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Structural Remedies in Article 82 Energy Cases

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Issuing the final report on its energy sector inquiry, the European Commission pointed to a range of competition concerns across the EU energy sector, including a lack of integration and transparency. In particular, however, the Commission identified the high degree of vertical integration in energy markets as an obstacle to competition. The Commission's suggested remedy is the separation of ownership and/or operation of gas and electricity transmission networks from other energy supply activities; the 'unbundling' of transmission and other activities that control market access. While the Commission strongly favours full ownership unbundling, other possible models are under consideration. Unbundling faces considerable political opposition from a number of Member States. Even if the Commission is successful in its objective of securing unbundling, it will be some time before the necessary legislation takes effect. Meanwhile, however, the Commission has been pursuing a number of investigations into individual energy companies. A key theme of those investigations has been the alleged abuse of transmission network activities in order to restrict competition on energy supply markets. Practices under investigation by the Commission include 'strategic under-investment' in network infrastructure. Remedies under consideration include the divestment of network activities. Any such remedy is likely to take effect ahead of legislative unbundling. Ordering unbundling as a remedy in individual competition cases would be a development for which there is little precedent. This raises the question whether the Commission has demanded concessions which it would not have done in the absence of wider concerns about the energy sector, or whether its work on the sector inquiry has simply provided it with a deeper understanding of the issues. There are also questions about the power of the Commission to order such divestment remedies. This article examines the background and the issues.

1. INTRODUCTION

The European Commission's inquiry into the energy sector between 2005 and 2007[1] uncovered issues that led it to launch investigations into the conduct of a number of individual companies in the sector. If these investigations confirm its suspicions, the Commission has, in addition to the power to impose fines, the power to impose wide-ranging behavioural or even structural remedies (or to accept commitments).

The sector inquiry also revealed a number of features of the sector that the Commission views as restricting competition, and that it hopes to remedy by legislative means. In particular, it proposes to secure the full separation of transmission grid activities from other energy activities, known as unbundling.

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[1] Final Report on the Energy Sector, SEC(2006)1724, 10 January 2007.

However, the legislative route is controversial, and will take some years to achieve – if it is not blocked altogether by those Member States that oppose it. It is therefore possible that the Commission will seek to secure the same outcome in a manner that will not be subject to the same degree of political pressure, by ordering unbundling as a remedy in certain of the individual cases currently under investigation.

This paper will examine the extent of the Commission's powers to impose such orders in individual energy cases (which it has never exercised before), conclusions that can be drawn from the way in which these powers have been exercised in similar cases in other sectors or under other legal frameworks in the past, and on the arguments against the exercise of these powers..

2. VERTICAL FORECLOSURE IN ENERGY MARKETS

The Commission's final report summarised the principal findings of the sector inquiry as follows:

a. high concentration levels exist in most geographic markets and at all levels in the value chain;
b. there is a high degree of market foreclosure, with incumbent undertakings having a high degree of control over infrastructure and the ability to reserve energy capacity;
c. there is an absence of market transparency;
d. doubts exist about the degree to which wholesale prices are set competitively;
e. balancing occurs in respect of small geographic markets with balancing charges being non-transparent;
f. long-term contracts with customers contribute to market foreclosure; and
g. liquefied natural gas is an important potential source of competitive energy supply, with prices converging with those of pipeline gas.

In the Spring 2007 edition of the Competition Policy Newsletter, Philip Lowe, Director-General of DG Competition, identified vertical foreclosure as one of the most important of these issues.[2] He stressed that this was not a new phenomenon and that the problem had been identified as early as the late 1990s following the adoption of the first electricity and gas Directives[3] which had enabled large energy users to choose their suppliers. However, it had become apparent that competition in supply could be curtailed by owners of the transmission networks. Regulated third party access had been introduced with a second package of Directives in 2003.[4] These Directives had also imposed an obligation on Member States to create national regulators and introduced the ability to adopt legally binding guidelines.[5]

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[2] Available at http://ec.europa.eu/comm/competition/publications/cpn/cpn2007_1.pdf.

[3] Directive 96/92/EC, OJ 1997, L27/20, concerning common rules for the internal market in electricity and Directive 98/30/EC, OJ 1998, L204/1, relating to common rules for the internal market in natural gas.

[4] Directives 2003/54/EC, OJ 2003, L176/37, and 2003/55/EC, OJ 2003, L176/57.

[5] Articles 23 of the Electricity and 25 of the Gas Directives, op cit, n 3.

Article 10 of the Electricity Directive and Article 9 of the Gas Directive (respectively Directives 2003/54/EC and 2003/55/EC)[6] provide that where the transmission system operator is part of a vertically integrated undertaking, it is to be independent in legal form and organisation and is to take its decisions independently from those relating to non-transport matters. Articles 15 of the Electricity Directive and 13 of the Gas Directives apply similar principles to distribution operations in vertically integrated undertakings.

Vertical integration occurs where the upstream and downstream operations are performed within the same company or by separate companies, one of which is controlled by the other. For these purposes, control is defined by reference to the EC Merger Regulation and the relevant Commission guidance.[7] In either case the Directives require a separate company to be set up to perform the distribution or transmission functions independently of its former parent company. The independent transmission or distribution network company need not own the network assets over which it exercises its independent decision-taking.

3. IMPETUS FOR FULL UNBUNDLING

However, the energy sector inquiry concluded that existing unbundling under the second package directives did not go far enough in remedying the problem of vertical foreclosure that had been identified. Mr. Lowe wrote that[8]:

> Whilst the Directives have already sought to address these issues by introducing a minimum level of unbundling, the Sector Inquiry has demonstrated that the current unbundling regime is inadequate.

A few months before that, in her speech 'A new energy policy for a new era' at Lisbon on 30 October 2006,[9] Competition Commissioner Neelie Kroes had remarked:

> Our sector inquiry has shown that the current level of unbundling is insufficient. Stakeholders tell us that network companies still favour their own supply or generation businesses.
>
> ... I see only one way forward if we are to restore credibility and faith in the market. Europe has had enough of "Chinese walls" and quasi-independence. There has to be a structural solution that once and for all separates infrastructure from supply and generation. In other words: ownership unbundling. Then we will finally see an

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6 Ibid.

7 Regulation 139/2004, OJ 2004, L24/1; Consolidated Jurisdictional Notice: http://ec.europa.eu/comm/competition/mergers/legislation/jn_en.pdf

8 Op cit, n 2.

9 Available at : http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/06/648&format=HTML&aged=0&language=EN&guiLanguage=en .

> end to discrimination, and we will also have laid the ground for a system of proper investment incentives.

And in a speech at Essen on 5 February 2007[10] Neelie Kroes had added:

> the fundamental problem with the current system of legal unbundling – where companies control energy networks as well as production or sales – is that it creates a conflict of interest inside a company
>
> ... fully unbundled operators see clearer incentives for investment in interconnectivity, and act on those incentive, because they are focused on optimising the use of the networks.

Her view was that reliance on independent system operators (whereby vertically integrated companies own the network assets but are not responsible for their operation or development) involves complex regulation and a heavy administrative burden. In contrast, full ownership unbundling would remove the root cause of the current problems of under-investment and discrimination and was 'the most simple and effective way forward'.

The Commission believes that even where a group involved in supply holds only a minority stake in a transmission business, its exercise of powers at board level, or its commercial influence as the major supplier or customer of the network operator, can still influence the conduct of that business, to the detriment of competition. For example, in its *Gaz de France/Suez* decision,[11] the Commission found (at paragraphs 631 to 633 of its decision) that the 27.45% shareholding held indirectly by Suez in the Belgian electricity transmission operator Elia conferred legal control and that the shareholdings which Electrabel held in mixed public- and private-sector utilities in Wallonia (which legally could not exceed 30%) conferred de facto control 'or at the very least... a position to bring considerable pressure to bear on them'.

