

# SECURITY OF ENERGY SUPPLY: WHEN COULD NATIONAL POLICY TAKE PRECEDENCE OVER EUROPEAN LAW?

*Carlos Padrós*  
*Endrius E. Cocciolo\**

**Synopsis:** The European Energy Market is currently under construction. In this complex process Member States have traditionally retained the power to secure each State’s energy supply as a matter of national security. However, the European Court of Justice (ECJ) has recently issued several judgments in which national policies are declared to be in breach of core European Union (EU) principles: free movement of capital and freedom of establishment. The article explores the risks of adopting this approach (negative integration) without a clear European regulatory framework (positive integration). Dismantling national regulatory controls without providing a true European alternative can result in a critical precedence of free market over national administrative law.

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## I. ENERGY POLICY, FREE MARKETS, AND SECURITY OF SUPPLY: A COMPLEX INTERRELATIONSHIP

This article focuses on the transformation of public intervention mechanisms (i.e., the administrative/regulatory framework) in companies operating in energy sectors, particularly in regards to legal tools designed to meet “security of energy supply” requirements.

The energy sector is strategically important because energy products and services are absolutely essential for society to function. In general terms, strategic sectors involve “public infrastructure and services of great individual or

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\* Dr. Carlos Padrós is a Professor of European and Economic Law at Universidad Autónoma de Barcelona (Spain), PhD European University Institute (1997), L.L.M. Universidad Autónoma de Barcelona (1994). Currently he serves as a Judge of the Catalan Supreme Court, Administrative Law Section. Dr. Endrius Eliseo Cocciolo is an Associate Professor of Administrative Law at Universidad Autónoma de Barcelona (Spain), PhD in International Relationships and European Integration, Universidad Autónoma de Barcelona (2006).

collective importance. . . . All of these sectors provide for vital individual needs, formally recognised as such, or vital collective needs which must be met through the establishment of business enterprises.”<sup>1</sup>

In more concrete terms, the energy sector’s strategic importance derives from its role as a

provider of inputs that are essential to the overall productive system and to final demand. It is all the more strategic in an economy such as that of Spain, which largely lacks energy resources, particularly in the area of foreign trade, which is conducted in very sensitive and unstable markets. It is also strategic because sector companies are part of the essential framework of the economic system.<sup>2</sup>

The energy sector is subject to pervasive and extensive administrative regulation for the following reasons:

- a) Energy is a service of general economic interest. Public intervention is designed on the one hand to ensure the existence of a real market and, on the other, to ensure that public service obligations are met.<sup>3</sup>
- b) Energy is a network-based service requiring extensive regulation.<sup>4</sup> Energy products are impossible or very expensive to store, making them very vulnerable to market abuse. Therefore, monitoring by national regulatory authorities is crucial.
- c) Certain functions of the energy industry (e.g., distribution, transportation and network management) are “natural monopolies” and are thus viewed as regulated activities, while others (e.g., generation and supply) are open to competition.
- d) Electricity supply is viewed as a universal service.<sup>5</sup>
- e) The electricity sector is investment-intensive, thus hampering the entry of new competitors.

1. Gaspar Ariño, *Algunas ideas básicas sobre regulación de sectores estratégicos* [Basic Ideas About Strategic Sectors Regulation], 9 CUADERNOS DE DERECHO PÚBLICO [PUBLIC LAW JOURNAL] 12 (2000) (Esp.).

2. Juan Carlos Jiménez, *Una década de profundas transformaciones en el sector energético español* [A Decade of Deep Transformations in the Spanish Energy Sector], in AA.VV., *ENERGÍA: DEL MONOPOLIO AL MERCADO. CNE, DIEZ AÑOS EN PERSPECTIVA* [ENERGY: FROM MONOPOLY TO MARKET. CNE [SPANISH NATIONAL ENERGY COMMISSION], A TEN YEARS PERSPECTIVE] 67-68 (Thomson-Civitas Madrid 2006).

3. Tomás De la Quadra-Salcedo, *Diez años de legislación energética en España* [Ten Years of Energy Regulation in Spain], in AA.VV., *ENERGÍA: DEL MONOPOLIO AL MERCADO. CNE, DIEZ AÑOS EN PERSPECTIVA* [ENERGY: FROM MONOPOLY TO MARKET. CNE [SPANISH NATIONAL ENERGY COMMISSION], A TEN YEARS PERSPECTIVE] 329 (Thomson-Civitas Madrid 2006) (Esp.).

4. Maria Yolanda Fernández García, *Reflexiones sobre la noción de red (su relevancia en la regulación de los servicios esenciales económicos en red)* [Thoughts About the Network Concept (Its Relevance in the Regulation of the General Economic Services in Network)] 18 REVISTA DE DERECHO DE LAS TELECOMUNICACIONES E INFRAESTRUCTURAS EN RED [TELECOMMUNICATIONS AND NETWORK INFRASTRUCTURE LAW REVIEW] 11-34 (2003) (Esp.); see also Francesco Vetrò, *Il servizio pubblico a rete. L’esempio paradigmático dell’energia elettrica* [Network-Based Services. The Electric Energy Paradigm] (Torino 2005) (Italy).

5. See, e.g., Wolf Sauter, *Services of General Economic Interest and Universal Service in EU Law*, 2 European Law Journal (2008); Gianfranco Cartei, *Il servizio universale* [The Universal Service] (Milano 2002) (Italy); Vittorio Gasparini Casari, *Il servizio universale* [The Universal Service], in *Diritto dell’economia* [Economy Law] 265 (2000).

There are a number of additional considerations that underscore even more clearly the strategic nature of energy and the energy industry:

a) The issue of energy dependence. Foreign energy sources currently account for fifty percent of Europe's total consumption; that figure is forecast to reach seventy percent over the next twenty years. Spain's prospects are even worse since oil and natural gas – almost all of which must be imported – account for seventy percent of the primary energy consumed in the country.<sup>6</sup>

b) The powerful geopolitical interests of certain countries, which are reflected in technical issues, are closely interwoven with the issue of energy dependence. Europe largely depends on Russia, Saudi Arabia, Algeria, Norway, Niger, Libya, Qatar, Egypt, Iran, and Iraq, which have the largest energy stocks. Many of those countries pose considerable risks (e.g., Middle East instability, the political situation in Venezuela, Bolivia, Niger, Iran, and Iraq, supply disruptions in Russia).<sup>7</sup>

This combination of factors creates intractable energy supply problems. Energy supply guarantees, which legitimise government intervention in the market, are viewed as a matter of national sovereignty by the EU member states, which are free to choose their energy sources and supply structures,<sup>8</sup> in accordance with Article 175 of the Treaty of the European Community (TEC). These guarantees should be understood as a matter of public security. In other words, in the energy field, public security translates into security of supply concerns.

Given the EU's common requirements and the global dimension and scope of the issues at stake, security of supply concerns should be dealt with jointly at the European level to strengthen collective negotiating capacity. To that end, an effective European energy policy and a true European energy market will prove essential. However, the accomplishment of these goals is hampered by the resistance, inertia, and distrust of the EU member states, which are concerned about controlling energy and corresponding interests, i.e., by issues that have always been and are still considered of primary national political importance. This is the core of the difficulty in developing a single European energy policy. It also explains the limited devolution of regulatory powers authorized by the EU Member States.<sup>9</sup> Following the Maastricht Treaty, the essential legal basis of this common policy is set out in TEC Article 3.u, under which the EU is required to adopt measures in the energy sphere in order to achieve shared objectives. In reality, however, the development of a common energy policy encompasses

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6. Gaspar Ariño, *Energía en España y desafío europeo* [Energy in Spain and European Challenge] 41 (Comares 2006) (Gren.) [hereinafter *Energy in Spain*].

7. Gaspar Ariño, Privatizaciones y liberalizaciones energéticas: balance de situación [Energy Privatization and Deregulation: An Evaluation of the Situation], in AA.VV., *ENERGÍA: DEL MONOPOLIO AL MERCADO. CNE, DIEZ AÑOS EN PERSPECTIVA* [ENERGY: FROM MONOPOLY TO MARKET. CNE [SPANISH NATIONAL ENERGY COMMISSION], A TEN YEARS PERSPECTIVE] 466 (Thomson-Civitas Madrid 2006) (Esp.).

8. *Energy in Spain*, supra note 6, at 31.

