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# DIRECT SALES OF GAS IN THE EUROPEAN COMMUNITY

*Alexander J. Black\**

## I. INTRODUCTION

Direct sales of natural gas in the European Community (EC or Community) are increasing in frequency, but existing barriers to free trade in the energy transmission sector continue to interfere with the Community public interest. Public interest demands both regulation and deregulation. An organized federal-like Internal Energy Market is needed to achieve allocative efficiency, ensure a secure supply of energy, provide consistent and coordinated licensing, rate-setting and dispute resolution procedures, and provide transparent commodity and transportation rates. However, the market should be deregulated to increase open competition, promote third-party access, and in the long run, ensure lower prices and increased benefits for core (residential or small commercial) energy users. Rapid restructuring will cause some short-term market dislocation, but should yield beneficial competitive dynamics in the long term.

## II. THE STRUCTURE AND PROBLEMS OF THE EUROPEAN ENERGY MARKET

### A. *European Community Integration*

Responsible regulation of energy is a timely issue within the European Community.<sup>1</sup> In a broad sense, European law is not static, but is incrementally evolving towards federalism. Closer Community integration will follow the implementation of the November 1991 *Maastricht Treaty*,<sup>2</sup> if the controversial initiatives are indeed affirmed by Member States.

Its terms were implemented into U.K. law via the European Communities (Amendment) Bill. These include: (1) common citizenship for all

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1. See generally Leigh Hancher, *A Single Market for Oil and Gas - The Legal Obstacles*, 8 J.E.R.L. 77 (1990).

2. Feb. 7, 1992, 31 I.L.M. 247 (1992).

nationals of the 12 Community countries, (2) a single European currency by January 1, 1999, at the latest, (3) new powers for the European Parliament to veto measures proposed by the unelected Commission, (4) common action on asylum, immigration, and the fight against drugs and terrorism, and (5) a separate "social chapter" targeting improvements to working conditions, including a dialogue between workers and management, and proper social protection of employees. However, British Prime Minister John Major secured three concessions: (a) the word "federal" was removed from the text, which contemplates a process of creating "an ever closer union among the peoples of Europe;" (b) Britain would be allowed to decide at a later stage whether to join the single currency and accordingly scrap the pound; and (c) the "social chapter" was deleted from the main treaty and became a separate document signed by all Community countries except Britain.

On June 2, 1992, Denmark narrowly rejected the proposals in a national referendum, leaving the outcome of the draft Treaty in doubt. Nevertheless, if eventually implemented, the legally binding text (as it presently stands) on subsidiarity provides that Community action would not go beyond what was necessary in order to achieve the Treaty's objectives. "Maastricht" means that Community members have "chosen to 'broaden' and embrace a wider, more open, and outward looking vision."<sup>3</sup> Interdependence between nation-states requires worldwide solutions to environmental problems. These solutions must share the common goal of sustainable development. In May, 1993, Britain became the last member to ratify the Treaty, yet this event was marred by the collapse of the European Monetary Fund. Stringent parameters had been set for all Members' currencies. However, currency speculation forced Britain to withdraw from the arrangement, which was to be a precursor to a single currency. When currency speculation threatened the withdrawal of France, and total collapse, the currency bands were widened so much that the dream of a single currency was dealt a severe blow, possibly setting this objective behind by ten years.

### *B. Community Goals: The Single European Act*

Notionally, the idea of a common market is relatively simple, yet the progressive establishment of a barrier-free system<sup>4</sup> is not straightforward. For instance, physical frontier barriers and controls pertaining to the free movement of goods and people are to be eliminated in their entirety by 1993.<sup>5</sup> Technical barriers which operate unfairly include different environ-

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3. C.A.J. Herkströter, *The New Europe*, The Shell Lecture (University of Glasgow May 15, 1992), *infra* note 74.

4. In a petroleum context, the "landing requirement" of UKCS petroleum in the U.K. and restrictions on the liquefaction of natural gas and pipeline construction were arguably indirect barriers to the export of gas from the U.K.: A.C. Page, *Competition and Monopoly in the United Kingdom Energy Supply - The Case of Gas*, 2 J.E.R.L. 30 (1984).

5. Completing the Internal Market: White Paper from the Commission to the European Council, COM(85) 310 final at 9-16. The Commission has subsequently described procurement as "an extremely

mental and product standards, as well as divergent public procurement requirements.<sup>6</sup> Public procurement concerns purchases and works. A new Directive opens competition to this big market and applies to the so-called excluded sectors of water, transport, energy, and telecommunications.<sup>7</sup> Fiscal and business barriers involve indirect taxation (value-added tax (VAT) and excise duties), free movement of capital and services, mutual recognition of professional qualifications, harmonization of merger law, accounting standards, and regulation of subsidies.<sup>8</sup>

Idealistically, the so-called "single internal market"<sup>9</sup> calls for a Europe without internal frontiers, within a system of a customs union. This system promotes four freedoms, namely those pertaining to goods,<sup>10</sup> persons,<sup>11</sup> services,<sup>12</sup> and capital.<sup>13</sup> A further fundamental principle of the Common Market is the development of a common agricultural policy among the Member States.<sup>14</sup> Although these four objectives are primarily economic, derogation (or exception) clauses apply to all four freedoms in order to protect the character, traditions, and heritage of the Member States. Furthermore, public ownership or participation in European energy utilities, which is relatively high, is protected by Article 222. Yet as market participants, their behavior is governed by Articles 85-93, which are the general rules on competition, even where it is induced by state-imposed regulation.<sup>15</sup>

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vast area which is little known and where intervention by public authorities . . . is rarely official." *The Internal Energy Market*, COM(88)238 final at 15, para. 42.

6. Completing the Internal Market, *supra* note 5, at 17-40.

7. Council Directive 90/531, 1990 O.J. (L 297) 1. See generally David Marks & Rosemary Bointon, *The European Community Public Procurement Rules and the Oil and Gas Industry: the Current Position*, 10 O.G.L.T.R. 344 (1990).

8. Completing the Internal Market, *supra* note 5, at 41-55.

9. Blanche Sas, 1992 Implications for the Petroleum Industry, W.G. Hart Legal Workshop 1989: *The Single European Market and the Development of European Law*. Institute of Advanced Legal Studies, London. See also C.D. Ehlermann, *The Internal Market Following the Single European Act*, 10 C.M.L.R. 361 (1987).

10. TREATY ESTABLISHING THE EUROPEAN ECONOMIC COMMUNITY [EEC TREATY] arts. 30, 31 (Elimination of barriers, charges and measures incompatible with the free movement of goods); EEC TREATY art. 36 (Exceptions to the free movement of goods). Impediments to the free movement of goods include restrictions by the United Kingdom on the importing of potatoes: *Commission v. United Kingdom*, 2 C.M.L.R. 427 (E.C.J. 1979); poultry, *Commission v. France*, 3 C.M.L.R. 497 (E.C.J. 1982); lamb, *Commission v. France*, 1 C.M.L.R. 418 (E.C.J. 1980).

11. EEC TREATY art. 48.

12. *Id.* arts. 59, 60.

13. *Id.* art. 67.

14. The common agricultural policy has been controversial. See FRANCIS G. SNYDER, *LAW OF THE COMMON AGRICULTURAL POLICY* (1985).

15. Leigh Hancher, *Towards a free Market for Energy? - A Legal Perspective*, ENERGY POL'Y, Apr. 1990, at 233, 240-42. *Case 41/83, Italy v. Commission*, 2 C.M.L.R. 468 (1985). Article 86 of the EEC Treaty prohibits abuse of a dominant position within the common market or in a substantial part of it providing that trade between member states is affected. Such abuse may consist of (1) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions; or in (2) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive advantage.

The so-called "Internal Energy Market"<sup>16</sup> policies are themselves part of a fundamental policy which, pursuant to the Single European Act 1986 [SEA],<sup>17</sup> aims to harmonize and integrate inter-Community trade. Indeed, the Single European Act may be seen as an evolution of the Treaty of Rome (EEC Treaty) which founded the European Economic Community, seeking an "ever closer union" between the peoples of the Member States.<sup>18</sup> That multilateral agreement came into force on July 1, 1987 and it attempts to "eliminate the barriers which divide Europe, and to strengthen the unity of their economies."<sup>19</sup> These physical, technical, and fiscal barriers to a free internal market were identified by the Commission in a comprehensive White Paper<sup>20</sup> issued by the EEC in June 1985. The Commission's so-called working document<sup>21</sup> on The Internal Energy Market of May 1988 was the first Community attempt to address energy issues, stemming from the single market. The working document drew up an inventory of obstacles to greater integration of the energy market and described the scope of the task ahead. "In the EC . . . intra-Community energy trade is not so well-developed, obstacles have been traditionally of a different order. Markets have been compartmentalized by the operation of national or at least regional - whether public or privately owned - monopolies."<sup>22</sup> The European energy market is extremely diverse, in terms of products as well as end-uses. For instance, coal is not subject to much intra-Community trade, while oil enjoys significant competition. However, there is concern about electricity and gas production, and about their sophisticated network infrastructure, which has mainly developed on a national basis. Both of these energies are capital-intensive, hence the allocation of capital resources should be made efficiently and take precedence as an important policy objective. If the electricity and gas markets become more efficient, integrated, and competitive, then they will produce a positive effect on the industries' structures. This should encourage new entrants, diversify fuels and technologies, increase freedom of fuel choice, and should reduce disparities between Member States.<sup>23</sup>

16. See generally 1990 PROGRESS REPORT on the Internal Energy Market, COM(90)124 final.

17. Single European Act Suppl. 2/86. Bulletin of the E.C. In accordance with the requirement of British law, the European Communities (Amendment) Act 1986 gives (ratifies) internal effect to the Treaty in the United Kingdom. See generally Gordon Slynn, *Introducing a European Legal Order*, Hamlyn Lectures (London 1992).