In his Competition Policy Newsletter article[12] Philip Lowe defines ownership unbundling as the 'separation of the previously common ownership structure between network and supply activities', and he too describes this as the most effective solution for the foreclosure problems caused by vertical integration, with remedies of a behavioural nature being inadequate to address the concerns identified by the Commission. He notes that there are a number of possible legal obstacles to unbundling as a remedy, namely the legal requirements of proportionality, the neutrality in relation to national property rights required by Article 295 EC Treaty, and the need to address the principle of subsidiarity and to respect the rules on protection of property contained in the European Convention on Human Rights. However, in the

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10 Available at: http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/07/63&format=HTML&aged=0&language=EN&guiLanguage=en .

11 Case COMP/M.4180 *Gaz de France/Suez*, decision of 14 December 2006.

12 Op cit, n 2.

opinion of the Commission, none of these concerns would prevent the introduction of a full unbundling remedy.

The Commission therefore advocates full unbundling, rather than operational independence, with independent companies owning and operating the network infrastructure. The third package of Directives proposed by the Commission would involve the amendment of the existing gas and electricity Directives[13] in order to confer on integrated energy companies a choice between full ownership unbundling and the independent system operator (ISO) model, in which an integrated energy company would retain ownership of the network assets, and would appoint an independent system operator. The ISO would be independent of supply and generation interests. The system owner would have very little control over the use of or investment in the network. The ISO model appears sufficiently unattractive that many commentators suggest that it was included merely in order to make full ownership unbundling appear more attractive.

One feature of the proposed draft package which has disappeared in the published version is that of an independent monitoring trustee. This may be as a result of the Court of First Instance's rejection of such arrangements in it relation to Microsoft in its recent judgment.[14]

The Commission also envisages the establishment of an 'Agency for the Cooperation of Energy Regulators'. The Agency could (as could the Commission on its own initiative) open a certification procedure to verify compliance by the network operators with the new unbundling or independent operation requirements.

The Directive would enter into force within 18 months of the publication of the Directive in the Official Journal of the EU. Unbundling would be required within a year of entry into force. Given the likely timescale for the adoption of the Directive, it is therefore highly unlikely that its provisions would take effect before 2010.

4. INDIVIDUAL INVESTIGATIONS

The issues identified as a result of the sector inquiry confirmed concerns that the Commission had held for some time. One investigation which pre-dated the sector inquiry[15] related to Distrigaz (prior to liberalisation the only wholesale gas supplier on the Belgian market).[16] The Commission accepted commitments from Distrigaz to reduce the volumes of gas tied up in long-term contracts with customers. Distrigaz will enter into no new contract with gas resellers lasting longer than two years. New contracts with other large gas customers, such as industrial consumers and electricity

13 Op cit, n 3.

14 Case T-201/04 *Microsoft v Commission*, judgment of 17 September 2007.

15 Op cit, n 1.

16 COMP/B-1/37.966. See http://ec.europa.eu/comm/competition/antitrust/cases/decisions/37966/nccd.pdf.

generators (other than new gas fired power plant owners), will be limited to five years, with 70% of the total gas volume contracted to these customers being open to competition each year. This wide-ranging decision is designed to open up the Belgian gas market, previously considered to be foreclosed. It can be seen as a strong signal by the Commission to energy companies as to the permissible foreclosure levels (in terms of duration and volumes) which long term contracts may impose.

Relying on intelligence developed during the course of the sector inquiry,[17] the Commission identified for further investigation a number of specific instances of the systemic problems that it had encountered. Following Commission inspections of ENI's premises and those of its subsidiaries in Italy, Austria and Germany and those of RWE in 2006, in May 2007 the Commission sent statements of objections to ENI[18] and RWE,[19] accusing both groups of infringements of Article 82. The Commission accused ENI of capacity hoarding and strategic underinvestment in network infrastructure that resulted in the foreclosure of gas supply markets in Italy. The proceedings against RWE focus on the creation of obstacles by RWE to third party access on the regional gas market in RWE's core area in North Rhine-Westphalia.

At the end of July 2007, the Commission announced the issue of a further set of statements of objections,[20] alleging that Electrabel, the incumbent electricity company in Belgium and part of the French Suez group, and EDF, the incumbent electricity supplier in France, had infringed Article 82 by introducing long-term exclusive purchase obligations in their supply contracts with industrial customers that made it difficult for new entrant electricity suppliers to acquire those customers as clients in Belgium and France. It will be recalled that the foreclosing effect of long-term contracts was one of the key obstacles to the development of a competitive market that the Commission identified in the sector inquiry.

In addition to these investigations into alleged vertical foreclosure of energy markets, the Commission is investigating a number of other types of alleged infringement. For example, in July 2007, it issued a statement of objections[21] alleging that E.ON and Gaz de France had infringed Article 81 by entering into an agreement and/or concerted practice whereby they agreed not to sell gas in each other's home market. The Commission believes that this agreement and/or concerted practice concern, in particular, supplies of natural gas transported over the MEGAL pipeline, which is jointly owned by E.ON and Gaz de France and transports gas across Southern Germany between the German-Czech and German-Austrian borders on the one side

[17] Op cit, n 1.

[18] COMP/39.315, Commission Press Release MEMO/07/187, 11 May 2007.

[19] COMP/39.402, Commission Press Release MEMO/07/186, 11 May 2007.

[20] COMP/39.386 and COMP/39.387, Commission Press Release MEMO/07/313, 26 July 2007.

[21] COMP/39.401, Commission Press Release MEMO/07/316, 30 July 2007.

and the French-German border on the other side. Unlike the other investigations mentioned above, this statement of objections alleged infringement of Article 81

On the publication of the Commission's final report, Commissioner Neelie Kroes indicated that the Commission would consider imposing structural remedies in addition to possible fines:

> … if companies are found to have violated the anti-trust rules, the Commission cannot only impose fines of up to 10% of the global annual turnover, but also impose – under certain conditions - *far-reaching structural remedies*' (emphasis added).

Other Commission officials have also highlighted the possibility of structural remedies being imposed in the event that the Commission concludes that infringements of Article 82 have occurred. The ultimate structural remedy is unbundling of network infrastructure activities from generation and supply activities – the same remedy that is proposed as part of the Commission's third legislative package.

In the light of the likely timetable for unbundling to become a reality as part of the Commission's third package – even if it overcomes the significant political obstacles being thrown up by a number of Member States – the Commission will be tempted to consider ordering unbundling as a remedy in individual cases.

The remainder of this paper will therefore consider the legal issues raised by the Commission's possible use of divestment or other deep structural remedies under Article 82. We conclude that the Commission does have the power to order full unbundling as a remedy in specific cases, provided that it has first conducted a thorough economic analysis and that the remedy is proportionate to the alleged infringement. We conclude that the Commission is likely to be able to defeat any legal challenge based on arguments that it has infringed the European Convention on Human Rights, Article 295 or the principle of subsidiarity, again provided that it can demonstrate that the unbundling remedy is proportionate and necessary to achieve EC competition policy goals.

5. Precedents for Structural Remedies

Although, as we have noted above, the Commission has not previously ordered unbundling in energy cases under Article 82, there is some precedent for structural remedies, in behavioural cases in other sectors, and in merger cases in the energy sector. In the following section, we examine how these remedies have been applied.

5.1 The power to order unbundling in non-merger cases

Articles 7 and 9 of Regulation 1/2003[22] confer power on the EC Commission to take a decision or, in order to avoid the lengthy procedures that can accompany a decision, accept commitments from any undertaking accused of infringing Articles 81 and 82 EC

[22] OJ 2003, L1/1.