9. On the difficult process of elaborating European policy in the field of energy, see generally Ester Zapater Duque, *La Unión Europea y la cooperación energética internacional* [The European Union and the International Energy Cooperation] 58 (Dykinson Madrid 2002) (Esp.).

several areas of EU jurisdiction, e.g. the common market, the free movement of capital, services and persons, the environment, etc.<sup>10</sup>

Over the past twenty years, the European Community, followed by the European Union, have sought to liberalize the energy sector, initiated by the publication of Commission Working Document COM (88) 238 on the internal energy market. In that document, European institutions emphasized the need to reform the energy sector with the aim of ensuring more economically efficient and dynamic services management.<sup>11</sup> In 1992, the European Commission (EC) issued two electricity and natural gas directives designed to:

- a) Abolish exclusive rights with respect to energy generation and construction of electricity networks and natural gas pipelines.
- b) Introduce the right of third party access to networks for major industrial clients and distribution companies.
- c) Distinguish between generation, transportation, and distribution of energy services, divide up the service infrastructure (unbundling), differentiate between basic services (which may continue to be public services), and value-added services (which are open to free competition).
- d) Separate the regulatory and operating functions.

These proposals led to Directive 96/92/EC (repealed by Directive 2003/54/EC) concerning common rules for the internal market in electricity, and Directive 98/30/EC (repealed by Directive 2003/55/EC) concerning common rules for the internal market in natural gas. Sector liberalization is not the ultimate aim, but rather a way to achieve closer integration of energy markets, where “energy market integration means . . . not just the liberalisation of [27] national markets, which to a greater or lesser extent continue to respond according to a national logic, but also the effective achievement of a true single market at the European level.”<sup>12</sup> Integration is one of the fundamental objectives

10. In the first 50 years, a great emphasis has been placed on the free movement of goods and services. The internal market had to be completed in 1992. The integrative potential of free movement of goods and firms is quite impressive. However, free movement of capital (investment and ownership of undertakings) has only very recently been fostered as an integration strategy. In fact, the adoption of a single currency in 2002 and the need for a strong European capital market pushes the European Commission in that direction. Capital is much more mobile than the rest of the market elements (goods, services, people) and conflicts between European principles and national (public) laws have arisen. On the working of the internal European market and the process of harmonization, *see generally* Manuel Ballbé & Carlos Padrós, *Estado competitivo y armonización europea* [*Competitive State and European Harmonization*] (Ariel Barcelona 1997) (Esp.).

11. From an institutional point of view, Europe is neither a federal State, nor governed by a simple commercial treaty. Although it is clear that the origins of the European Union are based on an international treaty (Treaty of Rome 1956), the development of both institutions and policies through this first fifty years makes it impossible to recognise the original structure and scope of European integration. Today, the European Parliament acts as a true legislative chamber (together with the Council of Ministers) and the role of political impulse of the European Commission has been very much enhanced. Therefore, the European Community is a structure under construction and in permanent evolution. There are neither clear limits nor a rational design for the integration process. The same can be said about the geographical dimension, completely transformed after the last East widening which took place in 2004.

12. Ester Zapater Duque, *La gestión de la seguridad de aprovisionamiento energético en la Unión Europea: ¿Una cuestión política o económica?* [*Energy Supply Security Management in the European Union: An Economy or Policy Matter?*] 17 (Dykinson Madrid 2002) (Esp.); *see also* Ester Zapater Duque, *La seguridad energética de la Unión Europea en el contexto de la nueva política energética y el Tratado de Lisboa* [*The European Union Energy Security in the Context of the New Energy Policy and the Treaty of Lisbon*], in

of the EU's energy policy, as set out in the EC's 1996 White Paper, which also emphasised:

- a) Global competitiveness, through European energy integration
- b) Security of supply
- c) Environmental protection

The development of the process of creating a single European energy market reality has two implications: in the first place, the greater the European market the less the grounds for national security measures. If we assume that an integrated market would itself provide greater security for Member States, there is less room for national measures. In the second place, and related to the previous, the greater the legal tools the European institutions provide for regulating energy, the stronger the pre-emption will be of national legislation. These two phenomena are self-reinforcing.

Conversely, a poor development of an integrated energy market would mean the need for national measures and national regulation. In fact, European freedoms can be achieved through the two classical integration mechanisms: positive integration (European legislation) and negative integration (European prohibitions of given norms). Given that decision making processes are extremely complex, Europe is moving forward, using a combination of two legal techniques: negative and positive integration. Negative integration can be defined as the suppression of all unjustifiable obstacles to market integration. That consists of forbidding the adoption or maintenance of certain national policies or regulations. This opens the door for firms to operate in a single economic space, for example, through mutual recognition of national corporate laws. Along with this negative approach, European institutions rely upon positive integration. That is, they pass a considerable amount of European legislation (Regulations, Directives, Decisions, etc.) that harmonize different legal orders and create a common European legal standard. There is no doubt that positive integration is more difficult (due to complexities of European decision making process) and more aggressive with State's competences. In any case, the worst scenario is that of negative integration through prohibition of national measures without a true European energy market.

In 2002, the Commission launched a Communication to the Parliament and to the Council where it observed the high degree of energy dependence of European countries and the lack of adequate means of action at EU level. At that moment, the degree of completion of the internal market revealed insufficient harmonization of community measures with regard to oil stocks and insufficient coordination for gas supplies. These two elements required a common framework as a solution in order: to promote solidarity among Member States in the event of a crisis; to manage security supplies to deal with physical disruption of energy supplies; to manage infrastructures safety; and to promote market stability. In light of the ideas expressed in the present Communication, the Commission proposes, on the basis of Article 95 of the EC Treaty, some legislative measures, that look to the adoption of:

- a) Council Directive 2004/67/EC of April 26, 2004 concerning measures to safeguard security of natural gas supply;

- b) Directive 2005/89/EC of the European Parliament and of the Council of January 18, 2006 concerning measures to safeguard security of electricity supply and infrastructure investment; and
- c) Council Directive 2006/67/EC of July 24, 2006 imposing an obligation on Member States to maintain minimum stocks of crude oil and/or petroleum products.

More recently, the EC Communication from the Commission to the European Council and the European Parliament of January 10, 2007, “An Energy Policy for Europe”, once again affirmed that:

the point of departure for a European energy policy is threefold: combating climate change, limiting the EU's external vulnerability to imported hydrocarbons and promoting growth and jobs, thereby providing secure and affordable energy to consumers. . . . [For that reason] Europe needs to act now, together, to deliver sustainable, secure and competitive energy. In doing so the EU would return to its roots. In 1952 with the Coal and Steel Treaty and 1957 with the Euratom Treaty, the founding member states saw the need for a common approach to energy. Energy markets and geopolitical considerations have changed significantly since then, but the need for EU action is stronger than ever. Without this, the EU's objectives in other areas, including the Lisbon strategy for growth and jobs and the Millennium Development Goals, will also be more difficult to achieve. A new European energy policy needs to be ambitious, competitive and long-term – and to the benefit of all Europeans.<sup>13</sup>

Thus far, however, it must be recognized that “the absence of a single market means the mere juxtaposition of mutually isolated national markets. . . . The European single market requires transnational networks, harmonized regulations and joint (or at least coordinated) network management. None of these elements are in place.”<sup>14</sup> This is due to the member states' strategic interests, as well as to the inherent characteristics of energy goods and services and, in some ways, to the policy of consolidating and protecting national companies. This latter factor deserves close attention in light of well-publicized cases such as *Électricité de France (EDF)/Montedison*, *E.ON/Ruhrigas*, *Suez/Gaz de France*, and particularly the “battle” for ENDESA, initiated by Gas Natural, continued by E.ON, and finally won by Enel and Acciona on October 10, 2007. This list would be much longer if other strategic sectors such as telecommunications (*Telefónica/KPN*), motorways (*Abertis/Autostrade*), and banking (*BNL/BBVA*) were considered, all of which are examples of government intervention designed to protect the public interest by safeguarding essential services or, in the opposing view, unjustified examples of “economic patriotism.”

These cases show the tension between safeguarding public services and national service providers, on the one hand, and the free market and its rules, on the other, i.e., between national public economic law and European law. “This dichotomy is reinforced by the lack of specific European legislation relating to public services, an area that has not yet been subject to EC pre-emption.”<sup>15</sup>

13. An Energy Policy for Europe, COM(2007) 1 final (Oct. 1, 2007).

14. *Energy in Spain*, *supra* note 6, at 1.

