

The slow dawn of the internal energy market in Europe

- Explaining market liberalisation in the EU electricity sector



Master thesis by Casper Andersen

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Casper Andersen

Supervisor: Professor Frede Hvelplund

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LIST OF ABBREVIATIONS

DSO	Distribution System Operator
EC	European Community
ECJ	European Court of Justice
ECSC	European Coal and Steel Community
EDF	Electricité de France
EEC	European Economic Community
EP	European Parliament
EU	European Union
Euratom	European Nuclear Energy Community
GW	Giga Watt
IEM	Internal Energy Market
IMP	Internal Market Programme
ISO	Independent System Operator
kV	Kilo Volt
MEP	Member of the European Union
nTPA	Negotiated Third Party Access
OU	Ownership Unbundling
PSO	Public Service Obligations
rTPA	Regulated Third Party Access
SEA	Single European Act
TEU	Treaty on European Union
TPA	Third Party Access
TSO	Transmission System Operator
QMV	Qualified Majority Voting

1. INTRODUCTION

In the last couple of years, energy policy has skyrocketed to centre stage on the European political agenda. At a landmark summit in March 2007, the EU's heads of state for the very first time agreed on a coherent and much inclusive set of goals for the future EU energy policies and at the same time made clear the close overlapping of interests between climate concerns, security of energy supply and a proper functioning of the internal energy market to secure European competitiveness through affordable energy.¹ What makes it groundbreaking is the fact that EU's leaders were able to agree on these ambitions in light of the fact that energy matters have been largely underdeveloped during the first 50 years of EC and EU cooperation.

The European Union as we know it today is the offspring of the political epilogue that succeeded the ending of the Second World War. In order to guard against a repetition of the two world wars in the same century, the European leaders at the time began the process of establishing cooperation across national borders to ensure lasting peace in Europe. Already in 1946, Winston Churchill put forward his vision for a "United States of Europe" and in 1949, the Council of Europe was established as the first pan-European institution. The year after, the French foreign minister Robert Schuman held a speech in which he recommended a community for the integration of the European coal and steel production. The aim was to create a common administration of the two basic prerequisites for modern warfare. Schuman's speech in 1950 became the starting point for the European Coal and Steel Community (ECSC), which included six founding member states, namely France, Germany, Italy, Belgium, Luxembourg and the Netherlands.²

However, following attempts to create further integration in the form of a common European defence and an early political union were rejected. These failures led the European leaders to focus instead on economic integration, which led to the development and later adoption of the Rome Treaty in 1957. The treaty established the European Economic Community (EEC), while the European Nuclear Energy Community (Euratom) was established the same day. The result of this was the foundation of the modern EU in three crucial treaties. Two of these three deal with European harmonisation of energy matters within coal and nuclear power. Nevertheless, neither the ECSC nor Euratom succeeded in creating any spill-over to energy matters outside their initial

¹ Presidency conclusions - Brussels European Council 8/9 March 2007

² Urwin 1995: 44

purpose of handling coal and nuclear energy issues. One important explanation for the lack of a more comprehensive energy policy not appearing from the ECSC and Euratom has to do with the fact that Germany and France each had their own favourite sector to nurture. Early on, France had put much effort into building up its own nuclear industry, while Germany focused more on coal-fired electricity. On top of that, Britain emerged as oil producer in the 70s and hence EC members pursued national programmes and priorities based on their individual preferences, which made energy unfit for cooperation within the EC.³

Incidentally, I was based in Brussels as part of an internship at the Confederation of Danish Industries' Brussels office, when the Commission published its comprehensive energy package in January 2007. I personally witnessed the intense atmosphere and excitement surrounding the publishing of the Commission's proposals. From many sides, I was told that this kind of interest from policy makers, interest representatives, the media, analysts, and many other actors was unprecedented, and that it was a clear testimony to the importance of energy policy on the European agenda. Some even believed that spearheading the road for Europe to become the low-carbon region of the world by use of renewable energy sources, energy efficient technologies and properly liberalised energy markets to facilitate it would become the future reason for the entire EU cooperation. And thereby replace what had to date been the reason for the European cooperation, namely preventing war between European states. This notion which was the main reason for the first 50 years of cooperation (1957-2007) and now to be succeeded by a united European fight for energy supplies with reduced dependency on imported fossil energy sources climate change holds a strong symbolic value.

The obvious importance of energy policy in European societies is the reason why I have chosen European energy policy as the overall theme of my master thesis. However, the size and magnitude of European energy policy makes it necessary to focus on particular policy areas. Energy policy has too many perspectives to find a possible way of analysing the whole subject. It covers international relations and security politics, economic and social politics and environment politics, not to mention the continuous enhancing climate change dimension. Due to my internship in Brussels and the fact that I still work for the organisation in Denmark, I have chosen to examine, in more detail, the Commission's long-lasting attempts to liberalise the energy markets in the member states. This

³ Matlary 1997: 17

entails a replacement of the divided national markets by an integrated European market based on general internal market principles and competition rules. By applying this perspective, the thesis will be able to integrate, in the best possible way, issues such as competitiveness of businesses, internal market principles, and a good understanding of how the energy sectors in Europe are organised and function.

Because of strong member state preferences for keeping the energy sectors under close national control, the Commission did not take action towards forming an internal market for energy until the last part of the 1980s. This was despite strong presence of energy policy in the original three treaties of the European Community. The turning point was the formulation of the Internal Market Programme, which aimed at creating one single market within the member state area for a range of sectors. Although energy was not initially included in the programme, the Commission chose to include the sector as it was deemed instrumental if the programme was to be successful. The electricity and gas sectors were two specific areas of energy selected as particularly important to reform. With the Internal Market Programme followed also a new political paradigm which supported liberalisation of markets with competing actors to replace state monopolies. Introducing competition in the sectors by means of liberalisation was vested in three key principles and put forward in directive proposals by the Commission in 1991. First, third party access (TPA) to the grids should allow more electricity providers to deliver power to end-users instead of being forcefully bound to a single supplier. Secondly, a non-discriminatory procedure replaced exclusive rights for the construction of new power stations and lines. Thirdly, the concept of unbundling was introduced as a means to separate the monopoly company's control over both production and transmission of the electricity. This was done in order to prevent discriminatory actions against third party actors and to prevent inter-company subsidies which would also hamper fair competition.

Liberalising the energy markets in Europe by means of the above principles has been a very difficult road for the Commission to pass. Opposition from sectoral actors and member state governments were as a starting point very fierce. The national utilities feared the new competitive market, and member state governments reacted negatively to the new ideas as it was believed to be too much in conflict with existing regulation of the sector. Nevertheless, a compromise on a directive to liberalise the electricity and gas sectors was reached in the Council in respectively 1996

and 1998 after years of negotiations.

In light of the above, it is interesting to examine the apparent success of the Commission and its supporters in presenting an adopted directive against such heavy opposition among member state governments and key sectoral players. Based on the developments described above, the research question of this thesis is as follows:

Why was directive 96/92 on common rules for the single market in electricity adopted despite initial opposition from a majority of member state governments and key actors in the national electricity sectors?

The research question is relevant to try and answer for a number of reasons. Above all, the composition of the research question will shed some light on the apparent political struggle for powers and ideas, i.e. the way the single market in electricity should progress and the direction of it. The struggle lay in the negotiations between the European Commission as driver of the internal market programme and the member states in the Council of Ministers is something that is vital to analyse in order to answer the research question satisfactorily. Moreover, the national energy companies played a big part in the political developments due to their traditionally strong role as a public service function and strong ties to the state. Liberalisation, as presented all along by the Commission in the different versions of the draft directive, would mean a radical overhaul of the entire sector, including not least the often monopolistic position of these companies. So their voice in the political discussions cannot be ignored. Lastly, the European business community as well as major users of electricity played a role in supporting whatever means that would provide them reductions in their electricity bills.

Secondly, directive 96/92 is relevant despite the fact that it has been rendered obsolete and replaced by a second directive and soon a third in late 2008 or early 2009. It begs the question of why the attempts to decide on satisfactory rules for the electricity markets have been going on for almost 20 years and counting. This long time-stretch is unprecedented for single market policy development across any policy area. It is also relevant because the directive introduced many of the key concepts still debated in stricter shapes and forms today and the negotiation process then still form the basis for today's heated negotiations. All in all, the first directive started the still unfinished

transformation of electricity markets in Europe towards liberalisation and competition. Therefore, to be able to understand today's discussions, it is imperative to have an understanding of the political history.

Also, the research question suggests that the EU as a political system is more complex and may leave actors apart from the European Parliament and the Council of ministers, which are the two legislative parties in influential positions, notably the European Commission..For students of EU politics, the case of electricity liberalisation used in this thesis may serve as a testimony to the fact that decision-making in the EU is much more pluralistic than strict interpretations of formal decision-making rules and procedures would suggest.

In section 2 on methodology, which follows next, I will elaborate further on the construction and meaning of the research question and its delimitation.

2. METHODOLOGY

This section is dedicated to providing a detailed and comprehensive account of how I will go about answering the research question. It includes further introduction to the research question, discussions on theoretical aspects and definitions of key concepts and aspects of the structure of the electricity sector. It also includes a discussion on liberalisation and competition as concepts. An overview of the EU as a political system is provided to illustrate its political set-up. This political set-up consists of the formulation, negotiation and ultimately the adoption of the directive concerning electricity liberalisation, which constitutes the case of analysis of this thesis.

2.1 DELIMITATION

The research question implicitly argues that opposition was widespread among member state governments and sectoral actors, notably the utilities. The extent of resistance is always a matter of comparison and is subject to interpretation as to what the term resistance really covers. The analysis will thus also qualify the notion of this by mapping the positions and arguments of individual member state actors. Further, due to space constraints and analytical focus, only the process of liberalising the electricity sectors will be investigated, while thus disregarding the similar process in the gas sector. Nevertheless, the two processes shared many identical conflicts and discussion points, so the reader may still gain an insight to the challenges of gas sector liberalisation from studying the electricity case. Moreover, delimitations have also been made as regards the lengthy time period during which electricity (and gas) sector liberalisation has unfolded. As noted in the introduction, the early work on the issue began in the late 1980s culminating with a final directive in 1996. However, the process did not end there. In 2003, a second electricity (and gas) sector directive package was adopted by the member states that amended the first set of directives with stronger provisions for third party access and unbundling as two key features. During the time of writing this paper, a third package on electricity and gas sectors has been proposed by the Commission and is now the centre piece for fierce negotiations between the Commission, the Parliament and the Council. The burning issue this time is the question of full ownership unbundling of energy companies compared to a softer version called Independent System Operator (ISO), which would still keep the production and transportation activities within the same company.⁴ Despite the fact that an analysis covering the entire 20-year-old liberalisation process

⁴ <http://euractiv.com/en/energy/liberalising-eu-energy-sector/article-145320>

including three directive packages would be very interesting, it would simply reach far beyond the scope of this paper. Attention will therefore be given to the first directive package as it brought about the most fundamental change to a sector that was previously left more or less untouched. Undoubtedly though, many telling aspects would have stood out more clearly to underpin the analysis in this thesis if the entire period was subjected to scrutiny.

It is important also to make clear that it is not the aim of this thesis to politicise on the advantages or draw-backs of liberalisation in the electricity sector. The outset of this thesis is instead the work done by the Commission, supportive member states and civil interest parties to push forward the process of liberalisation and the opposing side that fought against it. So the Commission's arguments will of course appear along with those of the key stakeholders on all sides of the discussion, notably energy companies and governments. Therefore, the arguments on this matter belong to the actors engaged and thus not to the author personally. The analysis will try to pin out the political and structural reasons for why actors positioned themselves the way they did.

The research question is formulated as it is in the attempt to encapsulate the fact that the idea of creating an internal electricity market over time altered member states' position in a more pro-reform direction. It seemed, at the time, that more or less all countries were against the proposed directive on liberalising the electricity sector or at least sceptical towards large parts of it. A compromise on the issue thus seemed insurmountable, but nevertheless it was achieved. The research question therefore implies that certain mechanisms and variables were in play to help transform opposition into support or at least acceptance of the final compromise. The analysis aims to pin out these decisive mechanisms and variables.

2.2 CHOICE OF THEORY

As mentioned, this thesis focuses mainly on the Commission's attempts to push for a liberalisation of the national electricity markets as part of a wider agenda for a single European energy market and member states' responses.

The Commission was met with considerable resistance from member states during the eight-year-long process of introducing this type of market. As it will be laid out in more detail in the following sections, all member states, except Britain, were more or less against the Commission's liberalisation plans at the beginning.

Nevertheless, the Commission was to a large degree successful in carrying out and implementing its ideas and preferences considering the massive resistance initially. This gradual support came from member state governments, some energy companies as well as large parts of the European business community, which were all against liberalisation at the beginning or did not actively support the reform.