Treaty. Article 7(1) of the Regulation empowers the Commission to impose on the relevant undertakings:

> any behavioural or structural remedies which are proportionate to the infringement committed and necessary to bring the infringement effectively to an end. Structural remedies can only be imposed either where there is no equally effective behavioural remedy or where any equally effective behavioural remedy would be more burdensome for the undertaking concerned than the structural remedy

5.2 Examples of past access remedies under Article 82

On a number of occasions, the Commission (with the approval of the European Court) has mandated interference with the proprietary rights of dominant undertakings, by requiring the grant of access or a licence, in order to remedy infringements of Article 82.

Some of the highest profile cases have resulted from refusals to license intellectual property rights. The remedies in these cases have come close, at least in terms of the intrusiveness of the remedy ordered, to the divestment that is contemplated in the ongoing energy cases. The key cases are those of *Volvo AB v. Erik Veng,*[23] *RTE & ITP v. Commission,*[24] *Tiercé Ladbroke SA v. Commission,*[25] and *IMS Health GmbH & Co OHG v. NDC Health GmbH & Co KG.*[26]

Most recently, in *Microsoft*,[27] the CFI confirmed the Commission's Decision that Microsoft should license interface information to competitors. The CFI judgment marked the end of a long-running battle between the Commission and Microsoft, in which the Commission was at one time reported to be considering ordering the separation of Microsoft's operating systems and applications businesses – a move that would have been comparable to the unbundling of network activities in the energy sector. Instead, the Commission settled for the less intrusive remedy of ordering Microsoft to license its Windows Server protocols to competitors on 'reasonable and non-discriminatory' terms.

However, it was not long after the publication of the Commission's energy sector inquiry report that Neelie Kroes, frustrated at what the Commission saw as Microsoft's continuing obstinacy over the issue of the royalties payable in the context of the licensing, told the American Bar Association[28] that '[i]t could be reasonable to draw the

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[23] Case 238/87 [1988] ECR 6211.

[24] Cases C-241 & 242/91 P, [1995] ECR I-743.

[25] Case T-504/93, [1997] ECR II-923.

[26] Case C-418/01, [2004] ECR I-5039.

[27] Case T-201/04, judgment of 17 September 2007.

[28] Transcript available from the European Commission and reported at http://www.pcpro.co.uk/news/111169/updated-eu-threatens-microsoft-with-new-antitrust-penalties.html.

conclusion that behavioral remedies are ineffective and that a structural remedy is warranted'. The Commission's experiences in *Microsoft* suggest that it may be less willing to give the energy undertakings the benefit of the doubt, and to be more resolute in its imposition of structural remedies.

Of more obvious relevance to the current energy cases are the cases relating to 'essential facilities', involving the granting of access to physical assets.

For example, in *Sealink/B&I Holyhead*[29] Sealink owned, controlled and itself used the port of Holyhead, which the Commission found to be an essential facility (defined by the Commission as 'a facility or infrastructure without access to which competitors cannot provide services to their customers'). It subjected B&I, a user of the port, to timetable changes and a degree of movement due to passing vessels which would oblige it to disconnect its ramp to the port more frequently, causing increased disruption,. The Commission found that a dominant company infringed Article 82 where it refused its competitors access to an essential facility, or granted access to competitors only on terms less favourable than those which it gave its own services. Similarly, in *Sea Containers v. Stena Sealink,*[30] Sea Containers intended to launch a new SeaCat fast ferry service at the port of Holyhead on the central Irish Sea corridor to Dun Laoghaire. Sea Containers was prepared to construct, at its own expense, temporary facilities at the port in order to launch the service and in order to overcome objections raised by Stena Sealink Ports. Stena stalled and instead gave rapid approval for its own fast service. The Commission concluded:

> (75) ... an independent harbour authority, which would of course have had an interest in increasing revenue at the port, would at least have considered whether the interests of existing and proposed users of the port could best be reconciled by a solution involving modest changes in the allocated slot times or in any plans for the development of the harbour

This case makes it clear that the dominant owner of an essential facility may be required to take decisions in the interests of competing users of the facility, and not merely to act in the interests of its own operating arm.

The parallels with energy transmission infrastructure are obvious. A key accusation against integrated energy companies is that they have placed the interest of their supply businesses above the interests of their transmission businesses.

Nowhere is this more apparent that in the *ENI* case referred to above, where the Commission argues that ENI failed to invest in additional capacity for which there was clear demand, a failure which was contrary to the interests of the transmission business.

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[29] [1992] 5 CMLR 255, at para 41.

[30] *Sea Containers Ltd/Stena Sealink,* OJ 1994, L15/8. At para 66 the Commission described the port owner, Stena Sealink Ports, as owning an 'essential facility'.

In *Port of Rødby*[31] the Danish Government had refused to allow Euro-Port A/S, a subsidiary of Stena, either to build a new terminal in the immediate vicinity of the port of Rødby or to have access to the existing terminal at the port with a view to operating a ferry service between Rødby and Puttgarden.

The Rødby-Puttgarden route was operated jointly by DSB, a public undertaking with the status of a department within the Danish Ministry of transport, and DB (Deutsche Bundesbahn), a German public undertaking. They jointly sold tickets, fixed timetables and rates, and granted identical discounts. There were no other companies providing ferry services on the sea route in question. Scheduled ferry services between Rødby and Puttgarden were an essential link between the ports on the east coast of Denmark and the west coast of Sweden with Germany and the rest of western Europe.

The Commission held that port operations at a single port could constitute a relevant market and a substantial part of the EU for the purposes of Article 82. DSB was dominant in port operations and DSB and DB jointly dominant in the provision of ferry services on the route. The refusal by the Danish Ministry of Transport to allow Stena to construct a new private port was an abuse of a dominant position and infringed Articles 82 and 86. The Commission ordered that the infringement be brought to an end, in essence requiring that Stena be allowed to construct a new private port at Rødby.

In *Frankfurt Airport*,[32] Flughafen Frankfurt/Main AG ("FAG") held a dominant position on the market for the provision of airport facilities for the landing and take-off of aircraft at Frankfurt airport. The Commission regarded the provision of ramp-handling services as being complementary or ancillary in that respect and found that it constituted a neighbouring but separate market. The Commission required FAG to end its ground handling monopoly and ordered it to grant access to third parties.

In *Disma*,[33] the Commission concluded that oil and gas pipelines are capable of being essential facilities. It applied Article 81 (there were a number of undertakings involved) and the essential facilities doctrine to the jet fuel storage facilities and pipes transferring jet fuel to supply points at Malpensa Airport in Milan.

So in all of these cases, the Commission found that refusal to give fair and non-discriminatory access to an essential facility constituted an abuse of a dominant position. In each case, the remedy amounted to grant of mandatory access to the facility – essentially depriving the owner of the facility of its right to do as it wished with its facility. Having said that, it will be noted that deprivation of ownership rights in all of these cases was only partial: the essential facility owner retained ownership of the asset in each case. It was only the owner's right to control access of the facility that was restored. Admittedly this right to control access is one of the key ownership rights.

[31] OJ 1994, L55/52.

[32] OJ 1998, L72/30.

[33] See the Commission's XXIIIrd Report on Competition Policy (1993) at pp 141-143.

Nevertheless, it is clear that divestment goes further still than requiring the grant of access.

5.3 Examples of divestment remedies under the ECMR

A rather more immediate model for unbundling in individual energy cases – and a demonstration of the Commission's policy in this area – can be seen in the Commission's acceptance of unbundling commitments in a number of recent energy merger cases. The Commission will undoubtedly use its experience in these cases when shaping any future behavioural divestment decisions.