18. EEC TREATY, pmbi.

19. *Id.* art. 2. This provision sets out the broad integration objective: "The Community shall have as its task . . . the closer relations of the states belonging to it."

20. Completing the Internal Market, *supra* note 5. Its ambits may be concurrently promoted through secondary legislation under, *inter alia*, EEC TREATY arts. 100A, 213, and to a lesser extent, art. 90(3).

21. The Internal Energy Market, *supra* note 5. This so-called "working document" seeks "decompartmentalization of the national gas markets."

22. Leigh Hancher & Alastair Lucas, *International Supervision of State and Private Organization of Energy Trade*, ENERGY LAW '90: CHANGING ENERGY MARKETS - THE LEGAL CONSEQUENCES (1990) (Proceedings of the Advanced Seminar on Petroleum, Minerals & Energy Resources Law organized by the IBA's section on Energy & Natural Resources Law), *infra* note 49, at 196.

23. Proposal for a Council Directive Concerning Common Rules for the Internal Market in Natural Gas [and] Electricity, COM(91)548 final at 3.

It is hoped that increased cross-border demand will boost trade in gas and electricity between Member States. But unless transmission infrastructures and interconnections are quickly developed, supply will be unable to respond. This concerns countries not yet connected to the European network, namely the United Kingdom,<sup>24</sup> Ireland, Spain, Portugal, and Greece. The Commission is proposing a package to foster this development, including a Community action program and a Consultative Committee, comprised of professionals' and consumers' representatives, to assist the Commission.<sup>25</sup> However "standardization" is essential: the single Community market will become a reality for European industry only if common technical standards can be developed progressively at the European rather than at the national level.<sup>26</sup>

Petroleum products, electricity, and gas are to be standardized. In particular, a European definition of "reference gases" is being made which concerns nominal equipment supply conditions and "limit gases," referring to extreme variations in gas characteristics.<sup>27</sup>

Removing the barriers to intra-Community trade requires a legal regime where electricity and gas can move "within and between Member States in response to demand."<sup>28</sup> This will require changing many existing national regulations concerning production, importation, exportation, transmission, and distribution. By implication, the completion of the internal market might benefit environmental protection through greater efficiency and through adoption of "cleaner" technologies.

Reducing CO<sub>2</sub> emissions to the atmosphere has been targeted by the resolution (at the combined Energy/Environment Council of October 1990) in order to stabilize total Community CO<sub>2</sub> emissions at 1990 levels by the year 2000. European Community Energy efficiency programs were ameliorated during the May 31, 1991 Council of Energy Ministers meeting. However, the Energy Ministers could not agree on details to enhance the Community's ability to deal with oil crises.<sup>29</sup> While the EC is making some progress, advances in a comprehensive energy policy will probably not be achieved within the next few years.

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24. The House of Commons Energy Committee concluded, "We are surprised that no comprehensive examination of the peculiarities and cost benefits of constructing a link with the European gas grid has been made known to us. We are persuaded that a fully competitive gas market cannot exist in Britain without such a link." ENERGY COMMITTEE, SECOND REPORT, 1990, CMND 1200, at xxix.

25. Texte E, *Achèvement du Marche Intérieur du Gaz et de L'Électricité*, COM(91)298 final at 7. This document met much opposition from member states, hence the Commission decided to implement third party access in three stages. Completion of the Internal Market for Electricity and Gas, Orientations for a Phased Approach Final version October 23, 1991.

26. Commission Green Paper on the Development of European Standardization, COM(91)52 final.

27. Texte E, *Achèvement du Marche Intérieur du Gaz et de L'Électricité*, *supra* note 25.

28. *Id.* at 3.

29. Community energy efficiency programs include: Community action program for improving the efficiency of electricity use (the so-called "PACE" program), Council Decision 89/364, 1989 O.J. (L 157) 32; and the so-called "SAVE" program: Specific Actions for Vigorous Energy Efficiency, Commission Communication to the Council, COM (90)365 final at 13.

Vis-à-vis energy, the harmonization objective is facilitated by Article 8A of the SEA, whereby Member States amended the three founding treaties of the European Communities. Article 8A(2) says: "The internal market shall comprise an area without internal frontiers, in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of this Treaty."

Clearly, this multilateral treaty affects the constitutional law of all the Member States. It encourages greater collective action in the Community and it will determine the ability of Member States to influence future Community law-making.<sup>30</sup>

The most significant institutional change concerns decision-making in the Community by means of the new "cooperation procedure," which affects only certain categories of Community legislation. This procedure promises to increase the influence of the European Parliament (as it will now officially be known), and the Commission, although ultimate power will remain with the Council of Ministers. Article 100A, for example, allows qualified majority voting by the Council, effectively preventing veto by a Member State, for most measures concerning the establishment and functioning of the internal market.<sup>31</sup> It represents the principal mechanism for facilitating agreement on the Single Energy Market (SEM). Indeed, the previous practice of unanimous voting obstructed policy agreement and budgetary progress. However, policy agreement over taxation and employment still requires unanimous voting.

Overall, the European Parliament (EP) enjoys a greater ability to participate in the legislative process, since Article 149 of the EEC Treaty was amended to provide for the cooperation procedure. The Parliament must be consulted about initiatives from the Executive Council and it may propose its own amendments. If the European Parliament votes by absolute majority to reject a Council position, then the Council can act on a second reading providing that its decision is unanimous. Institutional changes have been effected in other areas, namely, the official recognition of the "European Council," which includes heads of state or governments of the Member States. This council meets from time to time, but is not given any specific powers or functions. Additionally, provision has been made to ease the existing workload of the Court of Justice, by the establishment of a court of first instance to hear certain classes of action or proceedings brought by natural or legal persons.

### III. THE INTERNAL MARKET FOR NATURAL GAS

This chapter identifies structural characteristics of the Single Energy Market, and security of supply and environmental concerns. The emphasis is on policy coordination between trading partners, including regulatory

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30. See, e.g., *Maastricht to Go into Effect After German Court Clears the Way*, Agence France Presse, Oct. 12, 1993, available in LEXIS, Nexis Library, Agence France Presse file.

31. The extent to which the Luxembourg compromise will affect the new areas of majority voting remains to be seen. See generally ROYAL INST. INT'L AFF. & SCI. POL'Y RES. UNIT, *A Single European Market in Energy* (University of Sussex 1989).

authorities in different jurisdictions which are connected to a common grid. Such policy coordination is necessary to foster a single regional gas market.

In September 1986, the Energy Council unanimously adopted energy policy objectives for 1995.<sup>32</sup> The Council's Resolution recognized the diversity of national resources, needs, and policies with respect to energy, and called upon Member States to achieve individualized general and specific objectives for 1995.<sup>33</sup> Subsequently, these goals were expressed in a Directive entitled *The Internal Energy Market*. The Directive seeks "greater integration, free from barriers to trade, of the internal energy market with a view to improving security of supply, reducing costs and improving economic competitiveness."<sup>34</sup> A Community-wide dimension will gradually complement national programs for security of supply. The Commission has made tentative proposals concerning security of supply in Member States. In fact, these tentative proposals contemplate the maintenance of mutual aid from a "reserved" sector of energy supply.<sup>35</sup>

In particular, there is clear emphasis on the need to develop an integrated gas grid and on the need to identify the conditions which are a *sine qua non* for direct access.

For certain energy products, such as electricity and gas for example, the States or the regional entities give exclusive right of transport and distribution to public and private enterprises. It is appropriate to make an inventory and examine in what sense these exclusive rights prevent or make more difficult exchanges between Member States . . . if such a situation is compatible with the rules of the Treaty and more particularly *Articles 30 and 37*.<sup>36</sup> More specifically in the transport domain and in regard to the distribution of electricity and gas (even if these two sectors have characteristics which set them apart) two essential economic problems seem to dominate: [1] how to encourage the free transit of natural gas and electricity inside the Community while having a high level of *security of supply* and [2] having the conditions of transport on an economic basis. This would permit a transport or distribution company to have direct access to a resource . . . under what possible conditions could direct access to a resource be extended to a large industrial consumer. Both these options imply that third parties could have the possibility to have access, on payment of a reasonable tariff, to existing transport networks.<sup>37</sup>

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32. Resolution on the Follow-up Report on the 1995 EC Energy Objectives, 1986 O.J. (C 241) 1.

33. See generally TERENCE DAINITH & LEIGH HANCHER, *ENERGY STRATEGY IN EUROPE: THE LEGAL FRAMEWORK* (1986).

34. *The Internal Energy Market*, *supra* note 5, Annex III, at 66, para. 61. Two problems identified: (1) how to encourage free transit of natural gas (which) would permit a distribution company to have direct access to a resource, (2) under what conditions direct access to a resource might be extended to a large industrial customer.

35. *Internal Energy Market and Energy Policy*, PARL. EUR. DOC. (SEC 90) 1248 (1990).

36. Articles 30-36 of the EEC Treaty forbid tariffs, quotas and other restrictions to intra-Community trade. Article 37 controls the conduct of commercial state monopolies, especially regarding exclusive trade and transport rights. Proceedings were commenced under Article 37 against Member States maintaining exclusive rights to import and export gas and electricity as well as to break up gas and electricity monopolies. Andrew Hill, *Commission Sets Sights on Electricity and Gas Monopolies*, FIN. TIMES, Sept. 25, 1990, at 199.

37. *The Internal Energy Market*, *supra* note 5, at 21, para. 61 (emphasis in original).



In November, 1988, the Council agreed with the overall recommendations of the Commission in the *Internal Energy Market* report.<sup>38</sup> The overriding issue remains security of supply and the strategic nature of energy.<sup>39</sup> The above priorities, however, should not result in a watering-down of the diversification objective, nor should they prevent realization of the goal of limiting net imports of oil and petroleum products, which amount to approximately one-third of total energy consumption.<sup>40</sup>

The Commission also reported that the European energy market is relatively partitioned, being characterized by diverse products, services, market participants, and regimes in Member States.<sup>41</sup> Like the economy in general, the energy market is in a state of flux. It also possesses distinct characteristics.