My understanding of how this change of position came about derives mainly from looking at four aspects. Firstly, the impact of the liberalisation ideas and preferences of the Commission on the individual member state's public institutions and regulatory authorities. Secondly, the impact on the national industrial actors. Thirdly, threats and opportunities in the light of a potential liberalisation of the market the industrial actors were to operate in. Fourthly, the impact of the Commission's ideas as to how member state governments and the national industrial actors' believed in the ideology behind the ideas and what liberalisation could help to achieve.

In this, I am heavily inspired by the theory of Europeanization, which contains many relevant inputs and focus areas well suited for the analysis in this paper. Following, I will explain why.

2.3 BOTTOM-UP OR TOP-DOWN APPROACH

Since the adoption of the first liberalisation package, which held the first directive for the electricity sector in 1996, the theoretical scholarly literature has been poorly developed. Theoretical explorations covering the process towards the agreement of the second liberalisation package for the electricity sector in 2003 is almost non-existing. Let alone the current attempts by the Commission and the member states to reach an agreement on a third liberalisation package for the electricity sector, which is scheduled to fall into place in late 2008. Looking at the progress made by the Commission and the relative success by a majority of member states to water down the Commission's initial proposals in the final directives, the position and preferences of member states are important determiners of policy outcome. This is what state-centred theoretical approaches like liberal intergovernmentalism emphasise.⁵ However, it is puzzling to see that many member state governments and industry actors alike changed positions on the reform proposals. This is further highlighted by the fact that the first electricity package in 1996 has been succeeded by another package in 2002 and yet a third is under way in 2008. It thus makes it relevant to focus more on the

⁵ See Matlary, 1997

formal and informal influence of EU-level actors, notably the Commission and the EU as a political system, on the bargaining positions of the member states. Moreover, the responses by member state actors to proposals from the EU-level are equally relevant. The successive liberalisation packages introduce further liberalisation initiatives much spearheaded by the Commission and some member states, which have turned initial opposition towards liberalisation into support for more liberalisation. Against this is the continuous opposition and scepticism of other member states. This suggests that the strong role of the Commission as promoter and enforcer of liberalisation vis-à-vis the member state governments in the Council and market actors cannot be ignored and deserves attention.

Traditional integration theories, such as liberal intergovernmentalism, focus only on national governments and their preferences, while largely ignoring the many other influential political actors and processes. For instance, the liberal intergovernmentalist view holds that the member state governments are the main drivers of integration and acts in accordance with fixed nationally determined positions in EU-negotiations.⁶ This does not stand out as a sufficient outset for analysis as the energy policy sector includes many influential actors besides the national governments. The theoretical framework of this thesis must therefore be one which takes into account the influence of other political actors as well. Europeanization as a theory is first and foremost based on a top-down approach as opposed to liberal intergovernmentalism, which takes its starting point at the member states' preferences and impact on European legislation and policy outcome, i.e. a bottom-up approach. Europeanization instead starts at the EU level and then at that level explains the impact of the ideas and preferences on the domestic level. More explicitly, it looks at if, why and to what extent the pressure to reform by the EU-level can alter national preferences.

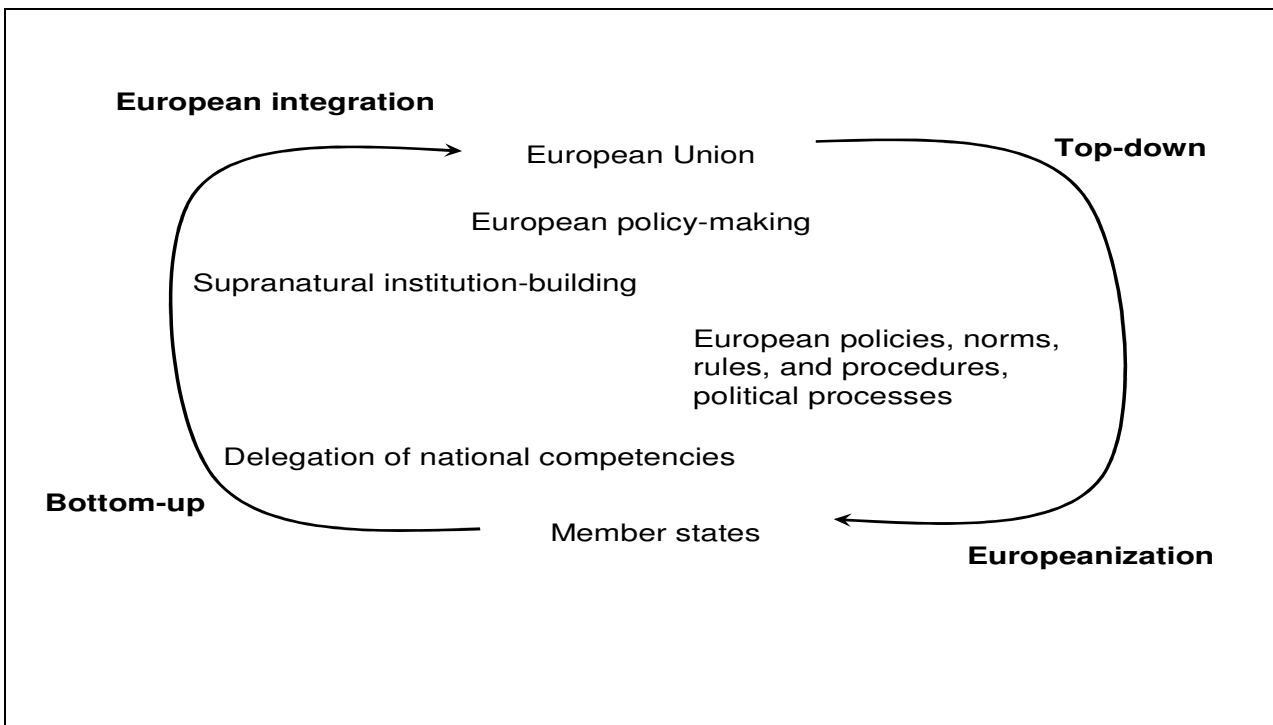
I find this approach ideally suitable since the idea of liberalised energy markets in Europe was pushed forward from the beginning by the Commission. In this analytical framework, the Commission is a representative of the EU level, and thus it is relevant to see how its ideas were, and still are, received in the member states and what effect they have had. This enables me to answer my research question more thoroughly as some member states have changed position vis-à-vis liberalisation, while other member states have maintained their opposing stands towards it.

I intend to identify a number of mechanisms and variables, which is supporting in explaining the

⁶ Börzel 2005: 47

degree and direction of change in member states' level of acceptance and implementation of EU-level legislation and guidelines. Basically, European pressure on member states happens through a series of mechanisms, i.e. the means available to the EU-level to promote its desired objectives. Thereafter, looking at distinctive variables in the member states is supporting in explaining the degree and direction of change, i.e. the response to the EU-pressure stemming from the evoked mechanisms.

Figure 1: The relationship between the EU and its member states: Bottom-up and Top-down



Source: Börzel 2005: 46

2.4 ANALYTICAL CONSIDERATIONS

Based on how the theory of Europeanization explains the EU-level pressure on the member state level, this thesis aims at providing an account of some empirically identified mechanisms and variables of policy change. These are important in explaining the process and outcome of the policy developments and negotiations on the electricity directive in 1996. The sum of my analysis aims at providing a plausible and valid answer to the central research question of this thesis. To enable this, the theoretical contributions in this study will be used both conceptually and analytically. This means that it will provide the reader with a sense of understanding of the subject of examination and analytically as the theory will help to define what to look for in the analysis and what analytical

attention a given subject must receive. This way, the theory should ensure that the analysis stays clear of a potential overflow of unnecessary information.

2.5 DEFINITION OF RELEVANT CONCEPTS

In prolongation of section 2.1 on the elaboration of the research question and section 2.4 above on the analytical contemplations, it is imperative also to provide clear definitions of the main concepts in the area of examination in order to set the scene for the analysis and to get a thorough basic level of understanding of the policy area in question.

2.5.1 Energy

The term energy is in this thesis the common denominator for electricity and natural gas as these two products/services are the focal points of the liberalisation process. However, energy does also cover other resources such as oil, coal, petrol, nuclear and various other renewable energy sources. 'Energy' is used as an inclusive term when no explicit differentiation of specific energy sources or energy sectors is needed.

2.5.2 Electricity and electricity systems

It is with respect to this thesis' topic and selected case of electricity liberalisation very helpful first to provide an account of what constitute the individual elements in the electricity system from production of electricity till it reaches the end-consumer. Electricity is basically both a produced commodity and an energy source, while the transportation of it is a service and includes transmission, distribution and system operation.

Unlike other services and commodities, electricity has certain characteristics that make it unique. Above all, electricity cannot be stored and this fact provides particular demands on generation capacity. There must be enough generation capacity available to adjust in accordance with varying levels of electricity demands during an interval. This means that generation capacity may sometimes be left unused in times of lower demands. Moreover, different technologies for generating electricity to provide flexibility in terms of shifting prices on raw materials such as oil, gas, coal, etc. to keep the costs of production as low as possible also play a role.

The service aspect of electricity comes into effect when generated electricity is to be transported through the grids to customers. It is in this regard normal to identify two phases of transportation;

transmission and distribution. The former is an interconnected system that carries the electricity at high voltage (400kV), while distribution systems run at lower voltage levels (60 kV). The Transmission system is interconnected because it is shared by all end-users, while the distribution system provides electricity off the transmission system to a certain group of end-users who are typically geographically defined.⁷

System operation is the third element and has as its task to coordinate the transmission and distribution systems. This is to ensure that the overall transportation system of electricity is constantly stable, i.e. that supply and demand is in constant equilibrium in the entire network. It is done by supervising the inflow and outflow of electricity in the network, and the system operator has competences to request ancillary production from the generator plants to balance the system.⁸

The two last elements in the electricity market concern end-user supply and services. It is noteworthy though that these two are primarily a product of liberalisation including unbundling of vertically integrated companies, which previously handled all of the above functions from generation to end-user supply. End-user supply provides electricity from the distribution grid to the final consumer along with the metering and billing responsibilities. Moreover, activities such as construction and maintenance of power plants and grids are important for the reliability and sustainability of the network. Another result of liberalisation is the growing number of financial services such as power exchanges and energy advisors.⁹

2.6 PRECONDITIONS FOR LIBERALISATION

Also relevant for the understanding of the research question posed in this paper is an introduction to some of the main preconditions for liberalisation. Four issues are relevant in connection with the European liberalisation process.¹⁰ Each of them holds additional sub-issues. The four main issues concern regulation and access, structure, liberalisation and ownership.

Regulation and access opportunities to the network are essential to ensure competition in the electricity sector. With the above-mentioned characteristics of the sector in mind, it is unlikely that

⁷ IEA 2001: 19

⁸ IEA 2001: 20

⁹ IEA 2001: 21

¹⁰ Cameron 2007: 30pp

market forces will foster competition on its own as long as there is a natural monopoly in the transportation phase. Public regulation of the use of the common network must therefore make up for the lack of natural competition in that phase.¹¹ This is especially vital in cases where the same company functions as both the producer and owner of the grid, the so-called bundled structure. Central to liberalisation is hence to create fair rights of access for third parties to the transmission and distribution grids. Allowing access is commonly referred to as TPA. TPA requires an independent regulator, who is independent both from the companies that are being regulated and improper interference from government in its daily work. The regulator's job is to shape and conduct supervision of the rights of access to the grid along with the proper pricing. Being independent as a regulator is a vital necessity in order to send a clear message of a level playing field to potential new players on the market. To further strengthen that message, all procedures and decisions must be fully transparent and published.

The structure of the electricity sector and its participants are of vital importance to the way regulation can be conducted. The special circumstances surrounding electricity supply in society has historically fostered monopoly companies in control of production and transportation. This leaves it to the regulator to act very interventionist to break an entry for new market actors. In practice though, it has proven difficult to pursue that goal and hence the focus on restructuring of the sector. In terms of restructuring at the EU-level, unbundling of companies engaged in both production and transportation in separate entities has been predominant. By unbundling these companies, they should no longer be able to discriminate against outside competitors by not allowing them access to the grid. The inherent risk of ending up in a discriminatory situation has to do with the fact that the transmission and distribution phases are not suited for competition given that they are natural monopolies. Of this reason, duplicating the existing transmission and distribution grids to provide more channels of electricity transportation is not an economically sound approach and because of that it is regarded as a natural monopoly. That is why the regulator and the separation of generation from transportation through unbundling are important. Left unchecked, integrated generation and transportation companies are in theory free to charge end-users up to the costs of building an alternative grid system. In essence, three different ways of unbundling can be chosen.¹²

¹¹ Cameron 2007: 32

¹² Cameron 2007: 32

- Full structural separation by law, either from ownership unbundling or legal unbundling, where assets from the integrated company are split up in legally independent units with "*no common ownership, management, control, or operations.*"¹³
- Functional separation offers unbundling of functions. Functional unbundling allows the shared ownership of production and transportation by the same company, but the company must have separate managements to control operations.
- Separation of accounts aims to unbundle the integrated company's accounts of its activities in generation and transportation in order to promote more transparency by exposing any possible cross-subsidies going back and forth in the company.