It should be noted that divestment commitments under the EC Merger Regulation are essentially voluntary remedies given in order to secure clearance from the Commission. There is a qualitative difference between such voluntary commitments, which the merging parties can decide not to offer provided that they forego their merger proposals, and a mandatory divestment order in the context of a behaviour investigation. A closer parallel is seen in those rare jurisdictions (such as the UK) where obtaining prior merger clearance is not mandatory and where the competition authorities have in some cases ordered divestment, following completion of an acquisition.

5.3.1 E.ON/MOL

This case involved the acquisition by E.ON from MOL of sole control (75% less one share) in each of MOL WMT and MOL Storage, with options in favour of MOL to require E.ON to acquire MOL's remaining 25% (plus one share) stakes within 5 years.[34] E.ON is a German supplier of electricity and gas. In Hungary, E.ON was active on the gas and electricity retail markets through its control of several regional distribution companies. MOL was the incumbent gas supplier in Hungary. MOL WMT was active in the wholesale and trading of gas and supplied natural gas to regional gas distributors (RDCs), industrial customers and large power plants in Hungary. MOL Storage operated 5 natural gas storage facilities in Hungary.

MOL was also granted a put option under which it could require E.ON to purchase a minority (25% plus one share) or majority (75% less one share) interest in MOL Transmission. As part of the transaction, MOL retained its upstream gas exploration and production division (MOL E&P) and MOL E&P agreed a new long term gas supply contract with MOL and MOL WMT.

Prior to the transaction, MOL had 'an almost exclusive control over the Hungarian gas infrastructures and supply contracts'. It owned all the Hungarian gas storage facilities and had a quasi-monopoly on the gas wholesale markets. Since E.ON had equity stakes in three gas RDCs and was involved in gas trading, this would result in E.ON achieving vertical integration on the whole gas supply chain. This would strengthen the new entity's control over all Hungarian gas resources, both domestic and imported. The

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[34] Case COMP/M.3696.

Commission concluded that MOL WMT held a dominant position in the market for wholesale supply of gas in Hungary.

The Commission did not allege that the concentration would lead to the creation of a further dominant position downstream or to the enhancing of the existing upstream dominance. Instead, the Commission concluded that the vertical integration would lead to the new entity having the incentive and an enhanced ability to determine prices and other trading conditions on the downstream markets for:

(a) the supply of gas to industrial, commercial customers and residential customers. MOL WMT had a dominant position in the wholesale supply of gas in Hungary. Although MOL E&P was not a party to the concentration (and hence the domestic gas resources belonging to MOL E&P would not be controlled by E.ON), nevertheless the long-term supply agreement that it had entered into with MOL WMT would effectively deny third parties access to Hungarian domestic gas. Whilst the supply contract was not exclusive, it was for volumes which were largely equal to anticipated production. Gazprom would have no incentive to increase exports since it would displace or out price the supplies it was already committed to providing to MOL WMT

(b) the generation/wholesale supply of electricity and the supply of electricity to industrial, commercial customers and residential customers: E.ON had made significant investments in the electricity sector and was active in generation, wholesale and retail. It owned an electricity trading company, E.ON EK. Gas fired power plants were important in electricity generation in Hungary. MOL was a 'gatekeeper of gas resources in Hungary'.

Under both current market conditions and following liberalization of the Hungarian gas and electricity markets in 2007, without the undertakings offered by the parties, the concentration would have significantly impeded effective competition in the Community. The Commission concluded at paragraph 549 of its decision that:

> MOL Transmission is likely to have the ability and the incentive to discriminate against E.ON's competitors in granting access to the gas transmission network, owing to the structural link resulting from the 25%+1 minority shareholding of MOL into MOL WMT.

In order to address the Commission's concerns, the parties offered an extensive package of remedies. This included:

(a) the divestment by MOL of its remaining shareholdings in MOL WMT and MOL Storage. As a consequence, gas production and transmission would be unbundled from gas wholesale and storage. This eliminated the incentive for MOL Transmission to favour MOL WMT. In addition MOL agreed not to exercise its put option or sell its stake in MOL Transmission to E.ON in a way that would avoid triggering a merger notification under the EC Merger Regulation; and

(b) a gas release programme, entailing the release by E.ON of significant volumes of gas on the market on competitive conditions over an eight-year period and the divestment to an independent gas trader of half of E.ON's ten-year supply contract with MOL's retained gas production business. These measures would release an amount equivalent to 14% of Hungarian annual gas consumption. This offered market participants the possibility of concluding gas supply contracts on equal terms.

Unbundling of gas production and transmission activities was therefore an essential part of the remedial commitments accepted in this case, and it is notable that the Commission views the decision as something of an indicator of its likely approach in other similar cases in future.

5.3.2 DONG/Elsam/Energi E2

In this case, the Commission granted conditional clearance to the acquisition by DONG (the Danish state-held gas incumbent) of Elsam and Energi E2, two Danish regional electricity generation incumbents, and of Kobenhavns Energi Holding A/S and Frederiksberg Elnet A/S, two Danish electricity suppliers.[35] DONG is active in:

(a) the exploration, production, off-shore transportation and sale of oil and natural gas;

(b) the storage and distribution of natural gas; and

(c) to a lesser extent, in wind electricity generation as well as the supply of electricity and heat. ELSAM and Energi E2 are the incumbent electricity generators in east and west Denmark, respectively. Both produce and trade electricity (financial and physical) on the wholesale market as well as producing district heating.

The Commission's concerns focused on the lessening of competition along the gas supply chain in Denmark. Potential competition issues relating to the Danish electricity markets had been pre-emptively addressed by DONG's sale of various Elsam and Energi E2 power plants to Vattenfall, the Swedish electricity incumbent, and by virtue of the fact that the Danish electricity sector was quite fragmented.

The Commission focused on two issues;

(a) post merger, the essential absence of competition from Elsam or Energi E2 in the markets for gas 'flexibility' and wholesale retail gas supply; and

(b) with Elsam and Energi E2 being operators of gas power plants (the largest users in Denmark) the potential foreclosure of wholesale and retail gas supply due to the vertical integration of DONG.

The first noteworthy point of this case was the Commission's consideration of a possible market for 'gas flexibility', which included all mechanisms allowing gas operators to balance supply and demand in order to compensate gas price volatility, for example by the use of storage facilities or flexible supply contracts. The Commission considered that competition problems would arise whether the market was defined

[35] Case COMP/M.3868.

separately as that of flexibility or as a market for storage and the market definition was left open. DONG owned the only two gas storage facilities in Denmark. Elsam and Energi E2, as major gas customers benefiting from flexible long-term supply contracts, were found to be the most important independent sources of alternative flexibility. By eliminating the competitive constraints imposed upon DONG by Elsam and Energi E2, the transaction therefore increased customers' dependence on DONG's storage facilities and DONG's incentives to raise the storage costs of rival electricity producers and gas suppliers. Under the Danish Natural Gas Supply Act, DONG was obliged to give third parties access to its storage under the negotiated third party access scheme which required its access to be on the same terms as other users. However, the Commission found this regulatory regime to be relatively weak, with DONG not being obliged to decrease its revenues even when interest rates had fallen significantly. The Danish law allowed DONG to recover more than a fair return on its historic costs. Allowing DONG to use the integrated flexibilty resources of Elsam and Energi 2 would decrease its own storage needs and allow it to lay off more storage costs on to its competitors through increased tariffs, as they would be proportionately greater users of the storage facilities and there would be decreased economies of scale.