15. The relationship between national law and European Law is based on the principle of supremacy of the latter. European legislation preempts national law and prevails over it. This is partially compensated by the principle of progressivity. European legal instruments vary in their preemptive potential (from simple recommendations to imperative Council and Parliament Regulations). Therefore, States retain much of their

Conversely, the principle of “property neutrality” set out in TEC Article 295 implies that European law prejudices neither the energy companies’ ownership regimes nor the way services of general economic interest are managed. Therefore, Member States are free to determine their own public service systems. In addition, TEC Article 86.2 recognizes that the public services mission can be used to justify the existence of exclusive or special rights. Compensation measures can also be determined, regardless of the private or public status of the entities involved. Public service obligations are also set out in the two directives concerning electricity and natural gas liberalisation. Article 3.2 of Directive 2003/54/EC expressly states as follows:

Having full regard to the relevant provisions of the Treaty, in particular Article 86 thereof, member 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 environmental protection, including energy efficiency and climate protection. Such obligations shall be clearly defined, transparent, non discriminatory, verifiable and shall guarantee equality of access for EU electricity companies to national consumers. In relation to security of supply, energy efficiency/demand-side management and for the fulfilment of environmental goals, as referred to in this paragraph, member states may introduce the implementation of long term planning, taking into account the possibility of third parties seeking access to the system.”

According to Hancher:

It is now increasingly clear that Community action on energy cannot be limited to market integration and the removal of national obstacles to free movement of goods alone. A number of these same obstacles may be justified on either environmental protection or security of supply grounds. In other words, the Commission has gradually been forced to abandon its purely market-driven approach to creating a single energy market. The Commission is now grappling with the task of developing a more coherent energy policy framework within which more efficient competition can flourish. . . . It is suggested that the present Community law framework is not ideally suited to the simultaneous realisation of the complex task of reconciling energy market integration with other objectives. The paradox of increased competition in energy markets is that it can only be achieved by close regulation, which in turn requires stricter regulatory controls and the adoption of suitable mechanisms and instruments.<sup>16</sup>

Mergers between energy companies and corresponding public intervention measures do not pertain to the internal energy market, but rather to the market for corporate control, in which those companies are embedded. The EC has exclusive jurisdiction over mergers within the EU under Regulation EC/139/2004. Nevertheless, “public security” appears to be one of the EU Member States’ last areas in which they have ample authority and room to avoid compliance with European economic requirements. Indeed, Article 21 of the abovementioned regulation stipulates that:

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sovereign competence in so far as they are exerted in a way that is compatible with free market principles (free movement). On European Economic Law as a space for the relationship between the public and private spheres; see, e.g., Carlos Padrós Reig, *La transformación del régimen jurídico de la acción de oro en la jurisprudencia comunitaria europea* [The Transformation of the Golden Share Regulation in the ECJ Doctrine] 244 (Thomson-Civitas Madrid 2007) (Esp.).

16. Lee Hancher, *A Single European Energy Market: Rhetoric or Reality?* 11 ENERGY L.J. 217, 218 (1998). On the concept of an EU energy policy, see also Pekka Voutilainen, *Developing Energy Policy for Europe: A Finnish Perspective on Energy Cooperation in the European Union*, 29 ENERGY L.J. 121 (2008).

Member States may take appropriate measures to protect legitimate interests other than those taken into consideration by this Regulation and compatible with the general principles and other provisions of Community law. Public security, plurality of the media and prudential rules shall be regarded as legitimate interests within the meaning of the first subparagraph. Any other public interest must be communicated to the Commission by the member state concerned and shall be recognised by the Commission after an assessment of its compatibility with the general principles and other provisions of Community law before the measures referred to above may be taken. The Commission shall inform the member state concerned of its decision within 25 working days of that communication.

It is hardly surprising that security of supply, or more generally speaking, public security, has become the critical factor underlying the relationship between, on the one hand, free market, as defended by European institutions and, on the other hand, state powers in strategic sectors.

In recent years, the goal of a single European energy policy has gained momentum. In March 2007, the European Council invited the EU Executive to take measures, adopting a 2007/2009 Action Plan based on the European Commission's communication entitled "An Energy Policy for Europe" and setting out a series of high-priority issues, including security of supply. In this regard, the European Council has established the following goals:

- To enhance security of supply through effective diversification of energy sources and transport routes which will also contribute to a more competitive internal energy market.
- To develop more effective crisis response mechanisms on the basis of mutual co-operation and to build notably on existing mechanisms, and consider a wide range of options, taking into account the primary responsibility of Member States regarding their domestic demand.
- To improve oil data transparency and review EU oil supply infrastructures and oil stock mechanisms, complementary to the IEA crisis mechanism, especially with respect to availability in the event of a crisis.
- To carry out a thorough analysis of the availability and costs of gas storage facilities in the EU.
- To carry out an assessment of the impact of current and potential energy imports and the conditions of related networks on each member state's security of supply.
- To establish an Energy Observatory within the EC.<sup>17</sup>

On July 10, 2007, the European Parliament also expressed clear support for the introduction of a single energy policy. Building on these analyses, declarations, and commitments, the EC adopted on September 19, 2007 a third package of legislative proposals aimed at achieving a "true market" in addition to security of supply. This new energy package included the adoption of the following: 1) a regulation creating a European agency aimed at fostering cooperation between national energy regulators; 2) a directive and a regulation on electricity, amending current Directive 2003/54/EC and Regulation 1228/2003/EC; and 3) a directive and a regulation on natural gas, amending

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17. The European Council of Brussels, The Conclusions of the Presidency, 7224/1/07 REV 1 CONCL 1, Annex I (March 8-9, 2007).



current Directive 2003/55/EC and Regulation 1775/2005/EC. Under the draft version of the package, the internal energy market would be integrated and infrastructure would be interconnected. The goal is to build an internal market that is more open to competition; for that reason, network management must be kept separate from gas and electricity generation/distribution.<sup>18</sup> The basic equation established by these proposals is that greater competition equals greater security: in effect, a vertically integrated company has little incentive to increase network capacity or to expose itself to greater market competition given the resulting price reductions. In addition, separating network management from production and distribution activities would stimulate network-related investment, paving the way for new market participants and enhancing security of supply.<sup>19</sup>

The proposed energy package also contains norms aimed at making investments and the establishment of third-country companies contingent on the fulfilment of reciprocity clauses between country-of-origin regulations and those of the European Union. In other words, these are “anti-Gazprom mechanisms” aimed at forestalling predatory actions by non-European companies seeking to take advantage of a liberalized European market. This important and timely regulation has created perplexity among some observers because, in effect, the EC, in attempting to guarantee security of supply and liberalise national markets, has seized on the member states’ arguments aimed at defending special rights and powers. One thus wonders if the reciprocity principle and various “golden share” mechanisms should be condemned (as the EC and the European Court of Justice have done) or praised (within certain limits), at least while a truly internal energy market has not been fully achieved.

A strategy concentrating on market freedom and integration without providing a proper regulatory framework could weaken Europe’s overall Security of Energy Supply. In this respect, recent reforms introduced by the Lisbon Treaty, signed December 13, 2007, leave unaltered the competence balance between European Union and Member States.<sup>20</sup> After Lisbon, a new Title XXI was introduced devoted to energy that underlines the principle of solidarity among States. Moreover, article 194.1 establishes that the goals of Union’s energy policy are:

- a) to ensure the functioning of the energy market;
- b) to ensure security of energy supply in the Union;

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18. There are two formulas to achieve this objective: on the one hand, property separation and, on the other hand, the introduction of a so-called “independent network manager.”

19. On October 10, 2008, a step towards the approval of the new legislative package in the matter of energy was carried out through the agreement reached by European Ministers of Energy. *See, e.g.,* Press Release, *Council Deal on Energy Package: A Crucial Step Towards Completing the Internal Energy Market*, IP/08/1484 (Oct. 10, 2008), available at <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/08/1484>.

20. However, European competences are not clearly defined. There is no such a thing as a list of competences which are reserved to States or to European institutions. Instead, European institutions guarantee a delicate equilibrium of State interests in the Council and competences are attributed according to an open legal clause: the internal market clause. This mechanism resembles very much the U.S. “Commerce Clause” upon which it based. This goal oriented distribution of competences is very often under discussion before the ECJ which some scholars consider to be the true engine of European integration. As an example, energy policy was neither in the original mind of European founding fathers nor in the early Treaties.

- c) to promote energy efficiency and energy saving and the development of new and renewable forms of energy; and
- d) to promote the interconnection of energy networks.