Nevertheless, it is practically difficult to arrange airtight shutters between company activities from the types of unbundling other than ownership when employees still work and meet in the same building. Such structures will maintain the information asymmetry among incumbent and new actors.¹⁴

Liberalisation of markets in terms of legal barriers to free production and trade of electricity is the third precondition of liberalisation. It involves the possibility of consumers to choose freely between suppliers. New suppliers and producers of electricity must also be allowed to establish themselves on the market, where they are able to collect proper information on issues such as costs and capacity. Moreover, the actors on the market must operate under equal competitive conditions without improper subsidies and should not be granted special or exclusive rights compared to others.

Lastly, ownership should be mentioned as well. Full public ownership, state or municipal, of electricity supply is likely to serve as protection against competition from outside. Changes in ownership structures are therefore encouraged on the part of the public side. It includes unbundling of activities and often also a partial sell-off of the monopoly company, but with the state as a continuing majority shareholder to begin with. Moreover, a licensing or concession scheme must also be established in regards to the maintenance, operation and development of the remaining natural monopoly aspects, the transmission and distribution networks, which also include the vital

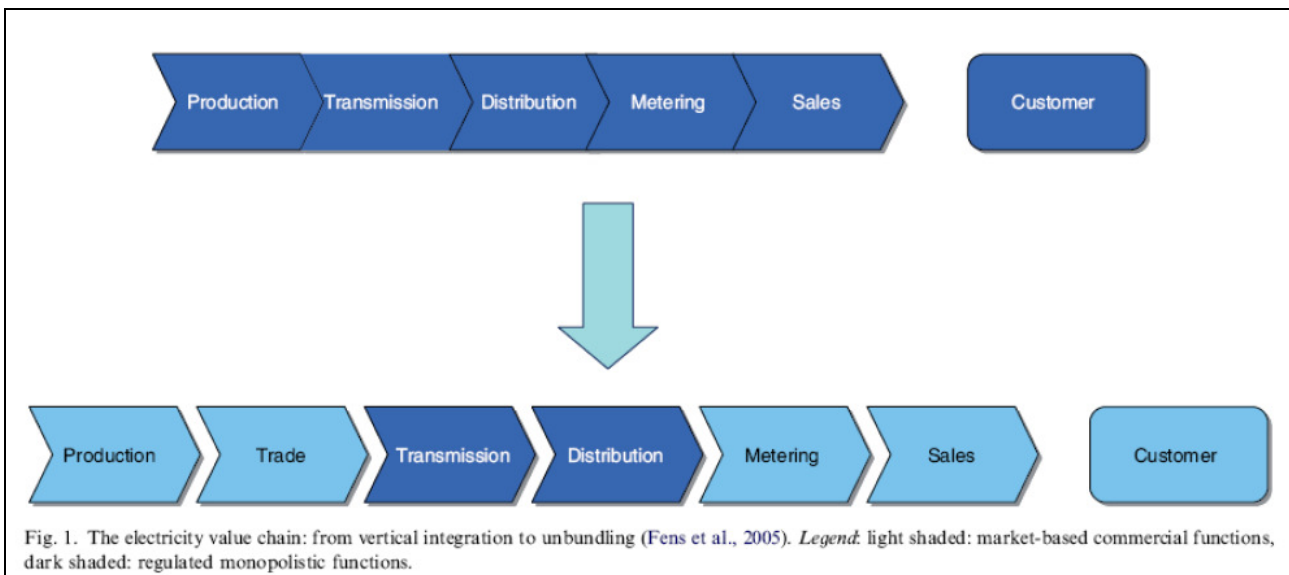
¹³ Cameron 2007: 32

¹⁴ Author's conversation with Torben Timmermann, former senior advisor on energy policy at the Confederation of Danish Industries

public service obligations (PSO).¹⁵ The latter may include supply obligations to peripheral areas within the network or the inclusion of electricity from renewable energy sources.

Figure 2 below provides an overview of the different phases distinctive for the electricity supply sector before and after liberalisation. The figure also illustrates what is now, and what used to be, considered a natural monopoly in the process before and after liberalisation.

Figure 2: Unbundling and the perception of natural monopoly before and after liberalisation



Source: Künneke 2007: 1921

2.7 STRUCTURE OF THE THESIS

The above considerations have led to the following outline of this paper.

- Section 1 sets the scene for choosing EU electricity liberalisation as a theme for this thesis as an introducing note before the presentation of the research question, which is put forward at the end of the section.
- Section 2 provides the methodological considerations as regards how this thesis will go about conducting the analysis that will lead to answering the research question. The methodological considerations first of all include an elaborate explanation of the research question along with definitions to concepts relevant as background facts. Moreover, the section includes a discussion on the theoretical and analytical contemplations.
- Section 3 is devoted to give an overview of the EC/EU as a political system. This political

¹⁵ Cameron 2007: 34-35

system functions as the institutional environment in which the negotiations on the directive was conducted and within which the basic ideas on liberalisation was formulated and gained momentum.

- Section 4 goes into further theoretical discussions of Europeanization. The selected theory which will form the theoretical aspect applied in the analysis.
- Section 5 sets the scene for the selected case of analysis by putting electricity liberalisation in a wider historical and political context. The aim is to provide an understanding of the evolvement of energy policy within the EU and in its member states as a whole and of the liberalisation process in particular. The section will thus give an account of the dominating political trends, while at the same time providing a chronological timeline leading up to the liberalisation process, which is still ongoing after 20 years.
- Section 6 is dedicated to the selected case for analysis. Backed by the theoretical inputs from Europeanization, along with the accounts provided in section 4 and 5, this thesis will analyse the negotiating process, adoption and subsequent implementation of the first electricity directive in 1996.¹⁶
- Section 7 provides the conclusion on the analysis and theoretical inputs based on the selected case and rounds off the paper by providing possible answers to the research question based on the analytical findings. Moreover, it puts into perspective some implications of the liberalisation process in the European electricity sector today.

2.8 ACTOR ANALYSIS

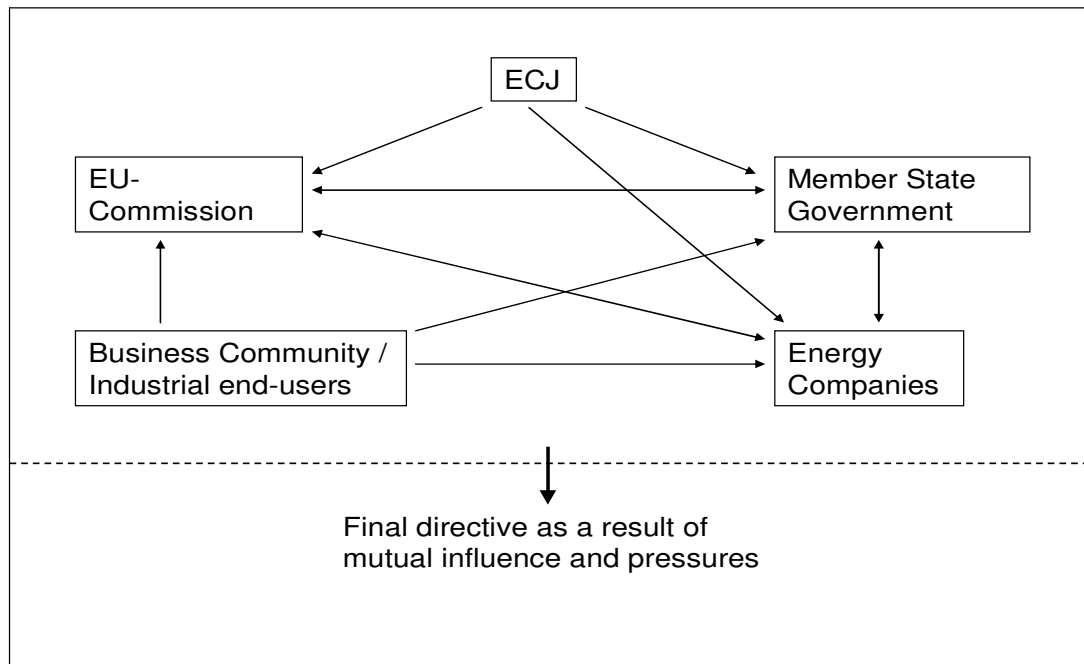
The top-down approach discussed in section 2.3 indicates that pressure for change in the case of electricity liberalisation arose from the top, understood as the EU-level, and spread down to the domestic governance levels and electricity sectors. Such political system consists of both supranational and national interests as well as interests for change and for preserving status quo. And the powers of the interests involved and the institutional conditions which the actors are either constrained by or empowered by together form the outcome that was the final directive in 1996.

In the analysis, the thesis will focus on three prominent member states and how their position towards the draft directive and the general idea behind liberalising the electricity markets were

¹⁶ Directive 96/92 EC concerning common rules of the internal market in electricity. Adopted by the Council of Ministers on 19 December 1996.

influenced by the ideas deriving from the EU-level. The same is the case for the national civil actors representing strong, but conflicting positions towards the EU-inspired ideas. Those actors are put in two groupings in the analysis. First, the national energy companies reacted negatively against the liberalisation proposals across the board from the outset and rejected the proposed changes. On the other side, the large industrial users of energy in Europe saw potentials in the promises of lower electricity prices following liberalisation. Lastly, the institutional set-up of the EU provides different institutions, and hence actors, with different powers at different steps in the decision-making process. For instance, the Commission is awarded with strong powers in the preparation phase of a directive, whereas the Council and the Parliament formally have to approve of the directive for it to be passed. Moreover, on the side is the European Court of Justice which is the institution which exclusively decides the legality of the other institutions' actions vis-à-vis the treaty provisions. All in all, the actors are mutually influential on each other and are all subject to the same rules of the game stipulated by the treaty framework. The fundamental analysis of this thesis will be to investigate how and to what extent the ideas on the EU-level helped change the initial positions among those four actor groups to ultimately secure support for the directive.

Figure 3: Actors and patterns of influence and pressure



Source: own production

Figure 3 illustrates the pluralistic nature of the EU-domestic interplay as it was played out during the long-lasting negotiations on the directive. The Commission holds agenda-setting powers and is also the guardian of the treaty and uses the European Court of Justice (ECJ) to its advantage by forwarding reluctant member states to the court. In that way, the Commission is able to put pressure on the member states to pursue a negotiated solution instead. This is also what the Commission did during the negotiations instead and the analysis will highlight this move as an important mechanism of change. The member state governments, on the other hand, are able to influence the Commission's preparatory work on the draft directive in the two reading phases. Being the ultimate decision-makers, the Council give them leverage against the Commission as the latter must be sure to present an agreeable draft text. The member states and the Commission are also responsive to the opinions of relevant civil society interests. In this case, the national energy companies that are being subject to new conditions in a competitive electricity market and the industrial end-users who are supposed to benefit from the changes. The same goes the other way around as the civil society actors are influenced by the priorities of the political levels of the governments and of the Commission.

3. DEFINITION OF THE EU AS A POLITICAL SYSTEM

As seen in figure 3, the EU is a pluralistic and complex political system in which a number of different interests meet to battle over influence on political decisions. In relation to this thesis as a whole and the theoretical framework, it is necessary to recognise the relevant interests and their positions and capabilities. The theoretical contemplations in this thesis overall concern the pressure from the EU-level to reform at the member state level. However, in reality it is not possible to isolate the two levels so categorically, since the EU-level is basically an extension of the member states as well as supranational institutions. Moreover, the EU-level institutions may represent different interests and from that pursue different, sometimes conflicting, policy priorities against member states. In order to understand the political pressure from the EU-level against the member states, it is central to establish the rules of the game, i.e. the institutional setup, the way decisions are made, and the general legal mandate originating from the treaties.

In terms of institutions, focus will be on the Commission as a representative of pan-European interests vs. the Council of Ministers/European Council as representatives of individual member state interests. Moreover, the decision-making process will be accounted for in order to explain the opportunities and constraints that influence the strategies and positions of all parties. The role of the European Parliament and the European Court of Justice will be highlighted as well as these institutions each played a role in the liberalisation process. On the legal side, the gradual emergence of a body of law for energy and the treaty provisions relevant for introducing the internal energy market deserve attention too.