The second point of interest was the Commission's focus on the competitive constraints posed by electricity operators on gas suppliers, in particular heavy relyiance on gas power electricity plants. The Commission considered that the transaction removed Elsam and Energi E2, the two largest users of natural gas in Denmark, as the most credible potential entrants on the Danish gas wholesale market. Furthermore, since they had access to large quantities of natural gas at competitive prices, Elsam and Energi E2 would have had, according to the Commission, the ability and incentive to implement active gas procurement strategies for the sourcing of additional quantities in order to serve retail customers. As a result, the Commission considered that the transaction removed a major competitive constraint upon DONG in the markets for retail gas supply to large business customers, small businesses and households, respectively.

The third point of interest was that the Commission was concerned that the transaction would raise barriers to entry to the Danish gas wholesale and retail markets, by removing Elsam and Energi E2 from the customer base potentially available to new entrants. In contrast, it would enable DONG to secure large volumes of supplied to the country's two largest customers.

To ensure sufficient liquidity of the Danish gas wholesale market while maintaining sufficient incentives for third-parties to enter the markets for retail gas supply, DONG committed to implement a gas release program of 400 million cubic meters – the equivalent of 10% of Danish total demand for natural gas (2005) – for a total duration of 7 years. This gas release would encourage entry into the market as well as freeing up contractually locked-in customers.

To remedy the Commissions' flexibility concern, DONG agreed to divest the largest of its two gas storage facilities at Lille Torup in Jutland. The Commission regarded this divestment as sufficient to create a second, independent player in the Danish gas storage market.

Ownership unbundling of the storage facility in Lille Torup would compensate for the loss of independent flexibility provided by Elsam and Energi 2 and was made necessary by the weaknesses which the Commission had identified in the existing Danish regulatory regime. Respondents had:

> suggested that the ownership by an operatator not involved in downstream supply activities would lead to an improvement of the products offered as the new owner would have an increased incentive to be fully responsive to the market's needs.[36]

The Commission considered this a strong likelihood.

5.3.3 Gaz de France/Suez

Gaz de France is an energy group active at all levels in the energy chain and in a number of European member states.[37] In France it is active in exploration, production, storage, distribution and natural gas sales. In Belgium, Gaz de France had, with Centrica, joint control over SPE. SPE was active in the Belgian electricity and natural gas markets and provided energy services.

The Suez group is active in the utility sector, providing energy and utility services. Suez's main subsidiaries are Electrabel which provides electricity and gas, Distrigaz which supplies gas, Fluxys supplying gas storage and transport and Elyo (renamed Suez Energy Services), Fabricom, GTI, Axima and Tractebel Engineering, all of which were active in the energy service sector. Suez Energie Europe holds a 27.5% stake in Elia, which operates the Belgian electricity transmission network. The parties argued that Fluxys was not controlled by Suez, but the Commission rejected these arguments.

Gaz de France had agreed to take over Suez. The Commission was concerned about the impact of the merger on a number of French and Belgian markets.

Belgium imports all the natural gas it consumes either through gas pipelines or as LNG. It uses high calorific ("H gas") and low calorific gas ("L gas"). It is technically impossible to transport L gas on the H network and vice versa. There are 15 entry points for H gas and three for L gas.

The Belgian gas network is used for international transit as well as domestic transmission. Fluxys owns the domestic gas transmission network, sells transmission capacity and operates the network.

The natural gas transit entry points were at Zeebrugge, at Gravenoeren on the Dutch border and at Blaregnies on the French border. The natural gas pipelines used for transit were owned by Distrigaz, SEGEO (owned as to 75% by Distrigaz and 25% by Gas de France) and Fluxys. There was only one underground storage facility for gas in

[36] At para 723.

[37] Op cit, n 11.

Belgium (managed by Fluxys) and a buffer storage facility at Zeebrugge, owned by Fluxys. There was no storage facility for L gas in Belgium.

L gas was supplied exclusively from the Netherlands. Gaz de France and Suez were the only Belgian importers, with long-term import contracts with Dutch exporters for L gas. They had reserved all capacity at the two key entry points at the Dutch border. Gaz de France was the only competitor of Suez's subsidiary, Distrigaz, in the supply of L gas in Belgium. It also had high flexibility due to gas storage facilities in France. The L gas network was primarily located in Brussels and the provinces of Antwerp, Limburg, Flemish Brabant, Wallooon Brabant and Hainault. There are no L gas transport networks in the Belgian provinces of West Flanders, East Flanders and Luxembourg.

H gas was supplied from the UK, the Netherlands, Germany, France and the Zeebrugge LNG terminal. The principal H gas transit routes were those owned and operated by SEGEO and Distrigaz. The H gas network covered the whole of Belgium.

The local authorities in Belgium had exclusive power to distribute natural gas once it had left the transmission network. As part of the liberalization of the gas market, mixed public and private sector companies had been set up, and Electrabel had equity stakes in these companies. Even though, under both Belgian law and their corporate statutes, these mixed public-private-sector companies were to be controlled by the local authorities (whatever the size of the private sector entity's shareholding), the fact that Suez/Electrabel could appoint directors and the companies' reliance on Suez group technical expertise led the commission to conclude that, 'Suez is currently in a position to exert at least significant influence on, and possibly control over, the local authority mixed public-and private-sector companies'.

The Commission concluded that Gaz de France had the following competitive strengths in the Belgian market:

- the merged entity would have very high combined market shares in Belgium. Suez had 80% to 90% in most gas supply markets (supplies of gas to electricity producers, gas dealers, large industrial customers, small industrial customers and households). The merger would remove Gaz de France (with market shares of around 10-15%) as the main competitor to Suez. The parties' market shares in L gas were even higher due to their highly developed operations in the sector, with competitors' market shares being only around 0-5%;

- no competitor in Belgium could exert the same level of competitive pressure as Gaz de France;

- the Belgian gas markets were characterised by high barriers to entry. The merged entity would have access to most of the gas imported into Belgium and would enjoy vitually all the long-term import contracts. The importation of gas into Belgium depended on the availability of gas and was subject to the prices that importers were prepared to pay. The Commission doubted that there would be additional gas supplies available from other Member States above that committed to the existing import contracts, and considered that there was little liquidity in the Belgian gas market; and

- the merged entity would have privileged access to supply infrastructure and storage in Belgium and access to L gas storage capacity in France, providing greater flexibility and reserved capacity.

As regards the French market, France has five gas entry points, Taisnières (on the border with Belgium), Dunkirk (connected to the Norwegian gas pipeline), Obergailbach (on the German border), Montoir and Fos-sur-Mer (methane terminals on the west and south borders of France respectively). There are two exit points on the border with Spain and Switzerland.

There are two natural gas transmission system operators in France. The Gaz de France transmission system operates most of the gas network. Total operates the network in the south west of France. There are five balancing zones, four within the Gaz de France network and one within the Total network. H gas is carried in all five zones and L gas in the northern ones. Transmission costs between zones are very heterogeneous.

Gaz de France's national distribution system handled 96% of all gas consumption. Gaz de Bordeaux and Gaz de Strasbourg accounted for 1.5% of gas consumption, with 20 other distributors having less than 1%.

The Commission found that Gaz de France's dominant position in the gas markets in France would be enhanced by the merger, as Distrigaz was one of Gaz de France's best placed competitors. The merger would significantly hinder effective competition following liberalization of gas markets on 1 July 2007. Although not an incumbent operator in France, having only entered the French gas supply market in 2002, Suez was one of the main competitors to Gaz de France, 'having played an active role in the liberalisation of the gas markets in France via its subsidiary, Distrigaz'.[38] Suez had a number of advantages which allowed it to apply competitive pressure on Gaz de France, namely its dominant position as incumbent operator in Belgium (through which part of France's H gas and all of its L gas supplies were routed via Taisnières) and range of large and diversified gas resources. The merger would also significantly impede effective competition in the supply of gas to electricity producers in the north (H and L gas) and East zones by eliminating a potential competitor.