In order to achieve a functional energy market, which is safe, efficient, sustainable, and interconnected, the European Parliament and the Council shall adopt necessary measures according to ordinary legislative procedure. However, the second paragraph of article 194.2, indicates that such measures shall not affect a Member State's right to determine the conditions for exploiting its energy resources, its choice between different energy sources and the general structure of its energy supply, without prejudice to Article 192(2)(c) (i.e., the norm that establishes the unanimity rule).<sup>21</sup>

## II. RECENT CASE LAW

The European Court of Justice (ECJ) is a powerful institution in the process of European integration. However, judicial decisions operate between two poles: the construction of Europe and respect for national governments' legitimate efforts to safeguard energy security. When the ECJ goes too far in approving national measures that may limit free movement principles, problems arise. Until a number of recent cases, ECJ jurisprudence gave member states the discretion to deviate from European principles in the interest of public security.<sup>22</sup> This notion, however, may be evolving in line with efforts to provide for free movement of capital.

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21. Lisbon Treaty, Art. 192.2, Dec. 13, 2007 states:

By way of derogation from the decision-making procedure provided for in paragraph 1 and without prejudice to Article 114, the Council acting unanimously in accordance with a special legislative procedure and after consulting the European Parliament, the Economic and Social Committee and the Committee of the Regions, shall adopt: (c) measures significantly affecting a Member State's choice between different energy sources and the general structure of its energy supply.

22. See, e.g., *Campus Oil Ltd. and Others v. Minister for Industry and Energy and Others*, Case C-72/83 (July 10, 1984) (Reference for preliminary ruling referred by the High Court of Ireland); *Bulk Oil (Zug) Ag v. Sun International Ltd.*, Case C-174/84 (July 18, 1985) (Reference for preliminary ruling of the Queen's Bench Division of the UK High Court). In regard to the scope of the public security objection, the Court established the following in *Campus Oil*:

(34) It should be stated in this connection that petroleum products, because of their exceptional importance as an energy source in the modern economy, are of fundamental importance for a country's existence since not only its economy, but above all its institutions, its essential public services and even the survival of its inhabitants depend upon them. An interruption of supplies of petroleum products, with the resultant dangers for the country's existence, could therefore seriously affect the public security that article 36 allows states to protect. (35) It is true that, as the court has held on a number of occasions, most recently in its judgment of 9 June 1982 (case 95/81 *Commission v. Italy* (1982) ECR 2187), article 36 refers to matters of a non-economic nature. A member state cannot be allowed to avoid the effects of measures provided for in the treaty by pleading the economic difficulties caused by the elimination of barriers to intra-community trade. However, in the light of the seriousness of the consequences that an interruption in supplies of petroleum products may have for a country's existence, the aim of ensuring a minimum supply of petroleum products at all times is to be regarded as transcending purely economic considerations and thus as capable of constituting an objective covered by the concept of public security. (36) It should be added that to come within the ambit of article 36, the rules in question must be justified by objective circumstances corresponding to the needs of public security. Once that justification has been established, the fact that the rules are of such a nature as to make it possible to achieve, in addition to the objectives covered by the concept of public security, other objectives of an economic nature which the member state may also seek to achieve, does not exclude the application of article 36.

This section is devoted to an analysis of recent ECJ judicial reviews of “security of supply” measures.

*A. Legal Authority for Prior Approval: CNE and Endesa Takeover, Judgments of March 6 and July 17, 2008, Case C-196/07 and C-207/07*

When the German electricity producer, E.ON, launched a takeover bid for Spanish utility Endesa, the Spanish government modified the control functions reserved for the Comisión Nacional de la Energía (CNE), the Spanish energy authority. The battle over Endesa shed light on a major legal inconsistency in the regulatory mechanisms: CNE’s fourteenth function was designed to control investments made by energy companies operating in regulated sectors in order to prevent negative impacts on their financial status.<sup>23</sup> However, nothing was said about the reverse scenario, i.e., ordinary (non-regulated) firms acquiring control over energy companies, jeopardizing energy suppliers’ operating continuity.

For that reason, Royal Decree 4/2006 was passed on February 24, 2006. This norm widened the energy regulators’ powers, enabling the CNE to approve or reject economic transactions involving energy companies or to subject them to conditions.<sup>24</sup> Once again, the “golden share mechanism” did not disappear but

23. See original version of Eleventh Additional Provision. Third. 1. Fourteenth of Act 34/1998.

24. After Decree Law 4/2006, function fourteenth appears as follows:

1. Authorize the acquisition of shares made by companies whose activities are considered regulated or activities subject to an administrative intervention that implies a special subjection relationship, such as nuclear power stations, coal-fired thermal power stations of special relevance for the consumption of nationally produced coal, or that are developed in island or non-peninsular electricity systems, as well as natural gas storage activities and the transport of natural gas via international pipelines destined for the Spanish territory or transit through the same.

The authorization will be equally required when the aim is to acquire shares of a greater percentage than 10% of the share capital or any other that awards significant influence, made by any subject of a company that, by its own account or via others that belong to the same group of companies, develops any of the aforementioned activities in the previous paragraph of this section 1. The same authorization will be required when assets required to undertake said activities are acquired directly.”

2. The authorizations defined in the two paragraphs of the previous section 1 can be denied or subject to conditions for any of the following causes:

The existence of significant risks or negative effects, direct or indirect, regarding the activities contemplated by the previous section 1.

Protection of the general interests of the energy sector and, in particular, guarantee of adequate maintenance of the objectives of sector policy, with special attention to what are considered to be strategic assets. Considered strategic assets for energy supply are those that could affect the guarantee and security of gas and electricity supplies. For such a purpose, the following assets are defined as strategic:

Installations included in the basic natural gas grid as defined in article 59 of the present law.

International pipelines destined for the Spanish territory or transit through the same.

Electrical energy transport installations as defined in article 35 of Law 54/1997, of November 27, on the Electricity Sector.

Installations for the production, transport and distribution of island and non-peninsular electricity systems.

Nuclear power stations and coal-fired thermal power stations of special relevance for the consumption of nationally produced coal.

The possibility of a company undertaking the activities described in the previous section 1 of this fourteenth function being exposed as unable to develop the same in guaranteed fashion as a consequence of any other activities undertaken by the acquiring or acquired party.

d. Any other cause related to public security and in particular:

was transformed. Following these reforms, the CNE oversaw not only economic and financial criteria, which meant assessing significant direct or indirect risks or negative impacts on regulated activities, but also had regulatory authority, which included safeguarding public security and the general interest.<sup>25</sup>

The CNE's powers had previously been criticized by the EC on March 27, 2006, when it objected that Spain could impose conditions on mergers having a "Community dimension" (in the case of E.ON's takeover of Endesa) pursuant to EC Regulation 139/2004, which granted the EC exclusive powers in this area.

The European Executive maintained that prior authorization to acquire an ownership interest in power companies violated the principles of free movement of capital and freedom of establishment. For those reasons, both the exercise of this control, as set out in the CNE's resolution of July 27, 2006 on the merger proposal, and the norm set out in Royal Decree 4/2006, were challenged by the Commission before the ECJ, which issued condemnatory judgements on March 6, 2008 (Case C-196/07) and July 17, 2008 (Case C-207/07).

The first of the ECJ's two decisions had merely procedural value since the Court did not examine the merits of the case; however, the decision shed light on how the process of adopting national intervention measures must be coordinated with the EC's process of authorizing European mergers and acquisitions. The facts that led to the litigation are as follows: On April 25, 2006, the EC unconditionally authorized E.ON's takeover; on July 27, 2006, the CNE,

The security and quality of the supply understood to be the uninterrupted physical availability of the products or services on the market at reasonable short and long term prices to all customers, regardless of their geographic location; and also:

Security against the risk of an investment or the insufficient maintenance of infrastructures such that they cannot guarantee a continuous set of demandable services for the guarantee of supply.

25. Eleven Additional Provision. Third. 2. Fourteenth of Act 34/1998 establishes as follows:

2. The authorizations defined in the two paragraphs of the previous section 1 can be denied or subject to conditions for any of the following causes:

a) The existence of significant risks or negative effects, direct or indirect, regarding the activities contemplated by the previous section 1.

b) Protection of the general interests of the energy sector and, in particular, guarantee of adequate maintenance of the objectives of sector policy, with special attention to what are considered to be strategic assets. Considered strategic assets for energy supply are those that could affect the guarantee and security of gas and electricity supplies. For such a purpose, the following assets are defined as strategic:

Installations included in the basic natural gas grid as defined in article 59 of the present law.

International pipelines destined for the Spanish territory or transit through the same.

Electrical energy transport installations as defined in article 35 of Law 54/1997, of November 27, on the Electricity Sector.