### A. Market Structure and Disparities

Structurally, the gas industry differs in the respective Member States of the European Community. According to some commentators, the structure of a utility is important, since it is a primary determinant of future conduct.<sup>42</sup> For instance, vertical integration dominates in France and the U.K., states which do not have "independent" local distributors. The spectrum of possible vertical integration is different in Germany or, *a fortiori*, in the U.S. or in Canada, where local distribution companies (LDCs) add another contractual and administrative dimension. According to independent observers,<sup>43</sup> the institutional features of the western European gas markets have tended to restrain developments. The major gas exporting organizations are characterized by monopoly, large resource rents, and state ownership, all of which contribute to organizational slack. A different structure would probably lower gas costs.<sup>44</sup>

The number of European suppliers is comparatively limited, largely consisting of nationalized corporations with government-controlled marketing operations.<sup>45</sup> Thus, to prevent monopoly windfall profits, any restructuring of the European gas industry requires regulation of the industry's generation, transmission, and distribution components. "Any system of integration proposed for the opening of the EEC's natural gas market must account for particular characteristics of the already-existing European

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38. Council of EC General Secretariat, 8954/88 (Presse 163).

39. The *Internal Energy Market*, *supra* note 5, para. 22.

40. *Id.* para. 24.

41. *Id.* paras. 8-12.

42. Dieter Helm & George Yarrow, *The Assessment: The Regulation of Utilities*, 4 OXFORD REV. ECON. POL'Y i, vii (1988).

43. Marian Radetzki, OPEC REVIEW 185, 191 (Summer 1990).

44. *Id.* at 191.

45. European "producer cartels" could be broken up, but, *a fortiori*, competition among the major importer-exporter countries (the former USSR, the Netherlands, Algeria, Norway) would increase. Thus, wellhead competition seems to be the aspect of gas pipeline business that most closely resembles a workable market. *US Open Access - Is It a Model for Europe: Assessing whether the US Open Access system is A Suitable Model for Europe*, 196 GAS WORLD 10 (1991) [hereinafter *US Open Access - Is It a Model for Europe*].

market structures and the precarious nature of limited indigenous supply networks."<sup>46</sup>

Presently, ninety-five percent of Community natural gas is consumed in only five Member States. The others are either developing or intending to develop a gas industry. European natural gas production is concentrated in The Netherlands and the U.K., although the latter has no pipeline interlink with the continent. A British Gas pipeline will soon link Northern Ireland to Britain, but successful integration of the European market requires improved interconnections.<sup>47</sup> Linkage of Britain to continental Europe is plausible, but requires an industry attitude change.<sup>48</sup> This requires coordination of energy policies. Commentators suggest that:

[i]n theory the Member States of the EC were obliged to coordinate their energy policies and to work towards the common energy objectives stipulated in various EC Council resolutions. In practice divergence remained, so that the European energy market today is as fragmented and partitioned as its North American counterpart, where there had been little attempt to synchronize energy policies.<sup>49</sup>

Better coordination between the principal regulatory authorities in the United States and Canada is arguably increasing and complementing the pace of commercial integration in the North American gas grid.

### B. *European Gas Transit and Relevant North American Experience*

Although the regulatory superstructure is nascent, European commercial exigencies are an important force behind the restructuring initiative. Depending on the statistical model used, demand for gas is expected to rise from the present level of 225 billion cubic meters (bcm) per year to about 330-350 bcm per year by 2010. To some extent, increased consumption is driving the move towards common carriage. This includes the increasing use of gas for the generation of electricity. In 1975, the Council promulgated a directive limiting the use of natural gas to generate electricity. Sub-

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46. Ernst-Joachim Mestmäcker, *Natural Gas in the European Internal Market: A Comparative Analysis of Common Carriage and Price Transparency*, 11 MICH. J. INT'L L. 691, 767 (1990); See Daniel Dreyfus & Annette Koklauner, *Open Access to Natural Gas Pipeline Transportation in North America: Lessons for the European Internal Energy Market*, 3 ENERGY STUD. REV. 277, 285 (1991). "Assurance of reliability must be provided both to government, as the guardian of the public interest, and to investors who must evaluate the risk of dependence upon the system . . . . Doubts concerning the risk of deliverability failures or shortage-induced price spikes are also evident in the (North American) market for gas, the electric power generation market, is currently confounded by the skepticism of investors in new electric power generating capacity concerning the long-term reliability of gas as a generating fuel option. The inability to develop convenient long-term contracts for gas to serve new investments indicates that both users and suppliers are today unable to evaluate risk adequately to accommodate ordinary business transactions."

47. Texte E, *Achèvement du Marche Intérieur du Gaz et de L'Électricité*, *supra* note 25, at 20.

48. *Where Britain Leads Europe Could Follow*, OFGAS NEWS RELEASE, May 21, 1992. OFGAS Director General Sir James McKinnon, citing the British, said "Britain's gas industry had in the last five years learnt a valuable lesson that others in Europe would do well to heed." He was bullish on the possibility of a link to the European gas grid provided that there was a "change of heart in Continental Europe to optimize the benefit of such a link."

49. Hancher & Lucas, *supra* note 22.

sequently, in 1989, Member States questioned and repealed the 1973 energy crisis-induced directive, since it was now an inefficient allocation of resources.<sup>50</sup>

Industrial demand for gas is increasing, along with an appetite for direct interruptible sales at discount prices; however, whether producers are amenable to direct sales is another matter. Structurally, the European gas industry is an oligopoly, in comparison with the hundreds of small producers who exist in Canada alongside the major players. European skeptics suggest that "[i]ncorrect conclusions or intervention . . . can . . . endanger the reliability of gas supplies and the integrity of gas pricing, as the painful experiences made in a number of countries have taught."<sup>51</sup> Others argue that the status of transmission companies should be preserved or even strengthened in order to balance the oligopoly of gas suppliers, to prevent the fragmentation of purchase power during potential supply difficulties.<sup>52</sup>

The gas industry also fears unnecessary "creeping regulation," arguing that it benefits attorneys and not the consumer.<sup>53</sup> For example, a sixty-eight page report prepared by Boston's Jensen Associates, Inc., for Germany's Ruhrgas, questioned the suitability of the U.S. open access system as a model for Europe, citing vastly different gas markets. The report criticized the U.S. executive branch for usurping state, Congressional or judicial prerogatives, and for failing to implement a comprehensive gas policy, upstream from the wellhead, and downstream to the burnertip.<sup>54</sup> Despite these criticisms, given the European Community's federal system of government, the Canadian and U.S. processes of "deregulation"<sup>55</sup> and so-called "common carriage" serve as a cursory model. While European problems and responses differ in degree, the North American experience presents a regulatory history of the restructuring costs incurred during transition from system-gas sales to an open access regime.

#### IV. INCREASING FREE ACCESS TO THE EUROPEAN GAS MARKET

##### A. *European Common Carriage Proposals*

Specific proposals for third-party access have been made by the European Commission. This chapter identifies the salient provisions of the Gas Transit Directive and the proposals for a directive on the common rules

50. EUR. PARL. DOC. (SEC 754) 2 (1989); especially art. 1, paras. 2-4. The Commission formerly declined to make a final decision on the Directive, allowing derogation by Member States.

51. Burckhard Bergmann, Director Ruhrgas AG, Speech at the Offshore Northern Seas Conference and Exhibition (Aug. 24, 1988). See generally JONATHAN STERN, EUROPEAN GAS MARKETS: CHALLENGE AND OPPORTUNITY IN THE 1990s (1990).

52. Nick White, *Third Party Access to Gas Pipelines*, 7 O.G.L.T.R. 191 (1990).

53. Comtec-Gaz Comments on the Proposed Council Directive on the Transit of Gas Through Major Systems, Hearing of the Committee for Energy, Research and Technology of the European Parliament (Brussels Apr. 18, 1990).

54. *US Open Access - Is It a Model for Europe*, supra note 45, at 10.

55. "[D]eregulation results in a shift in the net economic benefits from oil and gas consumers to producers and governments." John F. Helliwell et. al., *Oil & Gas Taxation*, 26 OSGOODE HALL L. J. 453, 480 (1988).

needed to operate the interconnected transmission grid. These legal instruments are critically examined and are contrasted with the natural gas transportation experience in the United Kingdom, a Member State which leads the Community in third-party carriage competition. While the Community provisions are politically expedient, they do not appear to be legally effective in regulating interstate transmission. Thus, the concluding component of this chapter identifies the basic Community competition law which will arguably be necessary, given the absence of a more powerful regulatory regime.

European natural gas companies stress how they cooperate, but their economic interests are divergent from the public interest. Spare capacity exists in European transmission systems, because a small "club" of large import actors has shown a willingness to transport gas for each other, but not for outsiders. For instance, in 1986 the German company Ruhrgas refused to carry gas internationally from the Norwegian Troll/Sleipner fields to Austria.<sup>56</sup> European gas companies have traditionally carried gas for other companies for an agreed price and often upon ad hoc arrangements. Transmission grid owners seek more than the cost of third-party carriage; they prefer to buy gas, add value, then resell the commodity.<sup>57</sup> Despite industry intransigence, the liberal European Community proposals on gas transit will alter the status quo. However, it is not clear when these changes will manifest themselves as tangible benefits for consumers.