There were high barriers to entry to gas markets and infrastructure in France, which further strengthened Gaz de France's dominant position.

As regards electricity, the Commission concluded that in the Belgian wholesale electricity market, the parties would have a combined market share of around 80-90% of electricity generated in Belgium and between 0-5% of Belgian electricity imports. In 2005 Suez (Electrabel) had 70-80% of Belgian generation capacity and Gaz de France (SPE) controlled 5-10%. Barriers to access to generation and the construction of

[38] At para 478.

generation were high. Suez was dominant and Gaz de France its best placed competitor in the Belgian wholesale electricity market. The merger would eliminate Gaz de France as Suez's only effective competitor in the Belgian market for ancillary srvices and balancing power leaving Suez with a dominant position, which would be strengthened by the merger. Similarly Gaz de France was the best placed competitor in the markets for electricity supply to large industrial and commercial customers and the merger would strengthen the dominant position of Suez in supplying electricity to eligible households.

The Commission expressed concern about the parties' access to confidential information on competitors, a factor which, according to the Commission, emphasised the need for clear ownership separation.[39] It also expressed concern about the competitive strength engendered by the merged entity's ability to make dual gas and electricity offers.[40]

The electricity supply market was also characterised by high barriers to entry, and electricity trading was illiquid

Finally, the Commission found that there would be further concentration in the district heating market in France by virtue of the combination of Suez, the largest operator in this market, with Gaz de France, the second largest operator.

The parties offered remedies, which the Commission market-tested. Those third parties who were consulted expressed serious doubts, as a result of which the parties offered wider final remedies, comprising:

- the full divestiture of Distrigaz;
- the full divestiture of Gaz de France's holding in SPE;
- the restructuring and relinquishing of all control over Fluxys, in particular ensuring that the parties would not hold more than 45% of its capital, that they would not have the right to appoint more than 7 of the 21 directors, would not nominate the seven independent directors, would ensure that no Fluxys director would exercise gas supply responsibilities, would set up an executive committee within Fluxys with exclusive powers of management (including commercial strategy) in respect of regulated infrastructures and the overall investment plan for regulated infrastructure in Belgium and would not control the executive committee;
- undertakings by the parties to invest in an increase in the Belgian and gas infrastructure capacity; and
- the disposal of Gaz de France's subsidiary operating in the French district heating market.

[39] At para 855 et seq.

[40] At para 861.

In its assessment of the commitments, the Commission remarked that the divestiture of Distrigaz would remedy the loss of competitive pressure in the French and Belgian gas markets and foreclosure problems in the Belgian electricity market which would otherwise have arisen as a consequence of the merger. The divestment of SPE would eliminate horizontal overlaps in the Belgian gas and electricity markets and restore effective competition in those markets. The commitments on investments and the restructuring of Fluxys would ensure that necessary investments would occur. Third parties would be able to invest in Fluxys and the parties would not be able to block its investment decisions. Thus although the remedies were structural (in the sense of requiring divestment), they were also behavioural, as the Commission anticipated that they would influence the behaviour of the parties and, for instance, would enhance access to and the emergence of new players on the affected markets. The restructuring requirements in relation to Fluxys (as with those in relation to the *E.ON/MOL* decision) were more extensive than those contained in the legal unbundling requirements under the second liberalization pakcage, foreshadowing the full unbundling required by the proposed third package.

5.3.4 EDF/ENBW

EDF, the former French monopolist and one of its leading electricity generators, agreed to acquire EnBW, a member of the group of the four largest German electricity generators (formed through the VEBA/VIAG merger).[41] EnBW, with its historic supply area adjacent to the French-German border, was well-placed as a potential entrant to the French market. Through a Swiss generation subsidiary, WATT, it had even participated in tenders launched by French eligible customers. The Commission concluded that the merger would shield the merged company from competition in France, as it would be able to use its presence in Germany to deter rivals from pursuing aggressive competition in the French market. It also found that:

(a) the entity would control a large proportion, if not all, of Swiss generation and the supply of peak load, through WATT,

(b) EDF would gain entry into the German market, further strengthening its already outstanding position as a pan-European supplier of large business customers with production sites all over Europe; and

(c) eliminate EGL, a German downstream electricity provider, as a potential competitor.

The Commission approved the transaction after accepting commitments by EDF-EnBW, namely:

(i) the divestment of WATT, the Swiss generation subsidiary, in an effort to avoid any improvement of EDF's access to Swiss peak supplies; and

[41] Case COMP/M.1853.

(ii) the innovative commitment to make available to its competitors, via auction, access to generation capacity located in France which amounted to between 30 and 32% of the volume of the national market for eligible customers. It was the Commission's intention that access to virtual power plants in France would facilitate foreign suppliers to become active in the market, especially German suppliers who would be able to cope with EDF's anticipated increased retaliatory behaviour in the French and German markets post-acquisition.

5.3.5 Neste / IVO

Imartan Voima Oy (IVO), Finland's largest company in the energy sector, active in power and heat generation, power trading, electricity distribution and supply, operation and maintenance of electricity-generating plants as well as a host of other smaller interests, proposed to merge with Neste, active in oil, energy (natural gas through its control via majority shareholding of Gasum) as well as the chemical sectors.[42] The Commission considered that the merger would strengthen IVO-Neste's position in the market for the wholesale sale of electricity in Finland, due to Neste's position in the upstream market resulting from its control of Gasum. IVO-Neste would inherit the de facto monopoly in natural gas enjoyed by Gasum. Given the importance of natural gas for electricity production in Finland, the parties' complete vertical integration and the strong position they enjoyed in natural gas and electricity markets, the merged entity would exert significant influence over electricty and gas prices in Finland.

The parties offered to relinquish complete control of Gasum. IVO-Neste would, reduce its shareholding in Gasum to a non-controlling 25% stake. It would sell its 50% shareholding to the Finnish State (as to 24%) and to Finnish and other EU entities independent of IVO-Neste (as to 26%). Gazprom would retain a 25% stake.

5.4 Conclusion on the energy divestment commitments

It is clear from the cases outlined above that the Commission is ready to extract commitments that amount to divestment or ownership unbundling wherever it believes that they will remove specific competition concerns in individual merger cases. In particular, *GDF/Suez*[43] and *DONG/Elsam/Energi E2*[44] demonstrate that the Commission is particularly alive to the foreclosure issues raised by common ownership of supply and network infrastructure activities.

6. Workability And Effectiveness Of Structural Remedies

One issue not raised by Philip Lowe in his article in the Competition Policy Newsletter was the question of whether unbundling remedies would be workable and effective.[45]

[42] Case COMP/M.931.

[43] Op cit, n 11.

[44] Op cit, n 35.

[45] Op cit, n 2.