3.1 THE SINGLE EUROPEAN ACT

The EC/EU has continuously undergone changes in terms of the general framework for cooperation. In regard to the issue of this thesis, the Single European Act (SEA) is highly relevant. The creation of SEA developed from the idea that the European political cooperation needed a new dynamic structure to take European integration further to replace the stagnation which had struck the EC. The answer was to create a barrier-free internal market within the Community to be in place by the end of 1992 at the latest. Moreover, the decision-making procedures in the Council concerning future internal market issues were altered from unanimity to qualified majority voting. This move basically removed the individual member states' veto power. In addition to the changes in the

decision-making process in the Council, the European Parliament was awarded co-decision powers as well.

3.1.1 The internal market programme

In the SEA framework, it was agreed to work for the gradual progression of the internal market to be finished no later than December 1992. The concept of this internal market was "*an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured*".¹⁷ The head of state and government of the member states further emphasised their firm will to carry out the political decisions necessary to help achieving the internal market in practise.¹⁸

3.1.2 New decision-making procedures

The second new feature of the SEA Treaty was the overhaul of the decision-making procedures which up to that point had required unanimity among member states in the Council. This often gave way to de facto veto powers to single member states. The new system consisted of a qualified majority voting system for issues concerning the internal market. With regard to energy policy, this area should now apply under the new voting rules and the general concept of free movement mentioned above. It is also worth mentioning that in connection with the member states' bargaining position in energy negotiations, the new weighting of votes among the member states following the procedural reform meant that two of the largest states could now be outvoted.¹⁹

3.1.3 European Parliament comes out strengthened

The European Parliament also achieved further competences in the decision-making process due the new co-operation procedure. Under the co-operation procedure, the Commission first sends its proposal to the Parliament for a first reading while also sending it to the Council. After its first reading, the Parliament informs the Council of its position on the proposal. The Council then agrees on a common position to the Parliament's position while still taking the original proposal from the Commission into consideration. The Council's opinion is then returned to the Parliament for a second reading. The Parliament can then accept the Council's common position, not act at all, reject the position, or propose amendments. If the Commission agrees to the Parliament's alterations, the

¹⁷ SEA article 8A, second paragraph

¹⁸ Declaration to SEA Article 8

¹⁹ Cameron 2007: 52

Council accepts them by qualified majority voting. On the other hand, if the Council cannot accept the Parliament's amendments, it has to "overrule" it by agreeing unanimously.

3.2 THE TREATY ON THE EUROPEAN UNION

During 1992, the EC's heads of state and governments agreed on further treaty reforms in the form of the Treaty on the European Union, the Maastricht Treaty, which was to take effect 1 January 1993. The Treaty changed the Community to the European Union and introduced a range of political areas to cooperate in, but it also brought new changes to the internal market dimension. Besides the modification of the Parliament's competences with the co-decision procedure, the most notable aspects with respect to the internal market programme and the energy field was the introduction of the subsidiarity principle. The principle was enhanced from only to apply in environmental areas under SEA to apply as a general principle under the Maastricht Treaty. The concept of subsidiarity basically means that decisions should only be made at the EU-level in cases where issues are not best handled by the member states.²⁰ The application of the subsidiarity principle is to be reviewed in a case-by-case manner and may both call on the EU-level to act or to refrain from acting. The Commission is hence obliged to make considerations on subsidiarity before each proposal is put forward and provide justification that Community action is in order.²¹ The principle of subsidiarity has also had an impact on the efforts made towards the liberalised energy markets. For the Commission's part, this meant that it had to rely on a framework directive in the electricity and gas sectors, providing the member states with more freedom in the way they wished to implement the directives into national law. It was highlighted by the Commission as it put forward the amended directive proposals for the electricity and gas sector in 1993, stating that "*[t]he Community must not impose rigid mechanisms, but rather should define a framework enabling Member States to opt for the system best suited to their natural resources, the state of their industry and their energy policies.*"²²

The Maastricht Treaty also brought further powers to the Parliament as the co-operation procedure in the SEA Treaty became the co-decision procedure. As mentioned above, the Parliament has to react to the Council's position by approving it, not acting on it, reject it or amend it during the

²⁰ http://europa.eu/scadplus/constitution/subsidiarity_en.htm

²¹ http://europa.eu/scadplus/constitution/subsidiarity_en.htm

²² Amended Proposals for a European Parliament and Council Directive on common rules for the internal market in electricity, COM 1993 643 final

second reading. In cases of rejection or amendments, the new co-decision procedure sets up a Conciliation Committee consisting of Council and Parliament representatives with the one task of negotiating an agreement, which is a feature that the co-operation procedure did not have. Finally, and very importantly in terms of bargaining powers among the two institutions, the Treaty gave the right to the Parliament to block final decisions in the Council on internal market matters, including also the energy field.

3.3 THE EUROPEAN COMMISSION

The prime mover of European integration and Internal Market development is the Commission and of this reason it is the institution which is primarily in focus when it comes to energy market liberalisation. The Commission has three overall functions which include being the initiator of new EU policy proposals; it has a range of regulatory and executive competences as well as being the guardian of the treaties ensuring that member states conform to them.

The legislative role is an important one since the Commission has been granted agenda-setting powers and the right to submit proposals to the Council and Parliament for adoption. The Commission is, however, limited in its agenda-setting role due to the principle of subsidiarity discussed above and may thus only act in cases where a given issue cannot be best handled at the national level. Moreover, the Commission is entitled to collect all data and information required to perform its duties properly and may publish white papers, green papers and sector inquiries to shed light on a given issue, which has been applied also in the energy field. The knowledge obtained from the papers and the inquiries usually makes up the first step towards the formation of concrete policy proposals from the Commission. In this phase, the Commission begins an in-depth process of consultations and hearings with interest parties from civil society and national authorities. It tries to include their positions in the draft proposals before sending them to the Council and the Parliament for further negotiations based on the co-decision procedure.²³ With its executive functions, the Commission is obliged to ensure that member states act in accordance with the general provisions in the EC Treaty framework and also the actions of companies. As guardian of the EC Treaty, the Commission has the power to infringe member states before the European Court of Justice if it

²³ From 2006, the hearing rounds with interested parties on draft policy proposals have been formally enhanced to include the Energy Expert Group and the High Level Group on Energy. These comprise of representatives from the Commission, the Parliament, Member States as well as industry, consumers and regulators. Their role is to advise the Council, the EP and national government agencies. http://ec.europa.eu/research/energy/gp/gp_pu/article_1100_en.htm

believes that the given member state has failed to conform to the EC Treaty. Following exchange of views with the member state (or states) in question, the Commission may choose to initiate court proceedings. The same competences are valid against companies or individuals suspected of breaching the EC Treaty provisions or secondary legislation such as directives. This is for instance the case in situations concerning abuse of market powers under article 86 and cases of granting exclusive or special rights under article 90, which have been taken into use specifically during the creation of the internal market for electricity and gas. Article 90 is potentially a strong means as it allows the Commission to issue administrative directives on member states which do not have to be adopted by the Council or the EP. The Commission's specific competences against state aid, cartels and general internal market principles such as mutual recognition and free movement further adds to its powers.²⁴

Table 1: The Commission's treaty-based powers against member states and industrial actors

Competence	Directed at	Procedure	
Infringement procedure (Art. 169), relating, for example to insufficient market freedoms	State actors	Interaction between Commission and member state on the allegations, reference to the European Court of Justice	
Control of cartels (Art. 85)	Private actors	Commission decisions amounting to: Prohibiting the action, requiring alterations, and/or imposing fines.	Appeal to the European Court of Justice
Prohibition of abuse of market power (Art. 86)	Private actors		
Control of subsidies (Art. 92–94)	State actors		
Control of the granting of special rights (Art. 90)	State actors	Decision or directive prohibiting the action or requiring alterations	

Source: Schmidt 1997: 13

The Commission's regulatory powers regarding competition matters are noticeable as well. These powers are most outspoken in energy matters when comitology procedures are used when further agreement is needed on technical issues after Council and Parliament adoption. In the comitology

²⁴ Hix: 2005: 49

procedure, the Commission is represented alongside national public officials to iron out the remaining technical issues.²⁵

3.4 THE COUNCIL OF MINISTERS

The relationship between the Commission and the Council is vital to EU law-making as the latter is the primary legislative body. Each member state is represented in the Council by the relevant ministers depending on the political resort area. That means the Council in energy matters are made up by the national ministers for energy. At any point, one member state holds the presidency for six months after which it rotates to a succeeding member state. It is the role of the Presidency to chair the Council meetings and acts the compromising mediator between the different member states in the Council, the Parliament and the Commission. The fact that the presidency state chairs the Council meeting provides it with certain leverage in the agenda setting and political priorities.

As introduced in the SEA, a number of policy issues concerning the Internal Market Programme are decided upon by qualified majority voting. Even though energy matters were not included in the original Internal Market plan, it has later been integrated in the programme and hence handled by QMV. QMV is basically a system where each member state is assigned a certain number of votes corresponding to its demographic size, i.e. its number of inhabitants. For this reason, QMV provides an easier way to political agreements than the previous system of unanimity, which allowed the individual member states to block adoption of legislation perceived to be in conflict with its interests by using its veto power.²⁶ With QMV, member states are willing to stretch further to reach a compromise rather in the face of the risk of suffering defeat in a voting session. For the part of the Commission, it has been able to act much more actively in terms of promoting the internal market programme since the introduction of QMV. This is especially true in controversial cases such as energy liberalisation, which section 6 and 7 will show.

3.5 THE EUROPEAN PARLIAMENT

Along with SEA and QMV came also the co-operation procedure followed by the co-decision procedure with the 1992 Maastricht Treaty on the European Union. The procedure strengthened the Parliament's role in Internal Market matters. The improved role of the Parliament as co-legislator has led to a tighter collaboration with the Commission. The Commission is aware of and pays in mind

²⁵ Hix 2005: 53

²⁶ Cameron 2007: 65

the strategic value of the Parliament as a potential supporter in its discussions with the Council on policy proposals.²⁷ The fact that the members of parliament (MEPs) are directly elected by the citizens in the member states adds further to the democratic legitimacy of the Commission's work and of the legislative procedure at the EU level as a whole.

3.6 THE EUROPEAN COURT OF JUSTICE

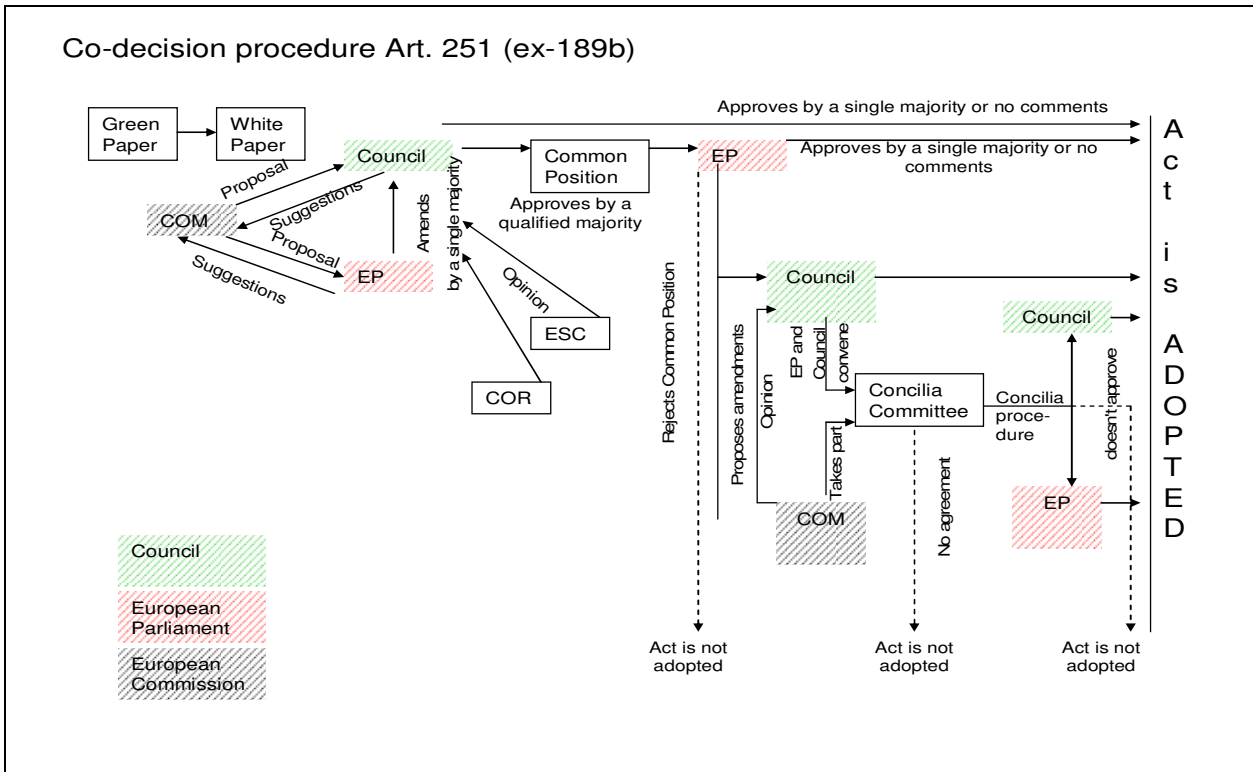
While the Commission is the policy initiator and enforcer, the European Court of Justice (ECJ) is the judicial interpreter of the provisions adopted in the Single Market Programme in the form of primary treaty law or secondary legislation such as regulations and directives. As this thesis will underline later, together these two institutions have been, and still are, in different ways, incremental to the progression of the single energy market, with the Commission in an activist role spurred by the Court's decisions. The reasons for this are several, but most importantly, once provided, judgments of the Court cannot be appealed against and member states are required to follow them due to fact that EC/EU law supersedes national law. In cases of judgments against individuals or private companies, the national courts are expected to carry out the sanctions imposed by the ECJ. Moreover, the core legal competence of the Court revolves around legislation for the Internal Market. It includes issues of failing to fulfil an obligation, where typically a member state is infringed by the Commission for not complying with Community law.²⁸ The competence for deciding matters of obligation fulfilment is a consequence of the nature of the legislative means available in EU decision-making. One of the most common means used is the directive, which has also been the case for energy market liberalisation. While always having a deadline for implementation, it leaves it to the member state to decide how it is best done in national law as part of the subsidiarity principle mentioned above.²⁹