Installations for the production, transport and distribution of island and non-peninsular electricity systems.

Nuclear power stations and coal-fired thermal power stations of special relevance for the consumption of nationally produced coal.

c) The possibility of a company undertaking the activities described in the previous section 1 of this fourteenth function being exposed as unable to develop the same in guaranteed fashion as a consequence of any other activities undertaken by the acquiring or acquired party.

Any other cause related to public security and in particular:

1. The security and quality of the supply understood to be the uninterrupted physical availability of the products or services on the market at reasonable short and long term prices to all customers, regardless of their geographic location; and also:

2. Security against the risk of an investment or the insufficient maintenance of infrastructures such that they cannot guarantee a continuous set of demandable services for the guarantee of supply.

exercising the powers granted under the amended version of its fourteenth function, decided to make the transaction authorization contingent on the fulfilment of various conditions. The Commission subsequently held that Spain had violated Article 21 of the EC regulation on mergers because of the adoption of the CNE decision without notifying the Commission, nor its authorization.

Spain based its legal defense on two arguments: the first held that the case lacked merit since E.ON's takeover had no real effect; the second asserted that the controversial national measures were justified because they were intended to guarantee security of energy supply – a key element of the Spanish Government's energy policy. Given Endesa's important role in the energy sector, Spain maintained that the notion of public security constituted a legitimate exception to the enforcement of the European rules.

On the first point, the ECJ ruled that the violation should be considered in light of the member state's circumstances at the end of the period considered in the opinion (this period had expired on March 16, 2007, whereas E.ON abandoned the merger on April 10). In addition, the Court ruled that, even though the violation had stopped after the prescribed period, there was an interest in continuing the proceedings to determine the member state's responsibility as a result of the violation. The ECJ thus rejected Spain's first argument and examined the merits and interest of the case.

Spain's second argument – that its national measures were in accordance with Article 21 of the merger regulation since they sought to protect a legitimate interest (i.e. public security) – was not addressed by the ECJ because:

the system of review that the Treaty establishes distinguishes between Articles 226 and 227 EC cases, where what is intended is a declaration that a member state has failed to fulfill the obligations that are incumbent on it, and cases of Articles 230 and 232 EC, whose aim is controlling whether acts or omissions of European institutions are according to Law. This complains persecute different goals and are subject to different procedures. Therefore, a Member State cannot, if a provision of the Treaty does not expressly authorize it, to invoke the illegality of a decision of which he is addressee as ground for opposition of a breach based on the non-observance of this decision. . . . In fact, in a situation in which the member State has not communicated the interests protected by the national measures that it has adopted, it is unavoidable that the Commission examines in the first place if such measures are justified by any of the interests contemplated in Article 21, section 4 second paragraph, of merger Regulation. . . . Therefore, it can be indicated, without being necessary to examine if the controverted national measures were adopted to protect a legitimate interest, such as the public security in the sense of Article 21, separated 4, paragraph second, of merger Regulation, that the validity of the decisions of the Commission cannot be questioned within the framework of the present procedure.<sup>26</sup>

Among the reasons cited in the first judgement, only one consideration is relevant for our purposes: although national governments may act to protect a superior public interest, the process of approving or rejecting European mergers due to reasons of public security must be coordinated with the corresponding European process.<sup>27</sup>

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26. See, e.g., Case C-196/07, *Comm'n. V. Spain* (2008), at §§ 34, 37-38.

27. The ECJ doctrine refers to "imperative reasons of general interest". See, e.g., Case C-503/99, *Comm'n. v. Belgium* (2002), at § 45.

The second judgement, issued on July 17, 2008, condemned Spain for violating European law by amending the CNE's fourteenth function under Royal Decree 4/2006. The decision examined the Spanish norm and the criteria arising from the Court's jurisprudence concerning golden shares. The CNE's powers of authorization – regulated in the additional eleventh provision (section 3.11 subsection 1, second paragraph) – were deemed to be in violation of European law for the following reasons:

- a) The freedom of movement of capital is restricted because investors in other member states are dissuaded from acquiring an interest in Spanish companies operating in the energy sector.
- b) The administrative authorisation regime is inadequate to guarantee the energy provision since merely acquiring a stake or assets does not pose a real or sufficiently serious threat to energy security.
- c) The regime is disproportionate in relation to the stated goal since it enables the public authority to consider energy policy objectives not necessarily related to Security of Energy Supply.
- d) The criteria regulating the exercise of the CNE's powers are general and vague.
- e) CNE's "fourteenth function" also sets out restrictions the freedom of establishment (art. 43 EC).

This judgement warrants criticism for three reasons relating to the suitability of the measure, its proportionality and its applicability criteria.

### 1. Critical Analysis of CNE Judgments

As a result of the judgement against Spain concerning the CNE's amended fourteenth function, the ECJ opened a new chapter in its doctrine on golden shares. This out of focus jurisprudence, centred exclusively on the free movement of capital, has been described by some scholars as "simplistic" and "mechanical"<sup>28</sup> – an example of improper "judicial activism" by the ECJ.<sup>29</sup> The EC's vision and the decisions of the European judges were also harshly criticized by Advocate General Ruiz-Jarabo Colomer.<sup>30</sup>

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28. Giuseppe F. Ferrari, *Motivi imperativi di interesse pubblico e libera circolazione dei capitali* [Imperative Reasons of Public Interest and the Free Movement of Capital], DIRITTO PUBBLICO COMPARATO ED EUROPEO [COMPARATIVE AND EUROPEAN PUB. L.] 1459 (2005). See also Endrius Eliseo Cocciolo, La Golden Share in Spagna: "Regulating Corporate Governance" [The Golden Share in Spain: "Regulating Corporate Governance"], 2 SERVIZI PUBBLICI E APPALTI [PUBLIC SERVICES AND PUBLIC PROCUREMENT] 247-282 (2004).

29. See, e.g., Luis Miguel Hinojosa Martínez, La acción de oro en derecho comunitario: activismo judicial versus intervencionismo estatal [The Golden Share in the European Law: Judicial Activism Versus State Interventionism], 228 GACETA JURÍDICA [LAW JOURNAL] 11 (Nov./Dec. 2003); see also, Carlos Padrós Reig, *La transformación del régimen jurídico de la acción de oro en la jurisprudencia comunitaria* [The Transformation of the Golden Share Regulation in the ECJ Doctrine] (Civitas, Madrid 2007); see also Jose Antonio Rodríguez Míguez & Carlos Padrós Reig, Las acciones de oro, el derecho de sociedades y el mercado interior: Reflexiones a propósito de la STJCE sobre la Ley Volkswagen [Golden Shares, Corporate Law and Internal Market: Comments about the ECJ Judgement Regarding the Volkswagen Law], 8 GACETA JURÍDICA DE UNIÓN EUROPEA Y DE LA COMPETENCIA [EUROPEAN UNION AND COMPETITION LAW JOURNAL] 47-75 (2009).

30. Opinion of Advocate General Dámaso Ruiz-Jarabo Colomer, presented in C-463/00, Comm'n. v. Spain & C-98/01, Comm'n. v. United Kingdom (Feb. 6, 2003).

It is clear why the ECJ insisted on considering the CNE case from the perspective of free movement of capital. As Torrent has observed, “This is one of the most indefensible arguments in all of the golden share jurisprudence.” Instead of analyzing the amendments to the CNE’s fourteenth function in terms of movement of capital, the Court should have considered the national norms treaty compliance, which the Commission criticized in terms of freedom of establishment, particularly with regard to national treatment obligation.<sup>31</sup> The ECJ’s error is especially evident in this case since the aim of the norm in the second paragraph of the fourteenth function is to control acquisitions that grant significant influence; this situation is not controvertible, according to the wording of the norm. The European judges’ abstract statement that acquisitions in excess of ten percent do not inherently result in real influence is quite simplistic and lacks economic common sense. It is more likely that the ECJ, in adopting the Commission’s single market vision, chose to examine the dispute in terms of freedom of movement of capital and not from the more appropriate perspective of freedom of establishment because the latter viewpoint would have legitimized national golden share measures. In effect, the principle of freedom of establishment essentially prohibits measures placing citizens of member states in an unfavorable situation in comparison to that of citizens in the state of establishment, in addition to stipulating that activities aimed at establishing companies must be carried out in accordance with the legislative conditions set by the country of establishment for its own nationals. It should also be noted that the free movement of capital has two components: the freedom to transfer capital, and the use of such capital by other member states, which is regulated in accordance with the destination country’s laws.