While we are awaiting the Commission's Article 82 Guidelines, some guidance can be had from the Commission's Notice on Merger Remedies,[46] paragraphs 7, 9 and 10 of which stress that any remedies offered in a merger clearance must be capable of eliminating the competition concerns which have been identified, and must be workable. It is easy to see that in the case of some unbundling remedies there may be difficulty in overcoming competition concerns with sufficient precision and without increasing the cost to the consumer. Will there be adequate bids for the networks from parties who will be both effective as operators and as investors? In the context of structural remedies in respect of mergers, some commentators have questioned whether, in seeking to achieve greater competition in a given market, competition authorities have tended to 'over-fix' the problems associated with a proposed merger with resultant loss of efficiency gains.[47]

The Commission has shown a marked preference for structural remedies in its merger decisions and guidance notices.[48] However, Recital (30) of the Merger Regulation[49] provides that 'commitments should be proportionate to the competition problem and entirely eliminate it'. The Court of First Instance has reviewed the issue of whether the Commission is right to be predisposed towards structural rather than behavioural remedies. In the case of *Gencor v Commission*[50], for instance, it concluded that under the then applicable Merger Regulation:[51]

> 318. ... the Commission has power to accept only such commitments as are capable of rendering the notified transaction compatible with the common market ...
>
> 319. The categorisation of a proposed commitment as behavioural or structural is therefore immaterial. It is true that commitments which are structural in nature, such as a commitment to reduce the market share of the entity arising from a concentration by the sale of a subsidiary, are, as a rule, preferable from the point of view of the Regulation's objective, inasmuch as they prevent once and for all, or at least for some time, the emergence or strengthening of the dominant position previously identified by the Commission and do not, moreover, require medium or long-term monitoring measures. Nevertheless, the possibility cannot automatically be ruled out that commitments which prima facie are behavioural, for instance...to

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46 The Commission's Notice on remedies acceptable under Council Regulation (EEC) No 139/2004 and under Commission Regulation (EC) No 802/2004 - available at: http://ec.europa.eu/comm/competition/mergers/legislation/draft_remedies_notice.pdf

47 Penelope Papandropoulos and Alessandro Tjana, 'The Merger Remedies Study - In Divestiture We Trust' [2006] ECLR 443; H.Vasconcelos, 'Efficiency Gains and Structural Remedies in Merger Control', 17th March 2005 No 6093, CEPR Discussion Papers.

48 Op cit, n 46, paragraph 18 of which provides that, 'commitments which are structural in nature, such as the commitment to sell a business unit, are, as a rule, preferable'.

49 Regulation 139/2004, OJ 2004, L24/1.

50 Case T-102/96 [1999] ECR II-879.

51 Regulation 4064/89/EC, OJ 1989, L395, as amended by Regulation 1310/97/EC, OJ 1997, L180.

> make part of the production capacity of the entity arising from the concentration available to third-party competitors, or, more generally, to grant access to essential facilities on non-discriminatory terms, may themselves also be capable of preventing the emergence or strengthening of a dominant position.
>
> 320. It is thus necessary to examine on a case-by-case basis the commitments offered by the undertakings concerned.

This judgment is also relevant to the issue of whether a structural or behavioural remedy would be proportionate in the context of Article 82. In their review of DG Competition's 'Merger Remedy Study'[52] Papandropoulos and Tajana[53] conclude, 'that divestiture remedies have been effective in 56% of the cases, partially effective in 25%'', mainly due to the particular problems associated with transferring businesses which will remain viable, competitive and which do not further distort the market, for instance by increasing market symmetry.

7. LIMITS ON THE POWER TO ORDER STRUCTURAL REMEDIES

As Philip Lowe acknowledged in his article in the Competition Policy Newsletter,[54] there are a number of limits on the power to order unbundling whether on a sector-wide or individual basis. They include:

- proportionality;
- subsidiarity;
- human rights; and
- Article 295

These are addressed in turn.

7.2 Proportionality

It is inherent within Article 7 of the Regulation that Commission enforcement decisions should impose remedies which are proportionate. In *Alrosa v Commission,*[55] the Court of First Instance made it clear that Commission decisions to accept commitments under Article 9 are also subject to the general principle of proportionality, and provided some useful guidance which is relevant not only to commitment decisions but also to 'hard' decisions under Article 7. Although Article 9 of Regulation 1/2003[56] is silent on whether commitments need to be proportionate, the CFI held that it is a fundamental principle of EU law that the Commission should act

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[52] Available at: http://ec.europa.eu/comm/competition/mergers/others/remedies_study.pdf.

[53] Op cit, n 47.

[54] Op cit, n 2.

[55] Case T-170/06, judgment of 11 July 2007, not yet reported in ECR.

[56] Op cit, n 22.

in a proportionate manner, taking only such steps as are necessary to achieve its objectives. The CFI held that where there is, 'a choice between several appropriate measures, recourse must be had to the least onerous and the disadvantages caused must not be disproportionate to the aims pursued'. In the *Alrosa* case the EC Commission's decision to accept a commitment from De Beers to reduce and then wholly end its purchase of rough diamonds from Alrosa in order to avoid an infringement of Article 82 was manifestly erroneous. The Commission had not assessed what proportion of Alrosa's production needed to be available to third parties in order to ensure that the foreclosure difficulties posed by the original exclusive arrangements between the parties were eliminated. The CFI concluded that the aim pursued by the Commission was to bring an end to practices which prevented Alrosa from establishing itself as an effective competitor and providing third parties with an alternative source of supply in the EU. The commitments offered were disproportionate to this aim. It was clear that other less onerous solutions were possible and would have sufficed.

In *Alrosa* the Commission opted for a rather extreme form of commitment in deciding to accept De Beers' offer to cease purchasing rough diamonds from Alrosa entirely. The Commission decisions to accept merger commitments reviewed above appear more surgical in their approach and seem more likely to survive a challenge on proportionality grounds. Nevertheless, the Commission will need to ensure that any structural remedies imposed in any of its current energy investigations go no further than is required in order to address the competition concerns that it has identified.

7.2 Subsidiarity

The second paragraph of Article 1 of the Treaty of the European Union provides that the European Union is created on the basis that 'decisions are taken ... as closely as possible to the citizen'. The test, according to the second paragraph of Article 5 of the EC Treaty, is whether in areas where the EU does not enjoy exclusive competence, 'the objectives of the proposed action cannot be sufficiently achieved by the Member States and can therefore, by reason of the scale or effects of the proposed action, be better achieved by the Community'. The European Court of Justice has tended to review the question of whether the EU institutions have considered the matter of subsidiarity and whether it is really necessary for them to enact measures at the EU rather than the national level. It has to some degree avoided 'second-guessing' the decision itself. If the judgment of the ECJ in *R v. Secretary of State, ex parte BAT and Imperial Tobacco*[57] is followed then the Commission will have little to fear. On the issue of whether the Tobacco Control directive had infringed the principle of subsidiarity the ECJ held that it had not. It was not possible for Member States to control tobacco advertising as effectively nationally as the EU could at the EU level. The Court defined the principle of subsidiarity as follows and appears to regard the issue as also involving the principle of proportionality:

[57] Case C-491/01 [2002] ECR I-11453

> 177. The principle of subsidiarity is set out in the second paragraph of Article 5 EC, according to which, in areas which do not fall within its exclusive competence, the Community is to take action only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States and can therefore, by reason of the scale or effects of the proposed action, be better achieved at Community level.
>
> …
>
> 184. Second, the intensity of the action undertaken by the Community in this instance was also in keeping with the requirements of the principle of subsidiarity in that ... it did not go beyond what was necessary to achieve the objective pursued.

The principle of subsidiarity is therefore equally unlikely to constrain the Commission's exercise of its powers under Regulation 1/2003. The Commission will undoubtedly argue that the failure of the existing second legislative package shows the need for action at Community level and that the Member States have accepted that Community action is necessary to create an internal market for energy. National courts have always tended to accept the need for action at Community level in such matters and in *Telefonica O2 Europe PLC and others v. Secretary for State for Business and Regulatory Reform*[58] Mitting J, whilst agreeing to refer the European Court of Justice questions relating to the legal basis and compatibility with the principle of proportionality of the Roaming Regulation[59] regarded the arguments of the mobile telephone operators regarding subsidiary as unarguable.