²⁷ Cameron 2007: 66

²⁸ McCormick 2002: 110

²⁹ Cameron: 2007: 73

Figure 4: The co-decision procedure used for the electricity directive



Source: Own production

4.0 THEORETICAL FRAMEWORK

As mentioned previously, the analytical focus of this paper is to explain how and to what extent EU-level policy affects the member state level and the subsequent reaction at this level. It is important to note that the term “policy” covers both adopted legislation *and* proposals, ideas and preferences for legislation. This makes the Europeanization theory relevant for the analysis as it is able to explain the developments prior and during the adoption phase at the EU level (the positioning phase leading up to the final adaptation of legislation) and the later implementation phase in the member states. This extensive explanatory framework should make it possible to provide an answer to why resistance towards liberalisation of energy markets persists in some member states, while others are in favour, as the latter part of the research question implies.

Overall, Europeanization focuses on *"the impact of European policies within the member states. It thus entails two steps: adoption at EU level and then incorporation at the domestic level."*³⁰

First, it identifies the means and methods available to the EU level to enforce policy on the national level. The first step furthermore identifies what parts of the national system that are affected.

Step two builds on the first step and goes on to identify *why* the EU-level is successful in transferring the policy outcome to the national level. The domestic impact of EU policy is by no means uniform when it comes to energy policy and step two is very well suited for explaining why this is so. Europeanization identifies and makes use of mechanisms and variables to help explain the process and the outcome of the pressure at the domestic level. The identified *mechanisms* provide an understanding of the means available to the EU level to foster changes at the national level, while relevant *variables* are proposed to illustrate the outcome of the effort to change.

Table 2: two points of analysis in Europeanization theory

- | |
|---|
| <ul style="list-style-type: none">• Step one: (Mechanisms) How EU policy is able to affect the member state level. This step includes the pre-adoption phase and the adoption phase at the EU level• Step two: (Variables) The extent and direction of change at the national level due to the EU-level pressure. Besides the pre-adoption phase, this phase includes also the post-adoption phase, i.e. incorporation and implementation in the member states of adopted EU-legislation |
|---|

³⁰ Bulmer & Radaelli 2004: 4

4.1 DEFINITION OF EUROPEANIZATION

Many definitions of Europeanization are provided in the academic literature. Radaelli provides a basic, but very explanatory account of what Europeanization deals with as he states that "*On the one hand, one has to specify 'what' is Europeanized (...); on the other, there is the question of 'how much change' has been brought about by Europeanization.*"³¹ This is in good accordance with the two steps in Europeanization analysis presented in table 2 above.

In a more recent article, Radaelli, together with Bulmer, provides a more thorough explanation of the concept of Europeanization:

*"Europeanisation consists of processes of a) construction, b) diffusion and c) institutionalisation of formal and informal rules, procedures, policy paradigms, styles, 'ways of doing things' and shared beliefs and norms which are first defined and consolidated in the EU policy process and then incorporated in the logic of domestic (national and subnational) discourse, political structures and public policies."*³²

Bulmer and Radaelli's separation of the Europeanization process in construction, diffusion and institutionalisation serves the purpose of explaining the different layers of this process. The construction layer covers the initial agenda-setting by EU-level institutions, which is most often the Commission, due to its treaty-based right to do so. The agenda-setting role by the Commission is particularly visible within the field of energy liberalisation, which will be accounted for later in this thesis. The construction layer also covers the subsequent negotiation phase at the EU-level among the member states in the Council. However, the negotiation process and policy adoption is also present in the diffusion layer, where the policy agenda or adopted legislation is diffused. In other words, spread to the member state level for analysis if it is proposals, or for implementation if it is adopted legislation. Finally, the institutionalisation layer means that the EU level's policy preferences may be transposed to the national level and hence a shared understanding of how things should be dealt with develops. Basically, Europeanization is in play from the earliest policy thinking to the ending implementation of legislation. All put together, Europeanization provides that "*(...) neither the intergovernmental council or individual member states nor the European Commission or the European Parliament enjoy complete control over the evolution of the policy agenda, the course of the negotiations, or their outcomes.*"³³

³¹ Radaelli 2000: 11

³² Bulmer & Radaelli, 2004:4

³³ Eising, Rainer 2002: 89

However, the process of Europeanization, i.e. the impact of the EU-level on the national level, is not at all an equal process in all member states. In some policy areas, the developments at the EU-level has hardly any impact on the member state level in terms of necessary reforms or regulatory set-up, while demands for the same in other member states may be heavy. Moreover, member states may find themselves in the opposite corner when looking at other policy areas. This is because the mechanisms occurring in the process of change occur with different impact and the variables are consequently affected unevenly by these mechanisms.

This is why the theory is so well-suited for the analysis shifting positions by member states to the liberalisation process as suggested in the research question.

4.2 EU-PRESSURE ON THE MEMBER STATES - EXPLAINING THE MECHANISMS

The EU level has three overall measures at its disposal to alter domestic structures depending on the specific policy area. The measures concern *institutional compliance*, *changing domestic opportunity structures* and finally *framing beliefs and expectations of national actors*.³⁴ Basically, the measures differentiate by their aim and means.

4.2.1 Positive integration - Institutional compliance

Positive integration refers to a correction of already existing markets by the EU-level. More specifically, positive integration deals with market-correction regulation by setting up specific policy templates, which the member states have to implement in their national legislation. It is then the Commission's responsibility to make sure that the rules are implemented correctly in all member states to ensure a common legal base throughout the EU. The Commission's authority in this respect includes a clear element of coercion towards the member states, especially due to the possibility of taking member states before the ECJ to ensure proper implementation.³⁵

The EU-level thus sets up specific requirements, which domestic institutions have to adapt to. A certain EU-wide institutional model of regulation is drawn up to replace individual domestic arrangements and therefore often results in a reshaping of the already existing regulatory and market design.³⁶ Positive integration focuses mainly on the capability of national institutions to

³⁴ Knill & LehmKuhl, 2002:256, Bulmer & Radaelli, Radaelli, Börzel

³⁵ Bulmer & Radaelli 2004: 6

³⁶ Knill & LehmKuhl, 2002:257-8

adapt the new policy templates from the EU-level. According to Europeanization theory, the basic question is then to what extent the new template corresponds with the existing national templates. If only little convergence is needed, then change to the new template is expected. On the other hand, if the EU and the national templates are too different, then the national institutions in question may reject the change. This situation is also referred to as “goodness of fit” of institutions.³⁷

Radaelli has further developed on “the goodness of fit” and lists four possible outcomes of EU induced pressure on domestic institutions. Individually, they can explain the domestic response to EU-policy. In relation to the analysis of this thesis, two outcomes are relevant.

- Inertia indicates a situation of no change when domestic institutions find that the new EU-template is too different from existing practice and tradition. Domestic institutions react defensively and foot-dragging against change as a result. In the end, however, inertia may be difficult to maintain and change may be introduced more abruptly than initially expected.
- Absorption means the ability of domestic institutions to adapt to change and still maintain the basic conditions of the existing template without fundamental changes. Due to this fact, it should not pose a problem to incorporate the new policy template to the existing one.³⁸

4.2.2 Negative integration - Changing domestic opportunity structures

In logical progression from the concept of positive integration above, negative integration means removing national rules and regulation in order to facilitate new markets by securing the efficient function of these markets. It shares the use of specific policy templates with positive integration above, but in a more specific way. Templates are in this case used in the transitional phase in the attempt to bring about a free market in a given sector in line with the general principles of free movement of services, goods, capital and people within the internal market. The goodness of fit of national institutions is thus also an issue in negative integration, since some member states would have to adjust domestic templates. Nevertheless, the aim is to introduce competition in an internal market in the sector, so institutions and other actors will start to adapt to the new situation and position themselves in the new competitive market.³⁹

The mechanism of changing domestic opportunity structures has many characteristics in common with the common perception of liberalisation because of its market-making objective.

Unlike the mechanism of institutional compliance with its focus on market-shaping policies, the

³⁷ Bulmer & Radaelli 2004: 16

³⁸ Radaelli 2000: 11

³⁹ Bulmer & Radaelli 2004: 16

mechanism of changing domestic opportunity structures is visible in market-making policies. In this, the aim is basically to exclude protectionist choices traditionally at the disposal of national legislators, which are used to protect certain industries against competition and general internal market principles. The market-shaping aspect affects how actors in the market are able to operate and how national markets are regulated by changing the "*distribution of power and resources between domestic actors*."⁴⁰ However, while the objective is to reorganise and empower new actor groups at the domestic level, it is not the purpose to set up a fixed regulatory and market-design, unlike the mechanism of institutional compliance above. Instead the purpose is to change domestic opportunity structures by creating new market opportunities, and hence there is no predefined model for how the new market. The emphasis on changing domestic opportunity structures among industrial actors is also the focal point in Radaelli's account of negative integration as "[w]hen markets are opened, existing domestic equilibria are challenged, but there is no description of how the new equilibria must look. The essential mechanism concerns the changing distribution of resources (and ultimately power) between domestic actors (...)"⁴¹

4.2.3 Learning and framing domestic beliefs and expectations

The last mechanism is also the least direct way of affecting the national level. Instead of applying market-shaping or market-making policies, the EU measures aim at framing domestic beliefs and expectations of national actors. Changes in the mindset in member states may help the other way around by affecting the preferences and strategies of relevant actors.

This mechanism is most often applied in very controversial policy areas, where substantial opposition from the member states is expected and is used to form a basis for later legislative proposals. In other words, "(...) *these policies are designed to change the domestic political climate by stimulating and the strengthening the overall support for broader European reform objectives*."⁴² The European Council initiately draws up the toolbox which the Commission may make use of in its preparatory work as well as in the post-adoption phase to ensure correct implementation in the member states. This toolbox includes "*EU guidelines combined with specific timetables; action to be undertaken at the national and regional level; benchmarking and sharing of best practice; qualitative, and when appropriate, quantitative indicators; 'period monitoring, evaluation, and peer*

⁴⁰ Knill & LehmKuhl, 2002:258

⁴¹ Radaelli 2000: 13

⁴² Knill & LehmKuhl, 2002:258-9

review organised as mutual learning processes."⁴³ From these measures, member states are supposed to learn a common discourse and beliefs on a subject. So in essence, the EU-level functions as an arena for learning about the new policy practice and subsequently change domestic discourse from that.