Presently, there are few gas importers and virtually no gas-to-gas competition. Community gas markets are shared between the monopolistic utilities/producers-importers by long-term (fifteen or more years) contracts. These arrangements contain expansive take-or-pay clauses, with gas prices being determined or indexed with reference to competing fuel prices. As a result, consumers are unable to choose their supplier.<sup>58</sup>

Discrimination is inevitable when a pipeline apportion costs to core customers<sup>59</sup> (small residential, medium commercial) or noncore customers<sup>60</sup> (large industrial customers). Any eventual "right of transit" will have to address transportation toll methodology. The Commission is duly con-

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56. For a comparison of the British position, See Alexander J. Black, *Competition Law and British Natural Gas Regulation*, 13 ENERGY L. J. 359 (1992); WORLD GAS REP. 8 (1987); *id.* at 4; STERN, *supra* note 51, at 79-80, 84 n.22. The "club" includes Ruhrgas (a consortium 60% of which consists of EXXON, BP, Shell and Mobil) Gaz de France, Gasunie, SNAM, Distrigaz and arguably Enagas. A rare public dispute concerning Article 86 of the EEC Treaty (abuse of a dominant position) and inter-Community gas carriage involving Germany's Ruhrgas and Bayergas was settled before the European Court could rule on the applicability of this provision to gas transmission services.

57. BURCKHARD BERGMANN, *THE ARCHITECTURE OF THE EUROPEAN GAS INDUSTRY BETWEEN MARKET OPPORTUNITIES AND POLITICAL VARIABILITIES* 12 (1988).

58. Texte E, *Achèvement du Marche Intérieur du Gaz et de L'Électricité*, *supra* note 25.

59. Core customers are customers with no fuel alternatives to natural gas, such as residential and small commercial customers. These customers traditionally receive gas service from gas utilities under a "bundled" service of gas supply procurement and transportation service.

60. Noncore customers are customers with alternative fuel capability, such as large commercial and industrial customers (including power plants and enhanced oil recovery customers). These customers have the option of purchasing gas from a gas utility's core or noncore portfolio or choosing to have their own gas purchases transported by the gas utility.

cerned about energy price transparency, especially off-tariff sales of natural gas to industrial customers.<sup>61</sup> It has found an acceptable level of transparency for the oil sector.<sup>62</sup>

Nevertheless, room exists for improvement in gas sector tariffs. After detailed discussions with various industry and consumer groups, the Commission proposed a legal instrument which will hopefully allow it to obtain the necessary price information on gas prices for its regular publication.<sup>63</sup>

### B. Right of Transit

In July 1989, the Commission made proposals to bring about the free circulation of gas between Member States by creating a "right of transit" (*droit de transit*).<sup>64</sup> The Gas Transit Directive<sup>65</sup> was approved at the May 1991 Council meeting. It is designed to facilitate and maximize gas exchanges across non-neighbor gas transmission utilities. This measure follows approval of the Electricity Transit Directive,<sup>66</sup> in which high voltage transmission utilities are enjoined from providing power exchanges through their grids, unless the arrangement would otherwise affect transmission reliability.

The gas directive contemplates the growth in export capacity, as in the case of Dutch gas to Germany or French electricity to Germany and Portugal. It therefore seems reasonable, as a general rule, that allocative economic efficiency creates a need for rights of access to networks.<sup>67</sup> Thus, the 1989 communication<sup>68</sup> contained a draft directive, whereby in Article 5, the Council was enjoined from deciding the principles and "complementary conditions relating to intra-Community transit."<sup>69</sup>

61. The Internal Energy Market, *supra* note 5, Annex III, at 60, paras. 76-79; *id.* Annex III, para. 8. n.b.: transparency; an EC term of art concerning the degree to which transportation and commodity rates accurately reflect their cost, including any cross-subsidization between different classes of customer. See Commission Directive 80/723, 1980 O.J. (L 195) 35 and Cases 188-190/80 France, Italy and the UK v. Commission [1982] E.C.R. 2545.

62. There is a weekly bulletin which is agreed upon by the Member States and the oil companies. Council Directive 76/491, 1976 O.J. (L 140) 4.

63. Proposal for a Council Directive on Transparency of Gas & Electricity Prices Charged to Industrial End-User, COM(89)332 final.

64. Draft Directive on the Transit of Natural Gas, COM(89)334 final; Proposal for a Directive on the Transit of Natural Gas Through Major Systems, COM(90)425 final at 10.

65. Council Directive 91/296, 1991 O.J. (L 147) 367; "We understand (as of January 1992) that the Commission intends to encourage other steps to integrate the energy markets before raising again the draft directive on gas transport liberalization. Reportedly, the Commission therefore intends not to drop, but to postpone the directive dealing with third-party access." Thomas Wälde, *European Commission Drops Hardline Open Access Approach*, GAS MATTERS, Oct. 30, 1991, at n.9.

66. Council Directive 90/547, 1990 O.J. (L 313) 30.

67. Michael Brothwood & Peter Cameron, *Rights of Access to Energy Markets*, A paper delivered to the International Bar Association, Committee K, Utility Law 2 (Strasbourg, Oct. 1989) (citing France's extra (5 to 8%) nuclear generated electrical power capacity).

68. Draft Directive on the Transit of Natural Gas, *supra* note 64.

69. *Id.* Other salient provisions in the 1989 Draft Directive included: Article 3: The conditions of natural gas transit through the gas transmission grids shall be negotiated and agreed by the bodies responsible for the grids concerned. Article 3(2): requests for transit shall, within one month be communicated to the Commission and the national competent authorities. Negotiations on the

On October 29, 1990, after intensive lobbying by interest groups, the European Community agreed in principle to a "common carriage type directive."<sup>70</sup> The EC Energy Minister, Antonio Cardozo e Cunha, said that the proposed directive did not commit Europe to a "common carrier" system, as found in Britain.<sup>71</sup> This statement may be indicative of the final "right of transit." While the British system leads Europe, it is quite important in comparison to incidents of common carriage in Canada or the U.S.

Such a radical opening of the market (as is being experienced in North America) is felt to be too unpopular with most Member States. One reason is that "gas supply as opposed to gas production is geographically monopolized and supplier dominated."<sup>72</sup> The European gas market differs from the related corporate concentration in Canada and the U.S. This perspective partly explains the strategy that the industry is taking when faced with the market dislocation threat of third-party access.

For instance, oil and gas industry spokespersons have remarked on how the British government has led the way in liberalizing the U.K. market for gas. Ostensibly, these spokespersons agree with European Commission moves to "free the movement of natural gas, to enhance security of supply, and to increase competition," but they are sophisticated in their public response to the Transit Directive.<sup>73</sup>

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conditions of natural gas transit must be commenced by the responsible entities within one month after such request. "The transit conditions must be equitable for all the parties concerned and should not include unfair clauses or unjustified restrictions, in particular, payment for transit must take account of the transporter's responsibilities for ensuring security of supply and contractual quality of service. Failure to agree within 12 months necessitates that the Commission and the relevant national authorities be notified by the interested parties who have to indicate their reasons." Article 4: In the absence of due reasons for the failure to reach an agreement or if the reasons appear unjustified or insufficient, the Commission, acting on a complaint from the requesting body or on its own initiative, shall put in hand the procedures provided for by the treaty or any other applicable provision of community law.

70. *Draft Common Position of the Council Proposal for a Council Directive on the Transit of Natural Gas through the Major Systems 10326/90, Annex I, art. 3(2):* The conditions of transit shall, pursuant to the rules of the Treaty, be non-discriminatory and fair for all parties concerned, shall not include unfair clauses or unjustified restrictions and not endanger security of supply and quality of service, in particular taking full account of the utilization of reserve production and storage capacity and the most efficient operation of the existing systems. EC Energy Council Press Release (Oct. 29, 1990). "The President of the Council noted that a qualified majority within the Council was in favor of approving the substance of a common position on this proposal as it stood following the proceedings of the Permanent Representative's Committee and today's discussions. The Council will be requested to act on the text as finalized by the Permanent Representative's Committee."

71. Lucy Kellaway, *EC Moves Closer to Single Gas Market*, FIN. TIMES, Oct. 30, 1990, at 3. The political hyperbole has to be recognized. For instance, in an address on Sept. 3, 1992 at University of Dundee, Centre for Mineral Law and Policy sponsored conference at St. Andrews, Scotland; Mr. Cardoso e Cunha became a bit carried away, saying that "[n]o other area, not even the United States has the quality of Energy in Europe."

72. Hancher, *supra* note 2, at 81. In a European context, regulation is arguably less likely to be used if those affected are small in number and if consensual alternatives such as negotiation and contracts can be used instead. H. Jarass, *LAW AS AN INSTRUMENT OF ECONOMIC POLICY: COMPARATIVE AND CRITICAL APPROACHES* 86-87, 40-41 (Terence Daintith ed., 1987).

73. Council Directive 91/296, 1991 O.J. (L 147) 367.

It does seem . . . that the Commission's suggested measures, notably the concepts of unbundling and regulating third-party access to gas pipelines, are out of step with its aims. By imposing unprecedented restrictions and terms on companies, rather than encouraging the industry to compete, to build on efficiency and to invest in further market penetration, the measures run the risk of actually reducing competition and endangering the security of gas supply in Europe . . . . And in common with others, the belief in Shell is that any EC intervention should uphold those [non-intervention] principles and not take the backward step of adding unnecessary regulation . . . . It will then be important that the UK does not allow its own position on gas liberalization to be misapplied in the broader market of Europe through the introduction of over-rigid regulation.<sup>74</sup>

Two criticisms can be made concerning this statement. The reasoning is fallacious in a narrow sense, since the U.K., as one member of the Community, cannot determine Community policy. It is also spurious in a broader, value-judgment sense. It speciously denies any imperfection, or that new regulatory responses are required to meet the exigencies of a maturing gas distribution system in Europe.

While the Gas Transit Directive<sup>75</sup> may be watered down following political compromise, it contains the basic building block of prudent public utility regulation, namely a proviso against discrimination in rates.

[Article 3 (1)] Contracts involving transit of natural gas between grids shall be negotiated between the entities responsible for those grids and for the quality of service provided and, where appropriate, with the entities [i.e., regulatory authorities] responsible in the Member States for importing and exporting natural gas.