7.4 Human Rights

The European Convention on Human Rights, Protocol 1 Article 1, states:

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

Property expropriation frequently occurs at a national level (compulsory purchase orders) and limits are placed on the exercise of property rights (compulsory licences of patents).

[58] [2007] EWHC 3018, 7 December 2007.

[59] Regulation 717/2007, OJ 2007, L171/32, imposing a cap on wholesale and retail network operators' tariffs.

The issue was tested in *James and others v UK,*[60] an action brought by a major private landowner in London against laws that allowed tenants to buy their flats. The Court remarked that, in a democratic society, opinions about expropriation will vary greatly but that governments have a wide discretion to implement social and economic policies. The Court indicated that it 'will respect the legislature's judgment as to what is "in the public interest" unless that judgment be manifestly without reasonable foundation'.

Marius Emberland has observed that:

> the court's deferential stance is nearly tantamount to the inclusion of a "right to regulate" within the right to property protection under the Convention.[61]

The ECJ has said it recognises the issue of human rights on the basis of a general principle. So for example in *Orkem v Commission,*[62] the ECJ held that where the Commission's powers of investigation undermined the right of the company to defend itself this infringed the 'need to safeguard the rights of the defence which the court has held to be a fundamental principle of the Community legal order'.[63] This decision acknowledged the protection of human rights as a general rule of law rather than a right emanating from the European Convention on Human Rights ('ECHR'), Article 6(1) of which entitles anyone 'charged with a criminal offence' (within the autonomous meaning of that phrase in Article 6 ECHR) to remain silent and not to incriminate himself.[64]

In dealing with property rights (rather than criminal matters) the European Court of Justice has drawn a distinction between expropriation and limitations on use of property in line with the second paragraph of Protocol 1 Article 1 of the Convention, focusing on the issue of *impairment* of property rights. In *Hauer v Land Rheinland-Pfalz*[65] the Court considered an EC Regulation which limited new planting of vines for three years as part of a common organization of the EC wine market. Mrs Hauer, a grower, challenged the Regulation as interfering with her fundamental property rights. The European Court of Justice held that:

> 17. The right to property is guaranteed in the Community legal order in accordance with the ideas common to the constitutions of the member states, which are also reflected in the first protocol to the European Convention for the Protection of Human Rights.

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60 Series A No 98, (1986) 8 EHRR 123.

61 M Emberland, *The Human Rights of Companies: Exploring the Structure of ECHR Protection*, OUP, 2006, at p 192.

62 Case 374/87 [1989] ECR 3283.

63 See para 32 of the judgment.

64 See also (Case A/256-A) *Funke v France* [1993] 1 CMLR 897, 25 February 1993.

65 Case 44/79 [1979] ECR 3727

> 18. Article 1 of that protocol ... envisages two ways in which the rights of a property owner may be impaired ... In this case it is incontestable that the prohibition on new planting cannot be considered to be an act depriving the owner of his property, since he remains free to dispose of it or to put it to other uses which are not prohibited. On the other hand, there is no doubt that that prohibition restricts the use of the property. In this regard, the second paragraph of Article 1 of the protocol provides an important indication in so far as it recognizes the right of a state "to enforce such laws as it deems necessary to control the use of property in accordance with the general interest". Thus the protocol accepts in principle the legality of restrictions upon the use of property, whilst at the same time limiting those restrictions to the extent to which they are deemed "necessary" by a state for the protection of the "general interest".

The Court went on to note that the constitutional rules and practices of all the then nine Member States permitted the introduction of legislation to control the use of private property in accordance with the general interest. The right to property had a social function and was accordingly constrained thereby. The restrictions on the new planting of vines could not therefore be challenged in principle. The Regulation imposed, 'a type of restriction which is known and accepted as lawful, in identical or similar forms, in the constitutional structure of all the member states'.[66]

The Court observed that it was still necessary to examine whether the restrictions introduced by the Regulation corresponded to objectives of general interest pursued by the Community or whether, having regard to the aim pursued, they constituted a disproportionate interference with the rights of the owner, 'impinging upon the very substance of the right to property'.[67] The claimant considered that the Regulation should have taken a more targeted approach. She argued that only the pursuit of a qualitative policy would permit the legislature to restrict the use of wine-growing property based on its suitability for wine growing. The Court held that it was 'therefore necessary to identify the aim pursued by the disputed Regulation and to determine whether there exists a reasonable relationship between the measures provided for by the Regulation and the aim pursued by the Community in this case'.[68] The Court considered the Regulation and concluded that the measure was proportionate and not unduly restrictive.

7.4 Article 295 EC Treaty

Article 295 acknowledges that national property rights will be respected. This has been held to be subject to the principal objectives of EC law, both in the context of the tension between nationally conferred intellectual property rights and EC competition law and also where national; property rights or state conferred monopolies infringe

[66] See para 21 of the judgment.

[67] See para 23 of the judgment

[68] See para 23 of the judgment.

Article 82. However, both the essential facility principle and the *Magill* and *IMS Health* jurisprudence confer a narrow mandate on the Commission to interfere with national property rights in line with its powers under the EC Treaty and relevant Regulations enacted by the Council.[69]

In *Van den Bergh Foods v. Commission*[70] the Court of First Instance ordered that Unilever's subsidiary, Van den Bergh Foods, should make its freezers available to corner shops in Eire on a non-exclusive basis, holding that:

> 170. It is settled case-law that, although the right to property forms part of the general principles of Community law, it is not an absolute right but must be viewed in relation to its social function. Consequently, its exercise may be restricted, provided that those restrictions in fact correspond to objectives of general interest pursued by the Community and do not constitute a disproportionate and intolerable interference, impairing the very substance of the rights guaranteed ... Article 3[(1)(g)] of the EC Treaty ... provides that in order to achieve the aims of the Community, its activities are to include a system ensuring that competition in the internal market is not distorted. It follows that the application of Articles 8[1] and 8[2] of the Treaty constitutes one of the aspects of public interest in the Community ... Consequently, pursuant to those articles, restrictions may be applied on the exercise of the right to property, provided that they are not disproportionate and do not affect the substance of that right.

Advocate-General Cosmas in *Masterfoods*[71] *v HB Ice Cream* similarly was of the opinion:

> 105. ... There is no doubt that Articles 85 and 86 of the EC Treaty occupy an important position in the system of the Community legal order and serve the general interest which consists in ensuring undistorted competition. Consequently, it is perfectly comprehensible for restrictions to be placed on the right to property ownership pursuant to Articles 85 and 86 of the EC Treaty, to the degree to which they might be necessary to protect competition. Article [295] ... may in no event be used as a shield by economic operators to avoid application of Articles 8[1] and 8[2] to their detriment.

8. CONCLUSION

The above review of the energy merger cases in which divestiture was required, the general legal principles applicable to the Commission, the limits on its powers under Regulation 1/2003, Articles 5 and 295 EC Treaty and the ECHR demonstrate that, provided that the Commission fully investigates any infringement of Article 82 and applies a proportionate remedy, there is no reason why Article 82 remedies should not extend to an order equating to full unbundling. The Commission will need to act with

[69] Regulation 1215/99 [1999] OJ L148, p.1.

[70] Case T-65/98 [2003] ECR II-4653.

[71] Case C-344/98 [2003] ECR I-11369.

transparency and clarity, avoiding knee-jerk reactions to adverse comments from those parties which are canvassed on commitments. Finally, it will need to ensure that it does not create adverse welfare consequences from an over-zealous application of Article 82 and Regulation 1, a matter beyond the scope of this paper[72] but which nevertheless could leave consumers worse off.

72 As to which see, for instance, "The cost of inappropriate interventions/non-interventions under Article 82" an Economics Discussion Paper September 2006 prepared by Lear for the United Kingdom Office of Fair Trading.