Moreover, learning and framing domestic beliefs and expectations may also occur by the use of non-binding obligations set out by the Commission or the adoption of small-reaching, uncontroversial legislation in a given sector. For instance in the case of energy liberalisation, these initiatives may provide coalitions in member states in favour of liberalisation with more political backing or the domestic debates and discourse may turn in a more positive direction to follow suit of the European agenda. Little by little, the moulding of a new discourse and a new understanding of what solutions may look like may lay the groundwork for more controversial policies to be adopted than would be the case if no smoothing work had been done beforehand. Despite the apparent subtleness of this mechanism it is still important, because as Radaelli states, "(...), *even the vaguest European policy has the potential of altering the expectations of domestic players, for example by showing that the opponents of liberalization are fighting for a 'lost cause' because EU policy is heading towards a totally different direction.*"⁴⁴

Bulmer & Radaelli spell out a different emphasis, which is yet similar in its focus on beliefs and expectations. With a focus on the negotiation phase in the EU-institutions generally and in the Council in particular, their argument points to the relevance of "*governance by negotiation*".⁴⁵ The starting point in the argumentation is that every decision made at the EU-level, from a non-binding political agreement to adoption of legislation, is a result of a preceding negotiation. During the negotiation phase, learning by member states and national actors and hence their beliefs and expectations is a product of several influence-points. From the negotiation process, it is argued, the actors in the Council and outside form converging beliefs and expectations from proposed legislation as a result of learning of the premises for the legislation and the potential impacts on the fellow member states. This is especially clear in cases which require several rounds of negotiations such as the area of electricity liberalisation. The increased information level encourages member states to seek compromises instead of vigorously pursuing purely national preferences without

⁴³ Presidency Conclusions, Lisbon European Council, 23-24 March 2000. Quoted in Bulmer & Radaelli 2004: 11

⁴⁴ Radaelli 2000: 14

⁴⁵ Bulmer & Radaelli 2004: 4

consideration to the common European good. Finally, the more formal restrictions on member states' room for manoeuvre include the Council's voting rules, which leave the possibility of being out-voted.⁴⁶ As Bulmer & Radaelli concludes, "*In consequence, individual members are much less likely to pursue obstructionist negotiating strategies in the Council of Ministers, for fear that they will be over-ruled.*"⁴⁷

Radaelli speaks also of the importance of creating or shaping policy discourse as it "*provides a rationale and justifies change at the policy level.*"⁴⁸ Moreover, "*by contrasting the inertial scenario with the favourite scenario, narratives provide a sense of necessity and suggest that certain courses of action are urgent and legitimate.*"⁴⁹

4.3 HOW MEMBER STATES RESPOND TO EU-PRESSURE - EXPLAINING THE VARIABLES

Regardless of what happens at the EU-level, it is expected to have different impact in the member states across the EU. This is due to the individual conditions at member state level that are affected by the EU-pressure to reform. Therefore, it is necessary to identify a number of variables that can act as explaining factors for the uneven impact on member state institutions, socio-economic actors and markets and subsequent reaction towards the developments at the EU-level.

4.3.1 In case of institutional misfit

When speaking of domestic institutional compliance to a new regulatory scheme from the EU-level, it can be viewed as a two-step process. First, the domestic institutions' level of compatibility towards the new regulatory scheme imposed by the EU-level must be identified. This is also known as the "goodness of fit" of institutions at the member state level. According to theory, incompatibility may be too high for some domestic institutions and hence it is not possible to adapt and opposition towards the new EU regulatory model will emerge. High compatibility with the new system, on the other hand, provides good support for the new model because of high goodness of fit ratios.

Second, even cases of high goodness of fit does not always ensure change towards the new EU-

⁴⁶ Bulmer & Radaelli 2004: 5

⁴⁷ Bulmer & Radaelli 2004: 5

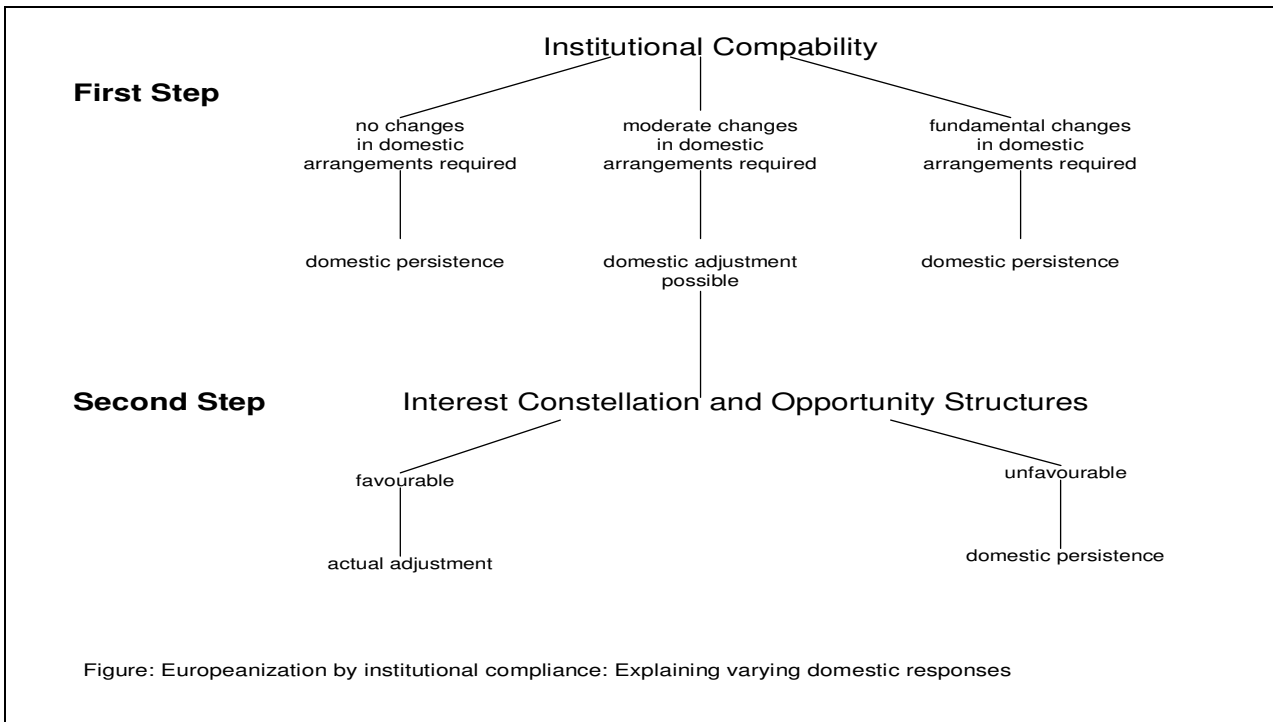
⁴⁸ Radaelli 2000: 18

⁴⁹ Radaelli 2000: 18

model. It is largely dependant on how the domestic institutional opportunity structures and constellations are manifested in order to mobilise support for actual change or support for status quo.⁵⁰

Radaelli explains in other words how the degree of goodness of fit comes into play. "*When adaptational pressure is low, because the content of EU policy is already present in a member state, there is no need to change domestic institutions. Simply put, there is a good 'fit' between national policy and the EU. Hence it is easy to absorb 'Europe'. At the other extreme, when the distance between EU-policies and national ones is very high, member states will find it very difficult to 'digest' and 'metabolize' European policy. Hence there will be inertia at the domestic level.*"⁵¹

Figure 5: Two steps determine the impact of EU-reform



Source: Knill & Lehmkuhl 2002: 260

4.3.2 In case of changing domestic opportunity structures

Unlike the above variable, changing domestic opportunity structures aims only to redistribute resources and market influence between domestic actors in the attempt to change the existing

⁵⁰ Knill & LehmKuhl, 2002:259

⁵¹ Radaelli 2000: 15

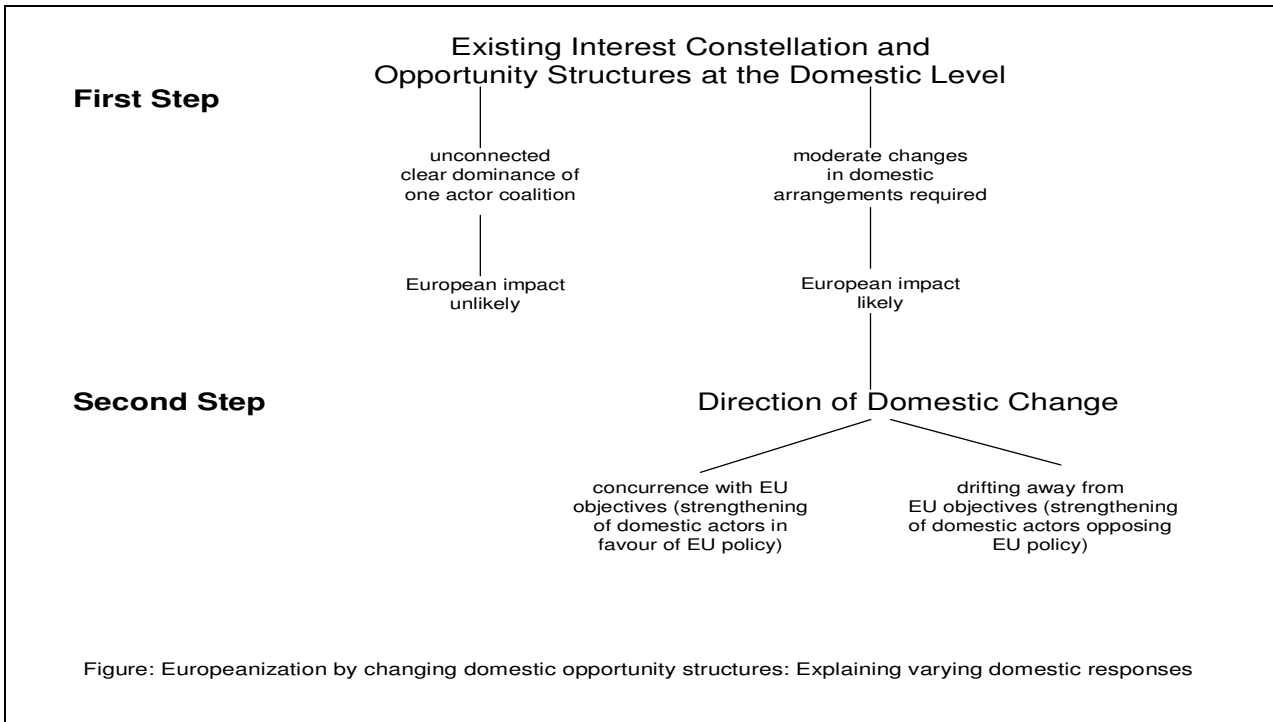
position of power, or equilibria, between them. In this scenario, any change or resistance following EU initiatives must be explained by looking at how or if these initiatives have altered the strategic position among the national actors. Accordingly, the level of impact by EU policies on member state actor coalitions follows the lines between the actors' powers. High impact is likely in markets that are characterized by evenly empowered interest constellations between actors and their powers and resources. Knill & Lehmkuhl set up a two-step analysis (see figure 5 and 6) of changing opportunity structures. Step one identifies how change may or may not come about at the domestic level by looking at the potential actor constellations and their interests. In case of equally powerful actor coalitions, *“Europe-induced changes in domestic opportunity structures are potentially more likely to tip the scales in favour of one actor coalition, hence triggering regulatory reform. By contrast, if domestic opportunity structures and interest constellations are characterized by the clear dominance of one actor coalition – as a result of the particular interest constellation and the highly uneven distribution of power and resources between different actors – the potential domestic impact of Europe will be much lower. In these cases new opportunities and constraints for domestic actors are less likely sufficiently to alter the existing distribution of powers and resources between domestic actors.”*⁵²

Step two, on the other hand, looks at the direction of domestic change, which often is not uniform across the member states. This is due to substantial room for manoeuvre in the implementation phase of EU policies, which is especially the case in liberalising electricity markets in the EU. Changes in member states may take different directions and may range a lot in scope of change as well. So the analysis of direction of change is important as well. Step two focuses on the extent to which domestic reform matches the objectives, or the intent, of EU regulatory policies. In their view, Knill & Lehmkuhl only *“expect domestic reforms which conform to European objectives when European changes in domestic opportunity structures actually strengthen those actor coalitions which support these objectives. By contrast, it might be the case that domestic changes go in the opposite direction if European policies strengthen – somewhat paradoxically – domestic actor coalitions which oppose the changes.”*⁵³

⁵² Knill & LehmKuhl, 2002:261

⁵³ Knill & LehmKuhl, 2002:261

Figure 6: Two steps determine the national outcome of EU-reform



Source Knill & Lehmkuhl 2002: 262

4.3.3 In case of framing domestic beliefs and expectations

Unlike the previous two variables, framing domestic beliefs and expectations disregards actual legislation and concentrates only on framing support for a certain political agenda or policy initiatives to come. In other words, the framing is aimed at changing the way domestic opportunity structures perceive the potential or threat behind policy ideas. Again, Knill & Lehmkuhl propose a two-step analysis of the way framing may alter the beliefs and expectations of domestic actors. Firstly, EU-framing might change *the outcome* of national reform initiatives, which are already under way in the individual member states. This is contingent on an already existing platform of support behind the reforms at the domestic level, which matches the idea-flow coming from the EU-level. If this is the case, the ideas from the EU-level may serve as an inspirational model that can offer solutions to national actors.