[Article 3 (2)] The Conditions of transit shall, pursuant to the rules of the Treaty, be non-discriminatory and fair for all parties concerned, shall not include unfair clauses or unjustified restrictions and [shall] not endanger security of supply nor quality of service, in particular taking account of the utilization of reserve production and storage capacity and the most efficient operation of existing systems.

Member States are required to take the necessary measures to ensure that the relevant entities (i.e., pipeline companies) act without delay to notify the Commission and relevant national authorities concerning any request for third-party transit.<sup>76</sup> Provision is made for non-binding conciliation through the auspices of the European Commission<sup>77</sup> and, failing that, Article 4 of the Gas Transit Directive reserves the Community competition

74. Herkströter, *supra* note 3.

75. Council Directive 91/296, 1991 O.J. (L 147) 367.

76. *Id.* In particular, this directive enjoins Member States to compel pipeline companies 1) to open negotiations on the conditions of the natural gas transit requested, 2) to inform the Commission and the national authorities concerned of the conclusion of a transit contract, and 3) to inform the Commission and the national authorities concerned of the reasons for the failure of the negotiations to result in the conclusion of a contract within twelve months following communication of the request.

77. *Id.* art. 4. "Each of the entities may request that the conditions of transit be subject to conciliation by a body, set up and chaired by the Commission on which the entities responsible for grids in the Community are represented."

powers and procedures as the legal mechanism for dispute resolution.<sup>78</sup> However, a question arises whether these competition powers will prove efficacious or whether the public interest could be promoted by different means.<sup>79</sup>

### C. Third-Party Access

Internationally, the Commissioners comprise a group appointed by the Member States to serve as a kind of cabinet for Community affairs. But under EC rules, the Commissioners can only propose rules, which must then be confirmed by a Council of National Ministers. Thus, a step-by-step approach was provided, *inter alia*, for consultation between Member States and sectarian interests. The consultative procedure aimed to discuss whether "third-party access to a European transport system needs to be organized and, when necessary, under what conditions."<sup>80</sup>

*Third-party Access* (TPA) is a regime providing for an obligation, to the extent that there is capacity available, on companies operating transmission and distribution networks for electricity and gas to offer terms for the use of their grid, in particular to individual consumers or to distribution companies, in return for payment.<sup>81</sup>

This initiative is timely, given the impetus towards an integrated market and the present volume of intra-Community gas trade, but the broad framework needs to be fleshed out.<sup>82</sup>

Common rules are needed to regulate access to common natural gas markets. The draft directives for gas and electricity require Member States to abolish exclusive rights concerning electricity generation and electricity and gas transmission lines. Additionally, electric and gas companies are required to unbundle their accounting procedures to promote non-discriminatory competition. Furthermore, the draft provisions specifically state that any state aid granted to one division may not benefit another division. This affects the remaining three EC state-controlled, vertically integrated energy companies in Greece, France, and Italy. Lastly, electric and gas companies must introduce third-party access to a finite group of high-volume electricity and gas consumers.<sup>83</sup>

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78. *Id.* "If the reasons for the absence of agreement on a request for transit appear unjustified or insufficient, the Commission, acting on a complaint from the requesting body or on its own initiative, shall implement the procedures provided for by Community law."

79. The depth of distrust and opposition to the Commission's proposals for the completion of the Internal Energy Market, and the political clout of major energy companies, was evinced in Brussels at the 1625th Meeting of the Energy Council on November 30, 1992. At this meeting, the Council noted reservations "in particular about the general third party access mechanisms, and indicated that debate on the completion of the Internal Energy Market would be continued at the next meeting." 1625th Meeting of the Energy Council (Brussels Nov. 30, 1992).

80. Draft Directive on the Transit of Natural Gas, *supra* note 64.

81. Proposal for a Council Directive Concerning Common Rules for the Internal Market in Natural Gas (and) Electricity, COM(91)548 final at 6.

82. Bergmann, *supra* note 51, at 8. Every fifth m<sup>3</sup> of natural gas produced in a member nation is exported to another EC country. Forty percent of EC gas is imported from non-community countries.

83. Proposal for a Council Directive Concerning Common Rules, *supra* note 81, arts. 23, 24; *A Fair Wind Blows for the Third Party Access Proposals*, EC ENERGY MONTHLY, Feb. 14, 1992.



The principles underlying recent proposals concerning the gas and electricity sectors do not contemplate a "rigid structure at the Community level;" instead, they contemplate a gradual approach. They are based on the principle of subsidiarity,<sup>84</sup> which requires Member States to implement measures best suited for their particular circumstances, in order to achieve broadly defined Community aims. However, the Community principle of "proportionality"<sup>85</sup> requires the means employed to be proportionate to the ends sought. The Commission also seeks to "avoid the trap of excessive regulation."<sup>86</sup> Member States will be accorded maximum authority to implement specific measures and to resolve disputes under the principle of minimum required regulation. Finally, the principle of progressivity recognizes the need for a transition period to allow industry time to adapt to proposed measures.<sup>87</sup> These principles will be implemented under a three-stage procedure.

A consultant's report, widely circulated in the industry but never fully disseminated to the public, examined the potential advantages and drawbacks of EC common carriage.<sup>88</sup> The Coopers and Lybrand Report recommended:

- IV. establishing a separate body responsible to the Commission with sufficient delegated powers to effectively police common carriage, including policing of dominant positions,
- V. the drafting of fair and reasonable transmission guidelines including the ratio of transmission tariffs to the average cost of the facilities used and special charges for interrupted service,

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84. Cf. Herkströter, *supra* note 74, at 2: "Subsidiarity will hopefully put an end to centralized bureaucratic regulation which defines, to the smallest detail, the way in which things must be done. It opens the door for sensible regulation that is close to the market and to players in the market, then puts the onus firmly on those players to do what is required in the most effective way, and, lastly, judges the outcome."

85. Commission of the European Communities, XXth Report on Competition Policy (Luxembourg, 1991) (ISBN 92 826 2314 9). Introduction: "Regulated sectors and those in which companies enjoy exclusive rights will have to be subject to the rules of competition if the internal market is to function properly. [T]he Commission will apply the rule of proportionality in deciding whether these services of a general economic interest can be effectively provided in any other way than by granting exclusive rights to particular suppliers. Such services of a general economic interest are usually found for basic utilities (e.g. gas, water, electricity, telecommunications, etc.). [A] further consideration is that many of these services necessitate a near universal network in each Member State and the Commission has to see to what extent the principle of open access to the network can allow competition without prejudicing the provision of the service."

86. Proposal for a Council Directive Concerning Common Rules, *supra* note 81, at 7. The principles follow the EEC Treaty Article 100(a) approach which fosters dialogue between the Council and the EC Parliament.

87. Texte E, *Achèvement du Marche Intérieur du Gaz et de L'Électricité*, *supra* note 25.

88. Coopers & Lybrand Belmont et. al., *Study on the Advantages and Drawbacks for the European Community of the Introduction of a System of "Common Carrier" for the Transport of Natural Gas* 8 (Brussels, July 18, 1991). Final Report issued by the Directorate-General for Energy, Commission of the European Communities, January 1989. The study was not a robust defense of open access and ostensibly looked like a systematic critique. Nevertheless, the EC asked for a follow-up to quantify potential benefits of open access, assuming the potential could be realized. These were found to be about two percent of gas costs. Although the report is skeptical about the wisdom of introducing a common carriage system in Europe, it acknowledges the need for additional regulation to accommodate such a regime.

- VI. requiring inter-regional gas supply companies to publish development proposals so as to facilitate third-party capacity requirements. By taking on additional investment costs, inter-regional supply companies would be obliged to create corresponding capacity,
- VII. developing a measure to prevent abuse of third-party transportation by the transmission companies.<sup>89</sup>

Presently, the Commission is implementing the Gas Transit, the Electricity Transit, and the Transparency Directives, which contain the "common rules necessary" for achieving the second stage.<sup>90</sup> The second stage itself has three elements:

First, it is necessary to create a transparent and non-discriminatory system for granting licenses for the production of electricity and the building of electricity lines and gas pipelines . . . . Second, the concept of unbundling, i.e. separation of the management and accounting of production, transmission and distribution operations, must be put into practice in vertically integrated undertakings . . . . Finally, Third-party Access (TPA) must be introduced on "a limited basis" . . . whereby the transmission and distribution companies are obliged to offer access to their network to certain eligible entities at reasonable prices within the limits of . . . capacity.<sup>91</sup>

Examples of "eligible entities" include large industrial users and distribution companies whose demands exceed a certain threshold (provided that other industrial and domestic users benefit indirectly from TPA).<sup>92</sup>

#### D. *Third-Party Access Thresholds*

The Natural Gas Directive does not pertain to exploration and production.<sup>93</sup> Third-party access to the network will begin by "progressive adaptation" and by the use of an interconnected network, and will be limited to suitable undertakings (i.e., large consumers and distribution undertakings). A threshold of 25 million m<sup>3</sup> per site has been set for individual companies. For distribution companies, a threshold of one percent of national gas consumption has been set, as compared with three percent (of the energy distributed in each Member State) in the case of electricity.<sup>94</sup>

#### E. *EC Take-or-Pay Obligations*

Liberalization of European gas transportation must face the problems created by long-term supply contracts, which include onerous take-or-pay

89. Mestmäcker, *supra* note 46, at 699.

90. Proposal for a Council Directive Concerning Common Rules, *supra* note 81, at 10, para. 6.5. The third stage or phase of TPA is to be introduced by January 1, 1996 on the Commission's evaluation of Phase 2.

91. *Id.* at 9, para. 6.3. By January 1, 1996, the Commission expects to evaluate the second phase and widen the scope of Third-Party Access.

92. *Id.* at 9.

93. *Id.* at 23, pt. C, para. 3.1, "Detailed proposals for natural gas for the realization of the second stage."

94. *Id.* at 23, pt. C, para. 3.2. Stage two for third-party (industrial customer) electricity access was set at 100 GWh/yr or more (equivalent to 25MW for 4000 hours a year). The Commission estimates that 400-500 large customers will benefit with the freer market for electricity as will 100 or so distributors.

provisions. Regrettably, there is neither a regulatory body in the Community with the power to intervene in contracts between Member States, nor a provision for the creation of such a "European Energy Commission" under the terms of the EEC Treaties.<sup>95</sup> In the absence of stronger political consensus, the provisions of the draft directive on common rules have to be seen as the next best alternative.

Article 24 of the Commission's draft directive acknowledges that the TPA regime may induce Member States to rescue gas companies from take-or-pay exposure. However, this type of state aid will require prior Commission approval. Take-or-pay obligations involve important sanctity of contract principles.<sup>96</sup> The Natural Gas Directive<sup>97</sup> seeks to protect the economic viability of existing gas companies while liberalizing the market.

A take-or-pay clause obligates a purchaser to pay for a percentage (a predetermined annual volume) of the gas which a seller can produce, whether or not the purchaser actually takes the gas. These risk sharing arrangements shift the long-term volume decline risk from the producers to the gas companies. The clauses were utilized to facilitate capital-intensive investment required for constructing the industry infrastructure at a time when the market was beginning to develop. The commodity price is usually linked or indexed to oil (the main alternative fuel) prices, and since the price can rise or fall, the risk exists in both directions. The Natural Gas Directive<sup>98</sup> envisages the need for offtake security, in the form of take-or-pay provisions, will wane in an interconnected European gas market.

Nevertheless, take-or-pay provisions remain an important factor along with other price-related provisions. For instance, European gas demand fell between 1982 and 1984 when gas prices and delivery conditions failed to respond fast enough to price changes in alternative fuels. Many arrangements were renegotiated, and subsequently, *fuel adjustment clauses* (FACs) increased the frequency of price and shortened the periods for indexation to about three months by the end of the 1980s. Following the development of the Norwegian Troll field, gas was sold on a netback (net of transportation costs) market basis. This guaranteed that continental importers would pay a price commensurate with competing fuel costs, but failed to account for production and transportation costs in relation to prevailing energy prices.<sup>99</sup>

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95. Brothwood & Cameron, *supra* note 67, at 2. The Internal Energy Market, *supra* note 5, at 83: At one time the Commission contemplated the idea of an EC regulatory authority, yet hasn't raised the possibility: "[t]he Community's natural gas industry could, for example, set up a flexible joint body to deal with carriage and the administration of the European gas pipeline network, access to which would be open to all transport companies in the Community."

96. "Pervasive regulation and contracts do not coexist well." Richard J. Pierce Jr., *Natural Gas Regulation, Deregulation and Contracts*, 68 VA. L. REV. 63, 113 (1982).

97. Proposal for a Council Directive Concerning Common Rules, *supra* note 81, para. C 3.5.1.

98. *Id.*

99. STERN, *supra* note 51. In Canada, instead of regulated producer prices, a netback pricing system was introduced whereby "producers received the netback from the . . . [marketing arm of TransCanada Pipelines Ltd.] . . ."; "Western Gas Marketing (WGML)-distributor negotiated

A parallel approach for gas and electricity is relied upon in the gas proposal. The Natural Gas Directive has proposals that differ from the Electricity Directive (which is contained in the same Commission document),<sup>100</sup> but it also shares similarities with the draft electricity directive concerning third-party access to, and operation of, the Community electricity grids. These similarities require a conjunctive reading of the Commission commentary concerning the electricity proposals.<sup>101</sup>

Unfortunately, a palliative to protectionism seems to have been stuck into the Directive as a political compromise. The Directive contains a safeguard clause<sup>102</sup> that allows a Member State, with the Commission's approval, to take "appropriate measures" in times of shortage if one of its gas companies faces economic difficulties due to existing take-or-pay obligations. This rather vague sounding clause threatens to emasculate the Community controlled third-party carriage regime. Community supply safeguards are needed.<sup>103</sup> Inter-Community gas carriage rates (and related take-or-pay agreements that also contemplate transportation of the commodity) should be set by the Commission or its agent, but the Directive seems silent in regards to the administrative mechanism to determine charges, rate rationale, and rates of return. Although charges should be "reasonable," the Directive fails to identify the person responsible for determining this mixed question of law and fact.

#### F. Uncertain Rate Rationale

European Community rate regulation will only affect competitive (third-party industrial/commercial) pricing of electricity or gas. Member States retain their regulatory powers concerning gas and electricity pricing, including standardized national prices, for all end-users who are not eligible for TPA.<sup>104</sup> Member States remain free to determine the scope of distribution companies' rights and public service obligations.

Furthermore, the Commission will not interfere with the right of states to establish licensing criteria for the generation and transmission of electricity and gas. Exclusive distribution rights may be granted as long as grid access is granted to eligible users. Users can buy from another supplier by means of a direct line (this refers to "bypass") if the transparency requirements are met.<sup>105</sup> Member States can set the criteria for granting licenses to construct power stations, transmission lines, and distribution lines.<sup>106</sup>

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wholesale prices rolled-in with the netback from export sales." R. HYNDMAN, *IMPACT OF NATURAL GAS DEREGULATION IN PRODUCING PROVINCES: ALBERTA*, at 8 (Alberta Dept. of Energy, 1987).

100. Proposal for a Council Directive Concerning Common Rules, *supra* note 81, at 25, para. C 3.

101. *Id.* at 13, pt. B.

102. *Id.* at 28, para. C 3.6.3.

103. *A Fair Wind Blows for the Third Party Access Proposals*, *supra* note 83.

104. Proposal for a Council Directive Concerning Common Rules, *supra* note 81, at para. 6.4(ii).

105. *Id.* para. 6.4(ii).

106. *Id.* para. 6.4(iii).

Finally, Member States will be free to choose how they will implement the Directive.<sup>107</sup> They will be able to determine their own regulatory regimes. While this may be a paean to commercial freedom, it may simultaneously complicate the market mechanism. Indeed, it may lead to intra-Community regulatory forums that are diverse and it may conflict with the inter-Community forum.

The failure of the European Community to set transportation and, by implication, commodity prices for all inter-Community sales creates a regulatory conundrum. First, in order to properly regulate third-party (direct) sales, the Commission requires complete financial, economic, and contractual information regarding both the majority volumes destined for core customers and the third-party volumes. More importantly, European gas regulation uses the term "non-discriminatory" with a connotation that does not fully comprehend the nuances of cross-subsidization between different classes of customers. For instance, bulk industrial buyers usually receive discounts because of their ability to switch easily to competing fuels, while captive core residential customers cannot change so readily.

In contrast to the European Community, Anglo-American law refers to "unjust discrimination," recognizing the inevitability of some discrepancies between customer classes. In common law countries, the art of public utility regulation involves apportioning the burden of a utility's revenue needs among customer classes. Thus, the EC proposals set a markedly different jurisdictional competence than exists in the U.S. and Canada. In contrast with North American states, EC Member States will have greater scope of authority in avoiding (and arguably disrupting) central control by characterizing rate issues as pertaining to core customers. To alleviate this problem, the Community should assert plenary transportation pricing control over all inter-Community bound gas. This would be similar to federal interstate and interprovincial competence in the United States and Canada.

### G. *Dispute Resolution Procedure*

Article 25 of the proposed gas directive allows a member state to use national measures in the event of an "energy crisis," an event which is not defined. Article 25 also provides that Member States shall establish a dispute resolution procedure, by which the parties can settle disputes on matters covered by the Directive.<sup>108</sup> Such a dispute resolution procedure is uncertain, and not binding as it stands. *A fortiori*, the draft Directive's preamble states that "[w]hereas, in accordance with the principle of subsidiarity, general principles providing for a framework must be established at the community level, but their detailed implementation should be left to the Member States."<sup>109</sup> Furthermore, Article 10 provides that:

Each transmission [c]ompany shall prepare and publish an annual estimate on the demand for gas in its area and on the system transmission capability, including transfer capabilities to and from neighboring systems. The estimate

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107. *Id.* para. 6.4(iv).

108. *Id.* at 82, art. 25.

109. *Id.* at 60.

shall cover a period of at least 10 years beginning from the year in which it is prepared.<sup>110</sup>

Under the subsidiarity principle, Member States will be left to administer a virtually meaningless reporting requirement.<sup>111</sup> Since gas demand information and system transmission capability information is required for transparency, responsible regulation will not be achieved by an obvious political compromise made at the expense of the public interest. Thus, it will be Member Governments which will, during Phase Two at least, decide the extent to which the provisions of the Directive become a reality or simply lie dormant in their legislation.<sup>112</sup>

Along with industry opposition to the unbundling and transparency proposals, third-party access seems destined to provoke the most opposition. For example, industry lobby groups such as Eurogas and Euroelectric have vociferously argued against forced imposition of TPA. Previously, the Netherlands and Germany (lobbied by its largest carrier, Ruhrgas) voted against the proposal to introduce third-party access during the so-called stage one of the Internal Energy Market.<sup>113</sup> Conversely, the U.K., which took over the Council Presidency in July 1992, was the only Member State firmly in favor of third-party access. Lastly, not a single gas company supported the Transit Directive.<sup>114</sup> Reaching a common position will thus be a priority. Despite industry opposition, "[c]ompetition in generation and transmission line construction is essential in the Single Market." Third-party access seems inevitable in the EC, but the timescale and thresholds still require political negotiation.<sup>115</sup>

Regrettably, a lacuna exists in EC energy law. There is a marked absence of a real Community energy policy concerning security of supply. Such a policy is needed to cope with the environmental and free-market pressures that are increasing in the industry.<sup>116</sup>

#### H. Transparency

Price and market transparency are essential requirements for competition generally and for evaluating costs and prices in the energy industry.<sup>117</sup>

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110. *Id.* at 69, art. 10. Earlier drafts (including Texte E, Achèvement du Marche Intérieur du Gaz et de L'Électricité, COM(91)298 final at 57), were extremely stringent and exacting upon gas companies, e.g., obligations to report average and peak demand, load curves, etc.