The ECJ also ruled that under the CNE’s fourteenth function, the regime is disproportionate in relation to the stated goal since it enables the public authority to consider energy policy objectives. However, if we compare the Spanish regulation with the norm on Belgium’s “action spécifique,”<sup>32</sup> which was backed by ECJ judgements,<sup>33</sup> it is difficult to understand why urgent reasons of public interest and public security were validated in the Belgian case, whereas Spanish Royal Decree 4/2006 violated European law. In effect, it is difficult to distinguish between the Spanish and Belgian norms.

The Spanish norm stipulates that:

[t]he general interest in the energy sector will be protected and, in particular, a suitable maintenance of sectorial policy goals will be guaranteed, with special emphasis on assets considered strategic. Strategic assets for energy provision will be taken into consideration if they affect the guarantee and security of the gas and electricity supply.

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31. Ramone Torrent, *Derecho comunitario e inversiones extranjeras directas: libre circulación de los capitales vs. Regulación no discriminatoria del establecimiento. De la golden share a los nuevos open skies* [European Law and Foreign Direct Investments: Free Movement of Capital vs. Freedom of Establishment Regulation. From “Golden Share” to the New “Open Skies”], 22 *REVISTA ESPAÑOLA DE DERECHO EUROPEO* [SPANISH JOURNAL OF EUROPEAN LAW] 300, (2007) (dismantles the entire jurisprudential construction on golden shares).

32. Belgian Royal Decree of June 10, 1994, regarding the *Société Nationale de Transport par Canalisations*, and Belgian Royal Decree of June 16, 1994, regarding *Distrigaz*.

33. Case C-503/99, *Comm’n. v. Belgium* (2002).

The Belgian norm, by contrast states that the Minister may oppose a merger:

[i]f the transaction is deemed to be against the national interests in the energy field.

Furthermore, it establishes that the government's representatives may take action against an energy company's decision:

[i]f it is deemed to be in conflict with the guidelines of the country's energy policy including the government's objectives with respect to the country's energy supply.<sup>34</sup>

In both cases, the wording is equivalent and should be construed as meaning that the general interest and the energy policy guidelines refer to the guarantee and security of energy supply and that the conditions governing the exercise of administrative powers meet various objective economic and technical criteria. The Spanish regulation does not lead to reduced objectivity or imprecise criteria since strategic assets are strictly defined and comprise:

- a) The facilities included in the basic natural gas network.
- b) International pipelines that terminate in or cross Spanish territory.
- c) Electricity transmission facilities as defined in Article 35 of Act 54/1997 (27 November) regulating the electricity sector.
- d) Electricity production, transmission and distribution facilities.
- e) Nuclear and coal thermal power stations of special relevance to the consumption of nationally produced coal.

The only noteworthy difference between the Belgian norm and the CNE's fourteenth function lies in the fact that the former covers only the disposition (assignment, pledge, or transfer) of energy-related assets, whereas the latter refers to ownership interests or assets. Nevertheless, the ECJ does not consider this to be a substantive reason in favour of the Belgian norm.

In its doctrine, the ECJ recognizes that security of supply is a justification for limiting the free movement of capital but goes on to specify that "the exigencies of public security . . . must be interpreted in strict sense, so that a single member state cannot unilaterally determine its reach without control on the part of the institutions of the European Community. Thus, the public security only can be invoked in case that a real and sufficiently serious threat exists that affects a fundamental interest of the society."<sup>35</sup> The Court apparently reserves itself the right to define the notion of public security, as if it could be "communitarised." Nevertheless, unlike the legal definition of "workers" or "merchandise", "public security" is tied to the definition set out in national norms. In this way, security continues to be one of the member states' last areas of unfettered sovereignty. The existence of assets such as nuclear power plants provides further guarantees for such strategic considerations and justifies restrictions on movements of capital and freedom of establishment due to reasons of nuclear security and thus national security, i.e., an issue that goes to the heart of national sovereignty and entails (as applicable) reinforced guarantee

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34. See, e.g., Articles 3 & 4 of Belgian Royal Decree of June 10, 1994.

35. Case C-207/07, *Comm'n v. Spain* (2007), at § 47; but see Case 463/00, *Comm'n v. Spain* (2003), at § 72.



measures.<sup>36</sup> According to Fleischer, after the golden share judgements, the ECJ had to be more tolerant with the member states and with security-related restrictions<sup>37</sup> because the ECJ otherwise ran the risk of becoming a dangerous mechanism of market deregulation, “playing a role that went beyond the ideological neutrality that should characterize the European judicial function.”<sup>38</sup>

The nuclear security argument has been upheld in other cases. In effect, in addition to the completed or pending cases, other golden shares exist in Europe that have not been contested by the EC. In Belgium, in addition to its two golden shares in the Société Nationale de Transport par Canalisations (SNTC) and Distrigaz reviewed and approved by the ECJ, the government has another golden share in the Société Belge des Combustibles Nucléaires, which was not included in the Commission’s inquiry. The Commission acted in the same way with respect to the United Kingdom, whose case focused exclusively on the government’s golden share in airport management companies, not on its golden share in companies such as Rolls Royce, Vickers Shipbuilding and Engineering (VSEL), or Sealink. In Gippini-Fournier’s view, “this may indicate that the Commission considers that certain sectors (nuclear energy, defence) require special treatment.”<sup>39</sup>

Another argument on which the judgment against Spain was based is that the intervention mechanism must be proportional to the stated goal, i.e., the same goal cannot be reached with less restrictive measures, particularly a system of *ex post facto* declarations. In other words, in the ECJ’s view, an intervention is more proportional when carried out using an *ex post facto* instrument, normally through an opposition regime, like that of Belgium. Based on the evidence, we view this as a European example of “placebo.” The basic idea is that measures are acceptable if they respect a private company’s autonomy.<sup>40</sup> However, it is difficult to differentiate between a regime of *a posteriori* opposition that establishes the suspension of the effects of acts or agreements before the expiry of the prescribed period, and a regime of previous authorization that anticipates a positive silence after the prescribed period.

If we consider the utility for the companies, in both cases it is necessary to wait because private autonomy is equally conditional. In fact, true progress towards the establishment of an administrative law in accordance with the market economy is not made by substituting authorization regimes with an (anomalous) opposition regime, but rather by developing procedures that set out the proper limits and means that provide protection for private persons.

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36. Opinion of the Advocate General Georges Cosmas, presented on March 23, 2000, Case C-423/98, Cabletron Systems, Ltd. v. The Revenue Commissioners (2001).

37. Holger Fleischer, *Golden Share: Judgments of the Full Court of 4 June 2002*, 40.2 COMMON MARKET L. REV. 49 (2003).

38. Hinojosa Martinez, *supra* note 29, at 23.

39. Eric Gippini Fournier & Jose Antonion Rodríguez Miguez, *Golden shares en la Comunidad Europea: ¿fin de la edad dorada?* [Golden Shares in the European Community: The End of the Golden Age?], 220 GACETA JURIDICA DE LA UNIÓN EUROPEA Y DE LA COMPETENCIA [EUROPEAN UNION AND COMPETITION LAW JOURNAL] 60 (July/August 2002).

40. María Nieves De la Serna Bilbao, *Comentario a la jurisprudencia del Tribunal de Justicia de la Comunidad Europea en relación con las denominadas acciones de oro: las restricciones a las libertades de la libre circulación de capitales y establecimiento* [Comments on the ECJ Judgments about Golden Shares: Restrictions to Free Movement of Capital and Freedom of Establishment], 7 REVISTA ESPAÑOLA DE DERECHO EUROPEO (SPANISH JOURNAL OF EUROPEAN LAW) 557 (2003).