Secondly, in addition to changing the outcome of domestic reform, EU-framing may also help alter the reform process itself by changing the beliefs and expectations of domestic actors. From the EU-framing, these actors may thus turn supportive towards promoting domestic reform based on new information and ideas from the EU-level. Knill & Lehmkuhl explain that “*Europe-induced changes in the belief of [national actors] might alter the domestic constellation of interests, thereby*

increasing the support for regulatory change as actors who previously opposed regulatory change no longer rely on their veto position. In this way European influence contributes to the emergence of a dominant advocacy coalition whose core beliefs are fairly congruent with the ideas behind European legislation.”⁵⁴

The extent to which EU-framing is successful towards triggering domestic reform relies very much on the initial constellation of interests, opportunities and beliefs among actors. If support from the beginning is low, it is less likely that framing will be able to overcome the opposition from national actors, who are against reforms that will converge with the EU-objectives.

⁵⁴ Knill & Lehmkuhl, 2002:263

5.0 ELECTRICITY MARKET LIBERALISATION IN CONTEXT

The ever evolving integration in economic and certain political areas in the European Community has progressed much more than the integration within energy matters. These matters have emerged slowly or not at all in terms of coordination and regulation. The reason for the exclusion of energy has to do with the strong interest of national governments to keep energy sectors national based on public service concerns. The strong natural monopoly in the transmission and distribution phases have traditionally led to the vertically integrated companies supplying society based on exclusive rights issued by the government. Governments have found that energy supply was essential for society and has thus obliged the monopoly company with strong supply obligations. Moreover, electricity and gas supply is vital to the states' overall economic and military capabilities, and governments therefore have strong interests vested in abundant supply. Also, electricity and gas sectors are extremely capital-intensive to build up and maintain and are additionally also very technically complex. This has necessitated strong public intervention in order to secure reliable supply for all.⁵⁵ A look down the historical lane for the relationship between governments and the energy sector, including also electricity supply, during the past 60 years will reveal some clear trends of public control. This might help to shed light on the much later progress in European Energy cooperation than in other areas.

5.1 THREE TRENDS IN GOVERNMENT-INDUSTRY RELATIONS

The move away from full governmental control over the energy sector and towards more competition has been slow. The attempts to rebuild societies after World War II and to cope with the ever increasing energy demand made the energy sector a key sector in this regard. At a later point, the energy crises in the 1970s fostered new thoughts on government-industry relations, which in the middle of the 1980s sparked the beginning of looser government control over industry by privatisation or industry regulators.⁵⁶

5.1.1 Post World War II

From a government point of view, the electricity and gas sectors in Europe after the Second World War constituted the backbone of the build up process of societies. From that principal view,

⁵⁵ Cameron 2007: 7

⁵⁶ Cameron 2007: 11-12

governments started to exercise heavy control over the energy sector, which often resulted in a nationalisation of the entire sector with the assets of this sector now being run by government agencies or public companies. A consequence of the state-run structure of the sector was that these companies operated outside the competition laws normally applying for business life and new entrants on the supply side were excluded. The latter was also the result of the issuing of exclusive rights for the incumbent energy supplier in return for public service obligations (PSO) set out by the state. These PSOs demanded equal treatment of all users and a certain level of service. All together, this structure opened into a de facto monopoly status of the incumbent energy company in the national energy sector.⁵⁷

5.1.2 Energy crises in the 1970s

The repeated energy crises in the 1970s put security of supply at the top of the political agenda and led to many governmental interventions in the energy sector.⁵⁸ The aim was to foster a more diversified contribution from energy sources, which could help reduce the dependency on Middle Eastern oil. Some of the measures included the construction of nuclear plant or subsidies for alternative, renewable energy sources and energy efficient technologies. The interventionist approach by governments resulted in decreased dependency on imported oil and to better and more efficient utilisation of domestic oil resources. This came along with the inclusion of other energy sources, notably nuclear energy as it was the case in France. On the other side, however, questions related to the governmental role in the energy sector and the abundant evidence that the energy sector was to some extent dysfunctional. This formed a base for a new set of ideas arguing for a less dominating role of government in energy sector affairs. Notably in the US and the UK, the idea of introducing competition in some phases of the energy sector emerged. The idea was carried by technological progression, allowing smaller decentralised power utilities to enter the system.⁵⁹ At the European political level, the focus on security of supply and the preferences for national programmes for energy policy forced the development of a common energy policy. This common policy was to rely on the lowest common denominator and only resulted in guidelines providing suggestions to member states on issues like energy conservation, import dependency and research on renewable energy sources.⁶⁰

⁵⁷ Cameron 2007: 12-13

⁵⁸ Matlary 1997: 18

⁵⁹ Cameron 2007: 14-15

⁶⁰ Matlary 1997: 19

5.1.3 Energy sectors influenced by general globalisation

The newly-emerging ideas of introducing competition in the energy sectors received further support in the 1980's as a horizontal paradigm of liberalisation and free trade across borders built momentum. The concept of 'globalisation' was born and did since bring competition into a range of sectors similar to the energy sector. These are for instance air traffic, telecommunication, railways, postal services as well as an overall liberalisation of financial markets and global trade. Moreover, the age of globalisation also witnessed the creation of several supranational institutions that were all contributing to the changes in governments' involvement in energy industries.⁶¹ These new ideas coincided with severe scepticism in Europe in terms of economic progress. The increasing competition from the US and Japan, which Europe was increasingly trailing behind was also a factor. The answer was to accelerate the idea of a common market in Europe based on deregulation and freedom of movement for goods, services, people and capital to cross national borders without discrimination. Deregulation was increasingly seen across Europe as a tool to make markets function properly and to bring about growth and global competitiveness.⁶² The political answer was to be the Single European Act, which included more than 300 directives that would help transforming separate national markets to one single market by the end of 1992. Along with the long range of directives, SEA also brought new voting rules and decision-making procedures to the table. Until this point, all decision in the Council were made by unanimity, which by implication meant many watered-down decisions if draft legislation was not turned down completely before that. The new system of QMV allowed more efficient decision-making and greater will among member states to stretch further during negotiations to compromise than during the former unanimity system. Moreover, the EP was allotted more powers in the decision-making process and was now equipped with stronger powers to amend the Commission's proposals.⁶³

5.2 SETTING THE SCENE: INCLUDING ENERGY IN THE INTERNAL MARKET PROGRAMME

In full accordance with the massive involvement and control by national governments in the national energy sectors, energy as a policy area was omitted from the general programme on the development of the common market. This was outlined by the Commission in its white paper in

⁶¹ Cameron 2007: 15-17

⁶² Matlary 1997: 19

⁶³ Matlary 1997: 20

1985. The foundation for this was that it was regarded as a sector not suitable to be exposed to the form of competition otherwise envisioned in the SEA programme. The white paper did however mention that four major sectors; transport, water, telecommunications and energy were "*at present not covered by Directives. Whilst it is clear that enlargement of coverage must be realised before 1992, additional action is required to take account of the fact that some of the awarding entities in these sectors fall under public law, while others are private bodies.*"⁶⁴ It thus seems from the statement in the white paper that the Commission was determent to include the network industries in Europe, including energy, in the general Internal Market Programme and introduce competition into these sectors at a later point. Nevertheless, special attention was given to the fact that these sectors had special characteristics to bear in mind. In addition to that, the Commission later stated that the European energy sectors were full of barriers of all sorts to the establishment of a single energy market in Europe due to the fact that "*[m]ost of the are the end-product of domestic rules and regulations originating in an often distant past predating the European idea: this applies for example to all the potential obstacles arising from purely domestic monopolies.*"⁶⁵

5.2.1 The Commission identifies obstacles to a common energy market and a way forward

Up until the formulation of the Internal Market Programme and later inclusion of perspectives for an internal energy market, the energy sectors were completely dominated by the traditional paradigm of heavy government interference and control.⁶⁶ However, a new approach came to the surface in the Commission's working document in 1988. This dealt with how to transform the energy markets and laid the ground for phasing out the traditional paradigm of strict government control and monopoly companies. The paper was in essence an inventory list of obstacles in the current market structures and regulations to the formation of a single energy market in the EC. In the paper, the Commission analysed the general problems involved with current energy markets, but also the difficulties in changing the status quo. The Commission also suggested a road map forward based on a set of priorities of the problems mentioned in all sectors of the internal energy market, including solid fuels, oil, nuclear energy, natural gas and electricity.⁶⁷ The Commission concluded that member states' energy sectors, while being very different in terms of market structure,

⁶⁴ EU-Commission white paper on the Single Market Programme 1985: 41

⁶⁵ EU Commission work paper 1988: 13

⁶⁶ Cameron 2002: 29

⁶⁷ Commission working document 1988: 31pp

regulations and government involvement, they all shared features which were counterproductive to the development of a common energy market. In the same connection, the Commission concluded that the member states' energy sectors also interfered with the general EC rules on free movement of goods, services and competition rules. Despite room for improvement in all branches of the energy markets, the current structure of the gas and electricity sectors stood out as especially problematic in the eyes of the Commission. The reason was that both gas and electricity were dependent on transmission and distribution networks in order to function. Obstacles emanating from the transportation system dependency included, among other things, the presence of vertically integrated monopoly companies in the member states, which held exclusive control of all phases of the electricity and gas supply from production to end-sales to customers. Exclusive rights or ownership control of the transmission and distribution networks created an opportunity for the incumbent company to discriminate against competitors by simply restricting or denying access to the grid. In the eyes of the Commission, this made it extremely difficult to introduce fair competition in the sectors under these conditions.⁶⁸

Having identified the obstacles to the common energy market in the paper, the Commission next provided the solutions to the way forward. The obstacles should be removed by way of the following means. First, the applying of the before-mentioned white paper from 1985 in which technical and fiscal barriers are dealt with. Second, applying Community competition law to allow free movement of goods and services. Thirdly, dismantling of state monopolies of commercial character and applying rules of competition and state aids rules.⁶⁹

5.3 SUM-UP

This chapter has had a dual purpose. First, it has identified the evolving trends or paradigms concerning the structure and regulation of the European energy sectors and especially the role played by the national government. The shift in paradigms have meant a shift from monopoly structures and strong government intervention to a structure allowing more room for competition in a market approach combined with independent regulation. It shows the "beliefs" factor which helps mold the ground for later legislative work. Europeanization also acknowledges this as an important mechanism for policy change. Secondly, this chapter has placed the work of liberalising the

⁶⁸ Commission working document 1988: 68pp

⁶⁹ Commission working document 1988: 13pp

electricity sector, the analytical case of this study, in a wider context in an attempt to grasp the idea of a common EU energy market. The common EU energy market includes sectors such as oil, nuclear, gas and coal along with rules and regulations on a number of surrounding mechanisms to take into account horizontal issues such as price transparency, state aid, PSO, environmental concerns.

6.0 EXPLAINING ELECTRICITY DIRECTIVE 96/92

This section seeks to analyse the progress and the result of the first electricity directive (directive 96/92 EC) adopted by the Energy Council in December 1996 in an analytical framework. It will do so by looking at the mechanisms and variables at play, which in combination have contributed to the political outcome. It is first necessary to establish that the EU-level, led by the Commission, proceeded in accordance with the mechanisms of Europeanization and how it went about doing it. The first half of the analysis will therefore focus on the actions taken by the Commission and partly the member states in terms of setting up a new regulatory regime to replace existing ones. Altering also the domestic opportunity structures in the member states and achieve momentum to do so by framing the beliefs and expectations of the relevant actors. The analysis includes a survey of the political contemplations from the start of the negotiations on the directive proposal by the Commission. The second part of the analysis will centre round the variables visible in the process, which help to provide an understanding of the development of positions of member states, public institutions and key socio-economic actors relevant to the negotiations. The socio-economic actors first and foremost include the national utilities and monopolistic energy companies and energy consumers.