111. *See, e.g., id.* Article 9 (1) requires transmission companies to provide other interconnected parties with "sufficient information to ensure the secure and efficient operation and the coordinated development of the interconnected system."

112. JONATHAN STERN, ROYAL INST. INT'L AFF. ENERGY & ENVTL. PROGRAM, *THIRD PARTY ACCESS IN EUROPEAN GAS INDUSTRIES* 12 (1992).

113. Proposal for a Council Directive Concerning Common Rules, *supra* note 81; *A Fair Wind Blows for the Third Party Access Proposals*, *supra* note 83.

114. *A Fair Wind Blows for the Third Party Access Proposals*, *supra* note 83.

115. Proposal for a Council Directive Concerning Common Rules, *supra* note 81; *A Fair Wind Blows for the Third Party Access Proposals*, *supra* note 83.

116. *A Fair Wind Blows for the Third Party Access Proposals*, *supra* note 83.

117. John Maurice Clark, *Toward a Concept of Workable Competition*, 30 AM. ECON. REV. 241 (1940).

Previously, the Commission acknowledged that there is a trend towards transparency in gas prices, and that "transparency is particularly difficult to achieve in relation to off-tariff sales to industrial customers."<sup>118</sup> Industrial customers throughout the leading western countries increasingly employ dual-fire boilers or generators. Their ability to switch to a competing fuel is the overriding reason for price discrimination in their favor. Residential and small commercial customers invariably cannot economically switch over to an alternative fuel. Whether such discrimination is justifiable and fair, is a matter of fact to be determined by the relevant regulatory authority pursuant to its enabling legislation.

A Council Directive on price transparency<sup>119</sup> requires electricity and gas utilities to supply the Community Statistical Office with the rates they charge to all types of customers. These figures have traditionally been published in the aggregate with a pledge to respect confidentiality. Outsider scrutiny has thus been inhibited by integrated utility undertakings which publish their accounts on a consolidated basis.<sup>120</sup> Furthermore, underlying European contractual relationships for gas "have been shrouded in secrecy to such an extent that it is difficult to go beyond a description of underlying principles."<sup>121</sup> The Directive, however, requires companies to keep separate accounts for each of their divisions (i.e. transmission, storage, local distribution, industrial gas sales distinguished from other purposes, and gas commodity purchases). New accounting rules require auditing of annual accounts in accordance with the rules of national legislation concerning limited liability companies. Unfortunately, the new transparent figures may not be very revealing in the absence of expressly defined rules against cross-subsidization and undue preference sanctioned by a strong European regulatory authority.

This crucial Directive will thus have to be buttressed by Community competition case law.<sup>122</sup> Article 90 of the EEC Treaty concerns the application of competition rules to public undertakings which enjoy special or exclusive rights granted by Member States and the power of the Commission to issue directives remedying relevant mischief. Transmission companies could possibly be characterized as entities enjoying special rights. For example, in the Transparency Directive Case,<sup>123</sup> the Court of Justice

118. Completing the Internal Market, *supra* note 5, at 60-61. For example, the British gas regulatory body suggested that certain industrial prices are out of line with EC prices. The EEC Industrial Gas Market, OFGAS 18-21 (Jan. 1989).

119. Council Directive 90/377, 1990 O.J. (L 185) 16. This goes further than the proposals in The Internal Energy Market, *supra* note 5, para. 79, noting the need to "combine a minimum of transparency with dialogue between the parties concerned and a normal degree of confidentiality (secret statistics)."

120. Texte E, Achèvement du Marche Intérieur du Gaz et de L'Électricité, *supra* note 25.

121. STERN, *supra* note 51, at 18-19.

122. ROYAL INST. INT'L AFF. & SCI. POL'Y UNIT, *supra* note 31, at 54; The Internal Energy Market, *supra* note 5, at 24.

123. Case 188/80, France v. Commission, 1982 E.C.R. 2545; Case 189/80, Italy v. Commission, 1982 E.C.R. 2545; Case 190/80, United Kingdom v. Commission, 1982 E.C.R. 2545. In Case 202/88 France v. Commission, 1988 E.C.R. 3611, the Telecommunications Directive case, these powers were

acknowledged the Commission's Article 90 (3) powers<sup>124</sup> to obtain information concerning financial dealings between public undertakings and governments. Thus, transparent energy prices will probably result in cases of a visible regulatory presence via Community competition law.

### I. *Operating the Interconnected Grid*

Article 4 (1) empowers Member States to grant licenses for the interstate construction and operation of natural gas, including *Liquified Natural Gas* (LNG), facilities and transportation systems. The application procedures must be non-discriminatory and, according to Article 4.4, were to be adopted by Member States by July 1993. Article 4 (2) requires Member States to set the criteria for the licensing concerning the building and operation of interstate facilities, transmission lines, and distribution lines. These criteria contemplate, among other things, environmental concerns. Article 4 (3) permits refusal of an application if requirements can be "satisfied by the existing transmission and distribution capacities available in the interconnected system at a reasonable and equitable price." Lastly, Article 4 (8) requires Member States to give reasons for refusing related applications, and provides for appeals from such refusals.

Article 5 provides for bypass of the transmission and local distribution facilities by allowing construction of direct lines. Member States are required to meet the directives concerning interconnected transmission (Article 7). The system's operation shall be "assured individually by each transmission company,"<sup>125</sup> and "each transmission company shall not discriminate between users or classes of users of the system."<sup>126</sup>

Article 12 provides that third parties may apply to transmission companies to enter into an agreement for the use of their systems. In response, the transmission company shall either "propose an agreement," or "refuse" (giving reasons) "to make a proposal . . . if such use would prejudice the transmission or storage of natural gas or the import or the export of LNG in fulfillment of any statutory obligation or contractual commitments."<sup>127</sup> Proposals for an agreement shall include proposed transmission company obligations relating to the entry point(s) where gas will be accepted.<sup>128</sup>

Each transmission company shall publish the basis upon which the terms of connection to and the use of the system will be set. The publication shall contain sufficient information to enable a reasonable assessment of the tariffs

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controversially used to implement a general ban on the conferral of certain exclusive rights on state telecommunications agencies.

124. Article 90(3) clothes the Commission with a duty of surveillance, executed by the adoption of Directives and Decisions (which may be preventative or curative) addressed to the Member States. Article 90(3) provides a "particular procedural Framework for the enforcement of some of the more general obligations resulting from Article 5(2)." Hancher & Lucas, *supra* note 49, at 189.

125. Proposal for a Council Directive Concerning Common Rules, *supra* note 81, art. 8. See generally Robert Bell & Deborah Porter, *A Single European Market for Natural Gas*, 10 O.G.L.T.R. 307 (1991).

126. Proposal for a Council Directive Concerning Common Rules, *supra* note 81, art. 8(5).

127. *Id.* art. 12(2).

128. *Id.* art. 12(3).



that would be payable for natural gas transactions involving the use of the system.<sup>129</sup>

Article 12 also requires that transmission company tariff terms be "reasonably related to long-term costs incurred in the provision of the relevant service, together with a reasonable rate-of-return" on the capital employed.<sup>130</sup> Ominously, the "transmission company shall not discriminate between any person or classes of persons" vis-à-vis terms concerning connection to the system.<sup>131</sup> In the event that capacities are not used or are partly used, the contractual right of LNG storage for transmission usage will be lost.<sup>132</sup>

Freedom of third-party access to the gas grid requires an interconnected network. It will therefore be the responsibility of the entities in charge of managing the interconnected network to define "harmonized, transparent, and non-discriminatory procedures" for transportation.<sup>133</sup> A period of "progressive adaptation" is envisaged.<sup>134</sup> Mysteriously, unlike the Electricity Draft Directive, there is no positive requirement for a gas transmission system operator. The office is defined, but not mandated. This omission begs the question: how will the coordination and rate setting take place?

The "distribution system operator" is defined as an undertaking having the "responsibility of operating and developing a natural gas distribution system."<sup>135</sup> "Member States shall ensure that natural gas companies are operated on commercial principles and shall not discriminate between these undertakings as regards either rights or obligations."<sup>136</sup> Thus, the failure to specifically nominate a specific distribution system operator implies that the third-party access procedures will rely upon the goodwill of pipeline companies:

#### IV. CONCLUSION

Direct sales of natural gas are part of a changing legal regime which must be seen as part of an ongoing process, with promotion of the Community public interest as its ultimate goal in the monopolistic energy transmission sector. Community goals require some reduction in Member State competence (national deregulation) and some corresponding increase in central government power. Increased governmental intervention is being substituted for free market forces in an attempt to balance the general interest with individual claims.

European Community harmonization is thus a progressive effort to remove barriers. For lack of better nomenclature, this "ever closer union"

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129. *Id.* art. 12(5).

130. *Id.* art. 12(6).

131. *Id.* art. 12(7).

132. *Id.* art. 12(8).

133. *Id.* note 81, pt. B, para. 4.3, at 18.

134. *Id.* pt. B, para. 4.4, at 18.

135. *Id.* Annex 2, at 62.

136. *Id.* art. 3, at 63.

resembles federalism. The adoption of various legal documents and policies are hallmarks of the Internal Energy Market program, but the pace of harmonization is incremental. Unlike Canada or the United States, the EC "federal government" structural rules were not set up *a priori*. Furthermore, the European Community does not have a strong natural gas regulatory authority. Nonetheless, *de facto* sovereignty of Member States (who desire to remain in the Community) is lessening, although *de jure* sovereignty remains. Reduction of Member State sovereignty is the price of reaping the advantages of a common marketplace with a common microeconomic policy.

Microeconomic policy concerns governmental initiatives that attempt to influence sectors of the economy. Because regulatory board decisions have an extraterritorial application and affect those in other jurisdictions along a common grid, expectation interests can be prejudiced by capricious and inconsistent changes in regulatory policy. Thus, market tensions exist in North America despite the Canada-U.S. Free-Trade Agreement<sup>137</sup> and long-standing comity. There, domestic regulators have a legal mandate to protect the interests of producers, brokers, pipelines, and consumers within their jurisdiction. Legislative and proprietary conflicts with companion tiers of government are characteristics of federalism. Thus, the scope, frequency, and sophistication of these democratic conflicts will increase as the Internal Energy Market matures. This maturation process includes the deregulation of current European Community natural gas transportation arrangements.

Instead of ad hoc carriage arrangements by European pipeline companies, the shared authority of a federal-like Internal Energy Market will, to some extent, systematize procedures. Presently, the market does not function freely. Thus, ad hoc arrangements will have to be replaced in order to achieve allocative efficiency. Microeconomic theory indicates that control of the commodity price of natural gas is unnecessary and supports deregulation (of cartel-controlled commodity prices) in this sense. There is also a strong normative or philosophical movement in favor of such "deregulation" to the extent that gas brokerage transportation contracts can be unbundled. In order to achieve this result, efficacious and centralized transportation regulation, involving transparent rates, is needed to control the monopolies which will constitute an integrated European gas grid.

Pipeline regulation licensing and rate-setting are quasi-judicial functions that require coordination and consistency in order to cope with conflict and minimize disputes. The Natural Gas Draft Directive and Price Transparency Directives are part of a symbiotic dichotomy; both must function efficiently to facilitate the goal of third-party access. Without strong natural gas utility regulation and the attendant unfettering of competition, concentration of power and misallocation of resources will continue.

Unfortunately, anti-competitive forces appear to be restraining the pace and scope of Community natural gas transit reform. Full liberaliza-

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137. Jan. 2, 1988, 27 I.L.M. 281 (1988).

tion will have to wait until 1996, and the actual details will depend on the success of the second phase. Negative interest group behavior seeks to preserve the monopolistic transmission broker systems within Member States. Some industry spokesmen appear dogmatic and intransigent. They reflect the position of their respective interest groups by ostensibly supporting competition principles and lamenting excessive governmental controls. Competition in the gas transportation industry is usually successful in the sense that it weeds out real competitors. Pipeline interests are monopolies or quasi-monopolies characterized by economies of scale. They need a check on their inherent tendency to seek windfall profits.

Initially, the proposed right of transit will only marginally benefit core residential customers. Unfortunately, the EC gas interconnection and coordination rules are so weak that they amount to a policy of voluntarism. The European Commission Energy Council appears to be reserving its formal competition powers until market forces and the specific directives fail to achieve their goals. This is a form of negotiated regulation.

Accordingly, the Canadian and American experience is of marginal political relevance to the European common carriage question. It does, however, offer a vivid regulatory and procedural benchmark. Unlike the small group of North Sea based producer cartels, both the United States and Canada possess a mature industry currently coupled with thousands of producers and considerable excess capacity (the gas bubble).

Following the collapse of communism, the 1990s is the age of a new Europe, complete with new markets and opportunities. The North American experience provides an historical account of a changing industry and the legal mechanisms employed to balance the interests of the main industry actors. The North American restructuring experience presents a source of information for use by European natural gas regulators, who will have to cope with the inevitable transition costs of a new regime.

Compared to Europeans, Americans and Canadians have greater practical experience in energy regulation. This experience includes a history of market-determined prices, a subsequent period of regulated prices, and then a move back to deregulated prices. The environmental impact of the industry also maintains an extremely high profile. Nevertheless, the associated experience, with direct sales in both countries, may be of general interest to Europeans, who must make important value decisions concerning the stewardship of a vital energy resource. The physical fact of excess capacity has been proven; it warrants third-party access in order to allocate resources for the greatest public benefit.

The theoretical economic efficiency of capacity brokering is also compelling, even though the current conflict between the California Public Utilities Commission, Alberta Producers, and Canadian regulators looks like a longer term restructuring problem. As the European gas grid evolves and interconnection increases, so too will the sale of excess capacity by third-party brokers increase. By alleviating the institutional Community barriers to market entry, commercially founded realities will encourage renegotiation of supply contracts.

Proponents of third-party access argue that community and non-community producers will compete better if given greater access to European markets at the reduced prices likely to result from an unimpeded market. They believe the gas industry profits unduly from its monopolistic position, and that market entry of rivals is effectively precluded. Unfortunately, strong opponents, including self-serving industry insiders, counter the weak alliance in favor of TPA. These opponents assert it has yet to be proven empirically that direct purchases from alternate suppliers are compatible with security of supply and low prices. Yet empirically, Canadian core customer prices have fallen (albeit not as much as consumer groups expected) following the advent of direct sales.

European skeptics' strategic opposition to TPA involves tactics of bluffing and delay with constructive responses to the new initiatives. The industry fears that the modest "right of transit" proposals will snowball into full-fledged common carriage, involving redistribution of risks at its expense, and, therefore, seeks to maintain its protected position. Since present supply arrangements are fully contracted, and direct sales have to be financially attractive in order to induce purchasers to leave the security of system gas, it seems likely that relatively small amounts of direct sales will occur. The existing take-or-pay agreements were freely negotiated with suppliers, and it is improbable that they will be put aside by administrative fiat. The sanctity of the freedom to contract should be upheld to protect the legitimate expectation interests of capital.

In any event, the new regime arguably lacks the administrative teeth to change the contracts that contemplate both transportation and brokerage functions. If these contracts are not voluntarily renegotiated, their buyers must honor them and face simultaneous competition from the suppliers' direct sales. The controlling contract provisions will probably call for prices above the unregulated market-clearing price. Hence, the right of transit will require hard choices to be made concerning competition. Many more proactive steps will have to be taken by the European Commission.

A balance will have to be struck between pipeline ownership and third-party carriage. One way to do this is to encourage pipeline profits by incentive rate regulation. However, given the comparative Canadian and American experience, deregulation is not a panacea for neutralizing negative interest group behavior. In Canada, anti-competitive forces are prevailing so far as core (residential or small commercial) customers are concerned. Well-organized Canadian interest groups have influenced the determination of this public policy initiative, receiving the benefits of deregulation through cross-subsidization by poorly organized core market customers. The onus should be on proponents of deregulation to prove that the system is superior to the status quo. The difficulties of implementing deregulation should be analyzed beforehand, and deregulation should be implemented quickly once decided upon.

Quick implementation is an economic-legal ideal that is difficult to achieve due to a lack of political consensus. Nevertheless, quick implementation would be more efficacious than the gradual approach recommended

by some commentators. A gradual approach will admittedly lessen the acuteness of market restructuring, but will also extend its duration and tension. History suggests that those who object to change are usually those who stand to benefit most from the retention of the status quo.

The efficacy of European Community natural gas regulation will largely rest upon the pertinent powers provided to the dirigible Commission and the delegated entity responsible for regulating gas transportation through the common grid. The new regime will have a long learning curve before costs come down. Monopoly gas supply used to be seen as a low-risk activity with a return comparable to government bonds. The creative chaos of third-party competition will definitely cause market dislocation, but should eventually yield competitive dynamics. Such creative chaos is a political hotbed. It includes the prospect of economic gains and losses for the players, including newcomer brokers who purchase transportation services.

In order to be effective, the right of transit requires increased and consistent regulation in the public interest. A level playing field must provide participants with notice of accurate or "transparent" commodity and transportation rates. It is by no means clear, for example, whether rolled-in tolls or incremental tolls will be employed to finance capacity expansion. Nor is it clear whether so-called "as-billed" tolls will be allowed, or whether some sort of incentive rate regulation can take root with domestic regulators.

Successful Community harmonization will necessitate harmonization of the public utility law principles. Arguments about subsidiarity should not obfuscate the need for a strong Community regulatory body that could occupy the inter-Community field of natural gas transportation rates. The European gas industry is presently secretive about toll methodology compared to Canada and the United States, which openly investigate rate rationale. The European gas industry, being understandably predicated upon profit maximization, eschews the scrutiny that leonine regulatory powers will bring to their monopoly business.

Hence, the EC natural gas regulatory relationship and objectives concerning transit and different market structures are not yet settled. They are nascent. They will alter the status quo but they are certainly not radical. Some sort of regulation is needed in the EC to compensate for market failure in the natural gas transmission sector. Stronger Community regulation is also needed to accommodate access to pipelines by non-EC importers. Regrettably, the regulatory stewardship of this vital energy source does not go far enough or fast enough with its reforms. For instance, as it stands, the proposed direct sale dispute resolution procedure is uncertain and not binding. Provisions establishing the operators of the interconnected transmission system seem insufficient to protect the public interest. Other than general EC competition law provisions, there are no specific legal instruments aimed at harnessing the concentrated upstream producer cartels.

Politicization of natural gas transportation seems inevitable in Europe because the stakes are high. Yet this need not be so. One way of de-

politicizing the issue might be to create a "European Energy Commission" with wide investigative and regulatory powers. Like North America, the European Community should utilize public regulatory hearings, where a wide body of intervenors regularly have *locus standi* to participate and utilize complex socio-economic and financial data to advocate their viewpoints. Policy implications of related areas, like environmental impact assessment, could be dealt with in this forum. A regulatory dialogue could develop between the main actors, concurrently allowing a wide range of intervenors to air their concerns.

Admittedly, the regulatory hearing process has been criticized for "regulatory capture," whereby the vested and vociferous industry interest groups dominate the agenda. Despite its faults, it brings to a public forum matters of a public interest. Such a "European Energy Commission" should employ administrative rule-making procedures and be a court of first instance. Presently, the EC gas transit regulatory regime possesses decentralized dispute resolution procedures, requiring time-consuming adjudication in both national and Community forums. Ideally, disputes could be resolved in a competent central tribunal, but these constructive criticisms will require hard-won political consensus.