Anticipating a reduced resolution period protects a company's decision-making freedom as an *a posteriori* control system would. In addition, *a posteriori* control mechanisms are not viable solutions, according to the ECJ itself. In effect, in the Analir judgement (C-205/99), the ECJ stated that

for a regime of previous administrative authorisation to be correct, even though introduces an exception to a fundamental freedom, must, in any case, to be based on objective criteria, non-discriminatory and known beforehand by the interested companies, so that the limits of the exercise of the faculty of appreciation are established for the national authorities, in order that these power cannot be used in an arbitrary way.<sup>41</sup>

On the other hand, it seems that the ECJ is suggesting that the opposition regime is proportional. In effect, in the Belgian case, the Court analysed the *ex post facto* control mechanism using the same parameter of legality it used for the authorization regime. As Hinojosa Martínez rightly points out:

When analysing *a posteriori* control mechanisms on certain management decisions in privatised companies created by the Belgian and French governments, the ECJ uses four criteria . . . to evaluate their compatibility with European law. In the case of the EC vs. Belgium, the Court identified the existence of a legitimate public interest, which it interpreted restrictively (par. 46-47), indicated that the Commission did not show that such an objective could be reached with less restrictive means (par. 53), confirmed that the measures were sufficiently precise and objective (par. 50) and stated that any administrative decision in this context should be formally motivated and subject to effective judicial control (par. 51). . . . The ECJ's analysis is identical to the previous administrative authorisation. The relevant issue, therefore, is not if the restriction is before or after the fact as regards the decision on the management of the company, but rather that the analysis should focus on adjusting concrete measures to protect a legitimate public interest.<sup>42</sup>

Based on this reasoning, it is possible to infer that, without minimizing the importance of the previous measure aimed at protecting the general interest, the true basic requirement concerns the relation between this intervention measure and the public interest, in accordance with the principle of proportionality.<sup>43</sup>

Therefore, modifying the CNE's fourteenth function to create a system of communication with opposition power and as a way of reforming a previous administrative authorization regime (the Spanish golden share) may be ill-advised. This solution was already addressed in Act 62/2003 (December 30) concerning fiscal, administrative, and social measures (additional provision 20). Advocate General Ruiz-Jarabo Colomer criticized the supposed *ex post facto* character of the Belgian administrative opposition model.<sup>44</sup> The fact that a communication regime does not suppose any substantial change and that adopting an *a posteriori control* mechanism is preferable stems from a correct dogmatic reconstruction of the mechanism itself. This mechanism, in fact, represents a regime of communicated activities in which the national government holds veto power during a prescribed period, which the doctrine has described clearly as a "preventive instrument, although sometimes exercised concurrently

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41. Case C-205/99, Analir v. Administracion General Del Estado, 2001 E.C.R. I-1271, at § 38.

42. Hinojosa Martínez, *supra* note 29, at 25.

43. On the principle of proportionality in European Administrative Law, *see, e.g.*, Jurgen Schwarze, *The Principle of Proportionality and the Principle of Impartiality in European Administrative Law*, 1 RIVISTA TRIMESTRALE DI DIRITTO PUBBLICO [QUARTERLY JOURNAL OF PUBLIC LAW] at 53-75 (2003).

44. Case C-463/00, Comm'n. v. Spain, and Case C-98/01, Comm'n. v. United Kingdom (2003), at § 39.

with citizens' activities.<sup>45</sup> In effect, on some occasions, lawmakers may ignore the nature of the prevailing norms, under pressure or even duress from European institutions, and may limit themselves to emulating the legal institutions of other member states.<sup>46</sup>

Finally, although the fact that the activities subject to control by the public authorities are made without an administrative measure of the government may appear more respectful of private autonomy, freedom of establishment and corporate governance, the nature, complexity, and special characteristics of these activities should dissuade the use of the previous communication technique and advise the control procedure that finishes with an administrative act.<sup>47</sup>

*B. Subsidies for Stranded Costs: ECJ Judgment of July 17, 2008, Essent Netwerk Noord BV et al. Case C-206/06*

According to Dutch law, purchasers of electricity must satisfy a price surcharge for the transmission of electricity in year 2000. Since the State and its subsidiary company SEP, are responsible for ensuring the proper functioning of the electricity infrastructures and since during the period previous to liberalization SEP made certain investments to secure supply, an agreement between four generating undertakings and twenty-three distribution companies was concluded in order to cover those non-market-compatible cost. The payment of that amount by the distribution companies was to be financed by an increase in the price of electricity charged to small, medium, and large consumers.

In a February 20, 1998 letter, the Netherlands government informed the Commission of the proposed compensation payments to the four electricity generating undertakings and asked the government to approve them in accordance with Article 24 of the Directive. By Decision 1999/796/EC of July 8, 1999, concerning the application of the Netherlands for a transitional regime under Article 24 of Directive 96/92 (OJ 1999 L 319, p. 34), the Commission took the view that the system of levies and the transfer of compensation payments provided for did not require a derogation from Chapters IV, VI, or VII of the Directive, and therefore could not be regarded as a transitional regime within the meaning of Article 24 of the Directive.

On December 21, 2000, the Transitional Law on the electricity generating sector (OEPS) was adopted governing the issue of non-market-compatible costs. As the Commission had expressed doubts concerning the compatibility of article 6 to 8 of the norm with the Treaty, the Netherlands government decided not to bring those articles into force and to provide for some non-market-compatible costs to be financed out of general resources.

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45. Maria Del Carmen Núñez Navarro, *Las actividades comunicadas a la administración. La potestad de veto sujeta a plazo [Regime of Communicated Activities to the Administration: The Veto Power Subject to a Term]* 110 (Marcial Pons Madrid 2001).

46. On the doctrine of "European Commandeering", see generally Manuel Ballbé, Roser Martínez, *Soberanía dual y constitución integradora. La reciente doctrina federal de la Corte Suprema norteamericana [Dual Sovereignty and Integrative Constitution. The Recent Federal Doctrine of the US Supreme Court]* 192 (Ariel Barcelona 2003).

47. Nuñez Navarro, *supra* note 45, at 152.

In the main proceedings, Essent Netwerk<sup>48</sup> is seeking payment of the amounts which it invoiced to Aldel,<sup>49</sup> together with interest and costs, under Article 9 of the OEPS. Aldel refuses to pay those amounts on the ground that Article 9 of the OEPS is contrary to Articles 25 EC, 87 EC, and 90 EC. Aldel has brought an action for indemnification against the State. Essent Netwerk has, in turn, brought an action for indemnification against Nederlands Elektriciteit Administratiekantoor BV and Saranne BV.

In those circumstances the Groningen District Court requested to the ECJ a prejudicial ruling about the interpretation of the Articles 25 EC, 87 (1) EC, and 90 EC, in connection with national legislation, establishing to surcharge on the price of electricity and payable, during to transitional period, to the net operator by consumers established in the Netherlands. Considering that the Dutch regulation also established the obligation on the net operator to pay that surcharge to to statutorily designated undertaking of the national electricity generators for the purpose of defraying to sum representing the amount of obligations incurred and investments made by that undertaking prior to liberalization of the market.

The judgement is rich and complex and we summarize its main findings:

- a) [a] charge which is imposed on domestic and imported products according to the same criteria may nevertheless be prohibited by the Treaty if the revenue from such a charge is intended to support activities which specifically benefit the taxed domestic products. If the advantages which those products enjoy wholly offset the burden imposed on them, the effects of that charge are apparent only with regard to imported products and that charge constitutes a charge having equivalent effect. It is for the national court to ascertain whether the generating undertakings were required to ensure that SEP defrayed those non-market-compatible costs or whether they could have enjoyed an advantage as a result of the charge, for example, because of a selling price incorporating the revenue from that advantage, by the grant of dividends or by any other means.
- b) Article 25 EC is to be construed as precluding a statutory rule under which domestic purchasers of electricity are required to pay to their net operator a price surcharge on the amounts of domestic and imported electricity which are transmitted to them, where that surcharge is to be paid by that net operator to a company designated by the legislature, with that company being the joint subsidiary of the four domestic generating undertakings and having previously managed the costs of all the electricity generated and imported, and where that surcharge is to be used in its entirety to pay non-market-compatible costs for which that company is personally responsible,

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48. Essent Netwerk is an autonomous legal person, a net operator, and a subsidiary of Essent NV, which is wholly controlled by provincial and local authorities. It delivered 717,413,761 kWh to Aldel's connection between Aug. 1, 2000 and Dec. 31, 2000.

49. On Dec. 19, 1996 Aldel a "special large consumer", acting pursuant to Article 32 of the EW 1989, concluded a contract for the provision of electrical capacity and the supply of electrical energy and "load management" with SEP, Elektriciteits-Productiemaatschappij Oost- en Noord-Nederland NV (a generating undertaking) and Energie Distributiemaatschappij voor Oost- en Noord-Nederland (a distribution undertaking).

with the result that the sums received by that company wholly offset the burden borne by the domestic electricity transmitted.

- c) The amounts paid to SEP constitute intervention by the State through State resources. Where a State measure must be regarded as compensation for the services provided by the recipient undertakings in order to discharge public service obligations, so that those undertakings do not enjoy a real financial advantage and the measure thus does not have the effect of putting them in a more favourable competitive position than the undertakings competing with them, such a measure is not caught by Article 87(1) EC (Altmark Trans and Regierungspräsidium Magdeburg). Therefore, Article 87 EC must be construed as meaning that the amounts paid to the designated company under Article 9 of the Transitional Law on the electricity generating sector (Übergangsgesetz Elektrizitätsproduktionssektor) of 21 December 2000 constitute “State aid” for the purposes of that provision of the EC Treaty in so far as they represent an economic advantage and not compensation for the services provided by the designated company in order to discharge public service obligations.

*C. Open Third-Party Access: ECJ Judgment of May 22, 2008, Citiworks AG, Case C-439/06*

Citiworks is a German electricity company that supplied electricity to DFS located on the site of Leipzig/Halle airport. DFS is a state owned entity responsible for air traffic control in Germany. FLH is the company which operates Leipzig/Halle Airport. In that capacity, it maintains an energy supply system by which it meets its own electricity requirements and those of ninety-three other users established on the airport site “the system at issue in the main proceedings.” During 2004, that system supplied in total approximately 22,200 MWh, of which 85.4% was used by FLH itself.

FLH applied for the system at issue in the main proceedings to be classified as a site network within the meaning of Paragraph 110 of the EnWG. During the inquiry into that application, on January 20, 2006, the regulatory authority invited Citiworks to intervene. By decision of July 12, 2006, the regulatory authority granted FLH’s application. Citiworks appealed against that finding to the Oberlandesgericht Dresden (Higher Regional Court, Dresden, Germany).

The Oberlandesgericht Dresden requested to the ECJ a prejudicial ruling about the interpretation of Article 20(1) of Directive 2003/54/EC in connection with National legislation which excludes networks wholly situated on the premises of an undertaking from the principle of free access of third persons to electricity transport and distribution networks.

Citiworks argues that the national provision which derogates from the principle of open third-party access to energy supply systems is contrary to that European established objective. There is no provision in Directive 2003/54/EC which authorizes Member States to freely determine in what situations they may derogate from that principle. On the contrary, the German government argues that the airport system is neither a transmissions system nor a distribution

system.<sup>50</sup> It is just an internal installation which distributes energy in a closed area. Therefore, it is not subject to interconnection obligations. It constitutes a site network and does not affect competition because of its low consumption and because the operation of that system is merely ancillary to the main activity of operating the airport.

According to recital in the preamble to Directive 2003/54, one of the main obstacles in arriving at a fully operational and competitive internal market relates to issues of access to the network, tariffication issues, and different degrees of market opening between Member States. Recitals and in the preamble to that directive state that, for competition to function, non-discriminatory, transparent, and fairly priced network access is of paramount importance in bringing about the internal electricity market. Finally, articles 16 to 20 of Directive 96/92 provided for a negotiated system of access to electricity transmission and distribution systems. The Community legislature decided to bring an end to that system in order to create more openness in the internal electricity market, as is apparent from the proposal for a directive submitted by the Commission on March 13, 2001.<sup>51</sup> It follows that open third-party access to transmission and distribution systems constitutes one of the essential measures which member states are required to implement in order to bring about the internal market in electricity.

Article 20(1) of Directive 2003/54 leaves the Member States free to take the measures necessary to establish a system of third-party access to transmission or distribution systems. It follows that, in accordance with Article 249 EC, the Member States have authority over the form and the methods to be used to implement such a system. Having regard to the importance of the principle of open access to transmission or distribution systems, that margin of discretion does not, however, authorize them to depart from that principle except in those cases where Directive lays down exceptions or derogations.

It is therefore only where a national provision comes within the scope of those exceptions or derogations that it will be compatible with Directive 2003/54, i.e.:

- a) An operator of a distribution system may refuse access where it lacks the necessary capacity, on condition that duly substantiated reasons are given for such refusal. This possibility of refusing access to the system is, however, to be assessed on a case-by-case basis and does not authorize the Member States to lay down those derogations in a general manner.
- b) Member States will be able to not to apply the provisions of Directive thereof where the application of those provisions would obstruct the performance of the obligations imposed on electricity undertakings in the general economic interest and in so far as the development of trade would not be affected to such an extent as would be contrary to the interests of the Community.

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50. Detailed explanations on the German concept of negotiated access to networks is to be found in Thomas Von Danwitz, *Regulation and Liberalization of the European Electricity Market: A German View*, 27 ENERGY L. J. 423 (2006).

51. Completing the Internal Energy Market, COM (2001) 125 final (Mar. 13, 2001), OJ 2001 C 240 E, p. 60

- c) Member States may decide to restrict third-party rights of access to transmission and distribution systems in order to ensure the supply of a public electricity service. However, in order to do so, the Member States must, on the one hand, ascertain whether an unrestricted right of access to the systems would obstruct the performance by the system operators of their public-service obligations and, on the other, determine whether that performance cannot be achieved by other means which do not impact adversely on the right of access to the systems, which is one of the rights enshrined in Directive 2003/54.

However, the Court has considered that the exception within the German regulation is not justified by the risk that the operators of systems coming within the scope of that provision would be prevented from performing their public-service obligations by the fact of that open access. That derogation can be justified only by the geographical or legal configuration of the area in which those systems are operated. Nor is it alleged by the German government that the Federal Republic of Germany would like to ensure the obligations imposed on electricity undertakings in the general economic interest.

From those arguments, it follows:

- a) that a provision such as the first point of Paragraph 110(1) of the EnWG does not come within the scope of any of the exceptions or derogations from the principle of open access to electricity transmission or distribution systems laid down by Directive 2003/54.
- b) that Article 20(1) of Directive 2003/54 must be interpreted as precluding a provision such as the first point of Paragraph 110(1) of the EnWG, which exempts certain operators of energy supply systems from the obligation to provide third parties with open access to those systems on the grounds that they are located on a geographically connected operation zone and that they predominantly serve to supply the energy needs of the undertaking itself and of connected undertakings.

### III. MAIN FINDINGS

The Treaty of Lisbon will not increase the power Europe needs to build a truly single energy market. It will introduce the basic principle of solidarity in confronting hypothetical energy crises while promoting network interconnectivity as a safety valve against potential crises. Taken together, these measures represent the first steps towards a truly single energy market.

Member states retain their ability to determine the operating conditions of their energy resources. They can also choose between various power plants and general supply structures, without prejudice to section 2(c) of Article 192. This provision, however, is difficult to enforce practically since the measures must be approved unanimously within a joint decision framework.

The existing European normative framework is still underdeveloped. We fully agree with Judge Von Danwitz's answer to the question of whether the Second Electricity Directive can really be considered an instrument for the

establishment of an internal market for electricity. This question must be answered in the negative in light of the broad discretion still given to member states.<sup>52</sup> As regards various European integration methodologies (both positive and negative), the present emphasis is on the elimination of obstacles, with no true European norm. It seems, then, that market dictates will take precedence over national administrative law (with regulation viewed as an obstacle to free movement principles).

Since stable European energy market norms are non-existent, the fight for security of energy supply has shifted to economic transactions such as asset acquisitions or interests in energy companies. In the E.ON/Endesa case, the ECJ considered that the national authorities could not impose economic conditions or prior administrative controls on mergers.

The imposition of free market restrictions based on security of energy supply is limited to national energy regulations. When it declared the CNE's fourteenth function unlawful, the ECJ ruled that public intervention could only be carried out following the merger (by means of public service contracts or administrative opposition). Stranded cost subsidies were also declared in violation of European law, together with unconditional declarations of third parties' rights to access energy networks, even in closed facilities.

The EC and the ECJ have progressively drained the member states' capacity (recognized in TEU Article 194.2) to guarantee security of supply. The adoption of measures based exclusively on the free movement of capital entails a weakening of the member states' jurisdictional authority without simultaneously creating a new European legal *corpus* to replace the old one. In this ongoing battle, security of supply safeguards are stuck in a no-man's land. Official approach tend to privilege opening the markets as a way of guaranteeing a secure energy supply.<sup>53</sup> At most, there is recognition of the need of a balance between (European) competition and (national) regulation.<sup>54</sup>

Security of supply has been diminished because the ECJ has prohibited half the tools designed to guarantee it. In addition, according to several recent rulings, the existing administrative controls must be dismantled (i.e., member states' technical-economic capacity) in order to ensure access rights, leaving only *a posteriori* controls on the fulfilment of public service obligations in service provision contracts. In other words, security of supply yields on the land of administrative controls and it remains in the effectiveness of the remedies in case of contractual breach.

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52. Von Danwitz, *supra* note 50, at 443.

53. Voutilainen, *supra* note 16.

54. Von Danwitz, *supra* note 50, at 450 ("administered form of competition").