6.0.1 The Commission as policy entrepreneur

As stated earlier in this paper, the Commission was instrumental in the initialisation of the internal energy market creation with the general internal market programme as a strong legitimising platform. Also in tune with the general internal market thinking, the Commission anticipated that energy market liberalisation would generate economic benefits to the member states. In its working document from 1988⁷⁰, the Commission comments on what is at stake for the single energy market and what benefits could be achieved. The overall aim is to make the European competitiveness of businesses stronger against international competition in which energy costs is a significant parameter. The Commission estimated that "*[e]nergy represents 25 to 30% of costs of production in the steel, glass, aluminium and building materials sectors.*"⁷¹ A reduction of energy expenses would thus lead to increased competitiveness, which would lead to lower prices on end-products to the ultimate benefits of other businesses and private households. Moreover, it would have a positive effect on employment emanating from general economic growth. The Commission also argued that

⁷⁰ Commission working document 1988: paragraphs 13-19

⁷¹ Commission working document 1988: paragraph 14

competition would have a positive impact on the structure of the energy sector itself as competition would lead to rationalisation of production and transmission activities. Improvements like these would equip the European sector with an advantage against international competition. Liberalisation would furthermore increase the security of energy supply in the member states, as better cross-boarder interconnections in the grids would mean better transmission in emergency situations. Overall, the Commission argued that the "cost of non-Europe" would affect the European economic performance. In this connection, the Commission argued that action had to be taken to implement a single European energy market which was deemed "(...) *of vital importance to the future of the Community.*"⁷² All aspects working as obstacles to the single market for energy sources and member state energy structures therefore had to be scrutinised. Also, in connection with additional legitimacy for the Commission to engage in energy liberalisation the impression was that special interests at the member state level discouraged member state governments and consumers from promoting reform on their own. On top of that, it should be added that the energy-intensive industry sectors mentioned above accounted for 15 million employees at the time, compared to the one million directly employed at the energy providers. Against that background, the Commission felt inclined to consolidate and expand future employment in the industrial sectors.⁷³

6.1 PUTTING FORWARD THE FIRST INTERNAL ENERGY MARKET DIRECTIVE PROPOSALS

The identification of obstacles to the internal energy market was then followed by the first concrete directive proposals from the Commission. Overall, the legislative agenda had some distinct features as the process could be divided in to two stages. The first stage focused on four proposals for directives aiming at improving the clarity of practises of existing supply companies in the energy sector. It did little to alter status quo in terms of allowing more competition in the field.⁷⁴ The package included proposals for a Price Transparency Directive, a Procurement Directive and Transit Directives for electricity and gas. They were all adopted by the Council during 1990-1991 without too much controversy as they did little to change the status quo in the national energy sector settings. Only the provisions on gas transit stirred up some discussion and took a little longer for the Council to agree on.⁷⁵ The second stage focused on proposals for common rules for electricity and

⁷² Commission working document 1988: paragraph 18-19

⁷³ Cameron 2002: 98

⁷⁴ Cameron 2002: 98

⁷⁵ Matlary 1997: 110-111

gas markets, which proved much more controversial among all actors involved. The Commission had already suggested that the before-mentioned directives on transit, price transparency and procurement were mostly served at the foundation for the more substantial internal energy market, based on the liberalisation of the electricity and gas sectors. Here, third party access was pivotal to the whole project as new actors' entrance on the market on the supply side were obstructed by the incumbent suppliers. Other obstacles to a well-functioning energy market were the bundled structure of the supply undertakings in vertically integrated companies blocking for fair competition and transparency in the sectors. Moreover, member states continued to intervene too often and too excessively in the two sectors.⁷⁶

6.1.1 The initial hearing phase on the draft electricity directive

As announced during the negotiations and adoption of the first package of directives, the Commission initiated the work on the electricity directive with intensive consultation with affected parties and conducted expert studies. The concept of TPA was particularly controversial and became the subject of extensive consultation. In short, the vision behind TPA was to allow all suppliers access to all gas lines and electricity grids after paying a uniform tariff decided by an independent authority. However, the energy industry opposed TPA as the sector largely consisted of integrated companies. They were in control of generation, transmission and distribution and the TPA concept posed a blow to their commercial activities. The Commission sponsored a number of reports and analyses from which two reports in 1990 were of particular importance and provided inputs to the later draft electricity directive. The reports consisted of a cost-benefit analysis of open access to the grids and how to provide third party actors access to those grids.⁷⁷ Simultaneously, the Commission established four consultative committees in which representatives from the energy production, transmission and distribution industry, industrial and private consumers, and member states participated. The aim of the consultative committees was to look into the need for implementing TPA in the grid systems and how this could be done. The outcome of these consultations showed that the consultation was unsuccessful in changing the positions of energy industry and most member states as they continued to oppose the concept of TPA in the energy system.⁷⁸

⁷⁶ COM 1991/548 final. general explanatory memorandum: 7

⁷⁷ Cameron 2002: 121

⁷⁸ Cameron 2002: 121

6.1.2 Selecting the legal basis for the electricity directive

The unwillingness from the energy industry and member states forced the Commission into considerations on the most productive way forward and it had two legal bases for further action. Internally in the Commission, the Energy Directorate and the Competition Directorate were the two dominant directorates in the work towards the internal energy market. The former directorate was in favour of including the stakeholders and was also responsible for setting up the initial committees for discussions on TPA models. The Competition Directorate, on the other hand, was more in favour of using its treaty-based authority to enforce the Community's competition rules on national monopolies' abuse of position.⁷⁹ The Treaty of Rome provides the Commission with extensive authority in competition policy issues in article 86, which includes the right to bypass consultation with the EP and without unanimity in the Council as an alternative to the co-decision procedure, which would include the EP and the Council more. Article 86 explicitly stated that:

1. *In the case of public undertakings and undertakings to which Member States grant special or exclusive rights, Member States shall neither enact nor maintain in force any measure contrary to the rules contained in this Treaty, in particular to those rules provided for in Article 12 and Articles 81 to 89.*
2. *Undertakings entrusted with the operation of services of general economic interest or having the character of a revenue-producing monopoly shall be subject to the rules contained in this Treaty, in particular to the rules on competition, insofar as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them. The development of trade must not be affected to such an extent as would be contrary to the interests of the Community.*
3. *The Commission shall ensure the application of the provisions of this Article and shall, where necessary, address appropriate directives or decisions to Member States.*⁸⁰

Despite the opposition in mind, the Commission chose to make use of its article 86 powers at first.⁸¹ In 1991, the Commission thus drew up directive proposals based on article 86. Besides demanding more open access to the transmission and distribution grids, the directive proposal "(...) required Member States to remove any exclusive or special rights for the import, export, production, supply,

⁷⁹ Matlary 1997: 112

⁸⁰ http://ec.europa.eu/comm/competition/legislation/treaties/ec/art86_en.html

⁸¹ Cameron 2002: 123

and marketing of electricity and natural gas."⁸² Nevertheless, the member states and the EP protested heavily against this procedure by the Commission. They raised concerns regarding the democratic legitimacy of excluding the EP and the Council in decisions of such magnitude to national affairs as energy markets were characterised to be. Internally in the Commission too, the chosen approach was up for debate. Throughout the negotiations, the Competition Directorate maintained its viewpoint that there was no reason why the general competition rules should not apply to the energy field. It also opposed the inclusion of the Single Buyer model in the final directive. However, the Energy directorate claimed that it was in charge of the Community's energy affairs and was in the end willing to compromise on this issue to at least be able to introduce some sort of liberalisation to the energy markets as a start.⁸³ Instead, the Commission chose to proceed under the co-operation procedure⁸⁴ to fully include the two institutions in the legislative work.⁸⁵

6.2 PUTTING FORWARD THE FIRST DIRECTIVE PROPOSAL

The first directive proposal was unofficially put forward by the Commission in 1991 prior to the formal presentation to the Council and the EP, while simultaneously holding additional consultations with relevant actors. In the general explanatory memorandum to the draft directive,⁸⁶ the Commission based its proposal on the overall objectives. First, free movement of products and services both inside and across member states in the single market should also apply to the electricity and gas sectors. Thus the draft directive required changes to "*(...) many existing national regulations regarding production, imports, exports, transmission and distribution (...)*".⁸⁷ Second, opening up the two sectors to competition would also imply better security of supply from more diverse sources of energy. Third, liberalisation would improve competitiveness for the European industry, particularly the energy-intensive part of industry. As additional benefits, the Commission also mentioned environmental improvements and lower CO₂-emissions, following more efficient use of resources.

⁸² Cameron 2002: 123

⁸³ Matlary 1997: 57

⁸⁴ By the use of article 95 EC Treaty/100a SEA concerning competition matter that required co-operation procedure with the EP and the Council. During the negotiation process, the Treaty on the European Union (Maastricht Treaty) introduced the co-decision procedure as replacement for the co-operation procedure. See section 3.2

⁸⁵ Cameron 2002: 124

⁸⁶ COM 1991/548 final, general explanatory memorandum

⁸⁷ COM 1991/548 final, general explanatory memorandum: 4

In the memorandum, the Commission elaborated on the many advantages of a liberalised single market for electricity and gas for the general economic growth and employment in member states. The Commission brought in to light the many advantages by referring to other nationally regulated sectors such as transportation, telecommunications and financial services also up for similar liberalisation. Moreover, the Commission also found reason to anticipate benefits for the energy industry itself from liberalisation and competition as this would lead to better efficiency and competitiveness from the introduction of new technology, fuel diversification and rising energy products trade across borders improving security of supply. Though above all, cross-border trade in the sector would provide end-users of both electricity and gas with greater choice of supply following competition and hence lower and more converging energy prices across the EC.

Again criticism was targeted towards the proposal which led to changes in the official draft directive in early 1992.⁸⁸ In essence, four main concepts were introduced in the draft directive that would spell changes to the existing energy industry structures and included provisions on transparency in licensing, unbundling, TPA requirements and eligibility criteria.

- The provisions on licensing centred round greater transparency for granting licences for electricity production and construction of electricity lines networks aimed at giving better conditions for new suppliers and to large industrial end-users.⁸⁹
- Management and accounting unbundling of generation, transmission and distribution activities of vertically integrated companies. This should be achieved by separating the transmission and distribution activities in two divisions within the company. Moreover, the accounts of the two new divisions, along with the generation division, should be required to publish individual accounts. This should allow greater transparency and thus fairer competition due to improved comparability between companies, avoidance of discrimination and abusive behaviour against third parties.⁹⁰
- TPA - obligation by the grid owner to allow TPA to the networks of other generation companies, but only to eligible entities. As regards eligibility of those entities, the Commission came up with two criteria: large industrial consumers with minimum electricity consumption of 100 Gwh pr. year, which would take in 400 to 500 potential consumers in the Community. This primarily included the aluminium, steel, chemical and glass industries. The second criteria

⁸⁸ COM 1991/548 final. Cameron 2002: 125

⁸⁹ COM 1991/548 final. General explanatory memorandum: 16

⁹⁰ COM 1991/548 final. General explanatory memorandum: 22

concerned the distribution companies with a minimum threshold of three per cent of a member state's combined supply to other industrial sectors and households. Here, the Commission estimated that around 100 of such distributors would meet the criterion inside the Community.⁹¹ A central element in designing the TPA system was security of supply and to guarantee a reliable operation of the networks. A network managing authority was to be in charge of technical and operational issues while at the same time being independent from electricity generation and transportation to ensure fair treatment of all actors.⁹²

6.2.1 Stepwise introduction to electricity liberalisation

Given the circumstances of widespread opposition and scepticism towards the liberalisation plans, the Commission pursued a gradual introduction of the new guiding principles in the sector. It was done with respect given to subsidiarity, a minimum of regulatory burdens on the industry and substantial consultation with actors involved.⁹³ This would allow the very fragmented European industry time to adjust to the new common settings instead of risking too much turmoil from an all-in-once approach. The Commission's solution was hence a division of the liberalisation reforms in three phases with a minimum of reform being incorporated each time without denying those member states that wished to go beyond the minimum requirements the right to move ahead. The principle of subsidiarity was also incorporated into the proposal to allow member states the necessary discretion to choose the best suited solutions. This was due to the special characteristics of the national energy sectors from the overall provisions in the directive. In extension of the subsidiarity principle, the Commission made an effort to underline that the new legislative regime should replace, rather than add to, the existing one. This was the assumption that the legislative framework for a liberalised electricity market would be more complex than what was needed to regulate domestic monopoly companies.⁹⁴ As regard consulting relevant actors in the reform plans, the co-operation procedure would allow a maximum level of involvement from the EP and the Council and from civil actors, whose level of involvement would rise from the more transparent decision-making procedure. Nevertheless, the Commission maintained its pressure on the legislative process by proclaiming its continued right to ensure proper competition and the free movement principle which the Treaty provisions obliged it to pursue.⁹⁵

⁹¹ COM 1991/548 final. General explanatory memorandum: 18

⁹² COM 1991/548 final. General explanatory memorandum: 9

⁹³ Cameron 2002: 127

⁹⁴ Cameron 2002: 128

⁹⁵ COM 1991/548 final. General explanatory memorandum: 5

6.2.2 Opposition from all sides

Despite all the Commission's considerations to mitigate the impacts of the reform on member states' electricity industry structures, there was still great opposition especially towards the proposal dealing with the TPA. In November 1992, the Council insisted that the Commission made changes to its proposal due to a threatening deadlock over the present measures in the draft directive.⁹⁶ The Council agreed to the general need for more efficiency, transparency and competitiveness in the sectors. However it preferred that the creation of the single energy market should rest on six fundamental principles: security of supply, environmental protection, protection of small consumers, transparency and non-discrimination, recognition of the differences between national systems and transitional provisions.⁹⁷ Moreