidelines concerning REMIT¹¹³ on the basis of the

¹⁰⁶ See (103) above, p.13.

¹⁰⁷ See (1033) above, p. 13. According to art. 2(7) of Regulation 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories [2012] OJ L201/1, a 'OTC derivative' or 'OTC derivative contract' means a derivative contract the execution of which does not take place on a regulated market. As a result of this Regulation the transparency of the trade in OTC derivatives is increased by, among others, a compulsory clearing by a central counterparty (CCP) and compulsory transaction reporting to financial supervisors (see De Bruijne and van Haersma Buma (9) above, p. 226).

¹⁰⁸ See CESR and ERGEG, "Advice to the European Commission in the context of the Third Energy Package. Response to Question F.20- Market Abuse" (October 2008), http://ec.europa.eu/energy/gas_electricity/consultations/doc/2010_07_23/cesr_ergreg_market_abuse.pdf [Accessed November 13, 2013].

¹⁰⁹ See CESR and ERGEG (108) above, par. 36 en 38, p. 10. For more examples of market manipulation see ACER, *Guidance on the application of Regulation (EU) no. 1227/2011 of the European Parliament and of the Council of 25 October 2011 on wholesale energy market integrity and transparency*, 2nd edition updated, 22 April 2013.

¹¹⁰ Directive 2003/6 (MAD) and Directive 2004/39 on markets in financial instruments. See ACER, *Guidance on the application of Regulation (EU) no. 1227/2011*, 2nd edition updated, 22 April 2012, pp. 11-12.

¹¹¹ See (103) and (107) above.

¹¹² See De Bruijne and Van Haersma Buma (9) above, p. 229.

¹¹³ These are merely non-binding guidelines and do not count as law interpreting guidelines.

experiences with applying REMIT, including considering feedback from energy market participants and other stakeholders.¹¹⁴ In addition, according to article 6 of REMIT, the European Commission may adopt delegated acts to update the definitions of “insider trading” and “market manipulation” taking into account the future developments of the wholesale energy markets. This dynamic adjustment of definitions based on the experience gained in practice and future developments makes sure that the legal framework is flexible to cover and deter new practices. At the same time it will not only cause uncertainty among market participants, but it will also require that they remain constantly alert and continuously update their internal compliance programmes.¹¹⁵

6.2. Transparency and registration obligations

In order to ensure effective monitoring of the functioning of wholesale energy markets, REMIT contains various provisions related to transparency, reporting and registration which complement and partly overlap with the transparency obligations from the Third Package’s directives.¹¹⁶

The monitoring tasks are being exercised by ACER in cooperation with the national energy authorities.¹¹⁷ In close consultations with the national energy authorities, the European Securities and Markets Authority (ESMA), national financial authorities and where necessary, competition

¹¹⁴ ACER, *Guidance on the application of Regulation (EU) no. 1227/2011*, 2nd edition updated, 22 April 2013, p.6. On 29 October 2013, as a result of the experience gained so far including the feedback received from the national energy authorities, market participants and other stakeholders ACER published a 3rd edition of the Guidelines aimed at providing guidance to national authorities regarding the registration of market participants and, in particular, the role of national energy authorities in the registration process. According to the preamble, clarifications have also been introduced concerning the definitions of wholesale energy products and inside information and the obligation to effectively publish inside information. See ACER, *Guidance on the application of Regulation (EU) no. 1227/2011*, 3rd edition, 29 October 2013.

¹¹⁵ See Feldner and Thalhammer (7) above, R. Feltkamp and C. Musialski, “Integrity and Transparency in the EU Wholesale Electricity Market - New Rules for a Better Functioning Market?” *Oil Gas Energy Law Intelligence* 2013, forthcoming, De Bruijne and Van Haersma Buma (9) above, p. 228.

¹¹⁶ See De Bruijne and Van Haersma Buma (9) above, par 4.

¹¹⁷ See REMIT (3) above, art. 7. ACER has concluded Memorandums of Understanding with both the national energy authorities as the ESMA in order to define the scope and practical terms of the cooperation under REMIT and to ensure an effective, efficient and coordinated monitoring of the wholesale energy markets. See ACER, *Multilateral Memorandum of Understanding between the Agency for the Cooperation of Energy Regulators and National Regulatory Authorities and market monitoring bodies*, 17 July 2013 en ACER, *Memorandum of Understanding between the Agency for the Cooperation of Energy Regulators and ESMA*, 18 July 2013.

authorities, ACER has to ensure that cases of market abuse are addressed in a coherent manner. ACER alerts national authorities to potential market abuse and facilitates the exchange of information between the concerned authorities.¹¹⁸ Article 10 of the REMIT regulation represents the basis for the information exchange between ACER and national energy, financial, competition and other involved authorities. This information may include among others the reports drawn up by national authorities regarding the transactions related to wholesale energy products.

All transactions on wholesale energy markets will now have to be reported.¹¹⁹ The information will be provided to ACER by the market participants themselves, by a trade repository or a third party acting in the name of a market participant.¹²⁰ ACER may make recommendations regarding the records of transactions which it considers necessary for effectively and efficiently monitoring the wholesale energy markets and to this end will consult ESMA and the national energy and financial authorities of the Member States.¹²¹

All market participants¹²² are obliged to provide both ACER and the national energy authorities with information related to the capacity and use of facilities for production, storage, consumption or transmission of electricity or natural gas or related to the capacity and use of LNG facilities, including planned or unplanned unavailability of these facilities. REMIT extends the information obligations to all market participants, whereas the information obligations flowing from Third Package's directives are limited to certain categories of participants (for example suppliers or TSOs). Furthermore, the obligation from the Third Package entails only that these participants have

¹¹⁸ Proposal for a Regulation of the European Parliament and of the Council on energy market integrity and transparency, COM(2010)726 final, p. 6.

¹¹⁹ See REMIT (3) above, art. 8(1). The information which should be reported includes the precise identification of the wholesale energy products which are to be bought and sold, the agreed price and quantity, the dates and times of execution, the parties involved in the transaction and the beneficiaries of the transaction and any other relevant information.

¹²⁰ See REMIT (3) above, art. 8(4).

¹²¹ See REMIT (3) above, art. 7(3).

¹²² See REMIT (3) above, art. 2(7): a market participant means any person, including transmission system operators, who enters into transactions, including the placing of orders to trade, in one or more wholesale energy markets. According to recital 18 transmission system operators, suppliers, traders, producers, brokers and large users are considered market participants.

to keep records with relevant data relating to all their transactions at the disposal of the European and national authorities and not actively provide these authorities with such information.¹²³

Also the registered or recognized trade repositories have to make available to ACER the information which they have gathered over the energy products which are to be traded on the wholesale markets. These trade repositories represent a new way in which transactions on the wholesale energy markets can be monitored.¹²⁴ ACER has also been given the power to make the information it has received publicly available, provided that commercial sensitive information regarding individual market participants is not disclosed.¹²⁵

According to the Commission, such transparency enhances confidence in the market and may contribute to a better understanding on the manner wholesale energy markets work. In this respect the transparency obligations and objectives of REMIT overlap with article 40 (3) of the Third Energy Package's electricity directive, in the sense that both ACER and national energy authorities may disclose the information which they receive to the public. Nevertheless, the powers which the national energy authorities have in accordance with the Third Package's directives concern the information which energy suppliers provide, whereas the information which ACER receives on the basis of REMIT concerns information provided by market participants in general, including energy suppliers.¹²⁶

The national energy authorities are responsible for the actual enforcement of the prohibition on insider trading and market manipulation (articles 3 and 5 of REMIT). This means that the effectiveness of REMIT depends to a large extent on the Member States that have to attribute the energy authorities effective sanction powers.¹²⁷ Member States should also ensure that national

¹²³ See REMIT (3) above, art. 8(5). See (1) above and compare art. 40 Directive 2009/72/EC and art. 44 Directive 2009/73/EC. Moreover Regulations 714/2009 and 715/2009 contain specific transparency requirements for TSOs.

¹²⁴ See REMIT (3) above, art. 8(4).

¹²⁵ See REMIT (3) above, art. 12(2).

¹²⁶ For a definition of "market participant" see (122) above.

¹²⁷ See REMIT (3), art. 13(1). Felkamp and Musialski (115) above.

energy authorities have the necessary investigatory powers. This entails fairly extensive investigatory powers, including, among others, the right to carry out on-site inspections, have access to any relevant documents, require telephone and data traffic records, require court or any competent authority to impose a temporary prohibition of professional activity and even request a court to freeze or sequester assets.¹²⁸

6.3. The administrative burden of REMIT¹²⁹

While aimed at promoting trade on wholesale energy markets, the transparency provisions of REMIT will also bring along a considerable administrative burden for market participants as well as for the involved European and national authorities that have to analyse the gathered data in a proper way.¹³⁰

Considering this burden the question which may arise is whether REMIT might miss its target. It is very possible that because market participants are expected to comply with so many administrative requirements, new entrants will be deterred from actually entering the market. In such a case the regulation would actually be counterproductive in the sense that market entry will be hampered, the competition on the wholesale market will decrease and consumers will end up with less choice in term of energy suppliers. Moreover, large users will also have to meet the transparency requirements if they have a consumption capacity of more than 600 GWh per year¹³¹ or if they

¹²⁸ These powers regard the market participants, but also any other person which has to comply with the requirements of articles 3 and 5.

¹²⁹ See also E. Michetti, *European Energy Markets Transparency report- 2012 Edition*, Florence School of Regulation, <http://fsr.eui.eu/Documents/ResearchReport/Energy/2012/RR2012ETA.pdf> [Accessed November 13, 2013] pp. 11-13.

¹³⁰ See Feltkamp and Musialski (115) above.

¹³¹ See REMIT (3) above, art. 2(5).

produce more than 100MW electricity per year for example through cogeneration.¹³² Thus it appears that although aimed at protecting consumers, REMIT introduces a heavy administrative burden in respect to large consumers that are not only consuming, but also generating energy. Nevertheless, it has to be emphasized that these administrative requirements should be limited in accordance with article 8 (5) of REMIT. According to this provision, ACER and the national energy authorities have to ensure that they collect the information required under REMIT in as much as possible from existing sources.¹³³

7. Concluding remarks

The provisions of the Third Energy Package do not provide for the direct regulation of the conditions and terms under which trade in the energy wholesale markets may take place.

The specific obligations arising from the REMIT have a greater and more direct impact on the behaviour of the market participants on the wholesale energy markets. These obligations are partly the result of the limited scope of competition law to address the practices on these markets which have price-increasing effects for consumers. Under the influence of REMIT the participants on the wholesale energy markets must take into account the prohibitions on market abuse when trading in energy products on the wholesale markets as well as extensive transparency obligations regarding transactions with such products. European and national authorities do not have the power to directly fix the conditions and prices for the sale of gas and electricity on the wholesale energy markets. However, the national authorities will have to be attributed effective enforcement powers to direct the participants regarding the manner in which they have to comply with insider trading and market abuse prohibitions and the new transparency obligations. Although REMIT has expanded the toolbox

¹³² The latter requirement does not follow directly from Regulation 1227/2011; ACER will interpret the term "insider" in anticipation of further implementing rules of the European Commission. See ACER, *Guidance on the application of the definitions set out in Article 2 of Regulation (EU) No 1227/2011 of the European Parliament and of the Council of 25 October 2011 on Wholesale Energy Market Integrity and Transparency*, 2011.

¹³³ See REMIT (3) above, art. 8(5).

of the national authorities, it remains to be seen to what extent this complex piece of legislation with vague definitions will effectively be enforced in practice.

It is expected that structural changes in the energy sector such as unbundling and structural European cooperation between ACER, the Commission, the national energy authorities and market participants in regulating cross-border transport of energy will ultimately have a significant impact on competition on the wholesale energy markets. These measures will contribute to the creation of a level playing field for all market players and will most likely reduce the risk of anti-competitive behaviour on these markets. Should there be any problems regarding abuse of a dominant position or market position, the energy authorities could act by making use, for example, of their new power to impose (proactively) structural measures and in this way promote competition in the wholesale energy markets or by enforcing REMIT. Considering that national energy authorities have made considerable efforts in monitoring and maintaining integrity and transparency on the wholesale energy markets, the question arises whether they will still have the necessary resources to monitor the retail markets and to address any problems which may arise therein.

National energy authorities must ensure that the benefits suppliers obtain as a result of more competitive wholesale markets are actually passed on to consumers in the form of more attractive conditions and prices for the supply of energy. There remains a risk of insufficient competition on the (often non-transparent) retail markets. This is also due to the fact that consumers tend not to exercise their right to choose their supplier.¹³⁴ Often consumers do not make the most rational choices in concluding contracts for the supply of energy, for example by failing to switch to a supplier which may offer better conditions and instead sticking to the old energy supplier. Studies have shown that energy suppliers can make use of this behaviour by charging significant higher prices to large groups of consumers to charge, then the prices charged to a relatively small group of active

¹³⁴ ECME Consortium, "The functioning of retail electricity markets for consumers in the European Union", EAH/FCW/2009 8601, November 2010 (this report was prepared at the request of the European Commission).

consumers which are searching for the best deals.¹³⁵ It is therefore important that the energy authorities engage sufficient resources for the monitoring of the competition on retail markets and, when necessary, take actions against suppliers that charge unreasonable prices.

¹³⁵ M. Guiletti, C. Waddams and M. Waterson, "Consumer choice and competition policy: a study of UK energy markets" (2005) 115 *The Economic Journal* 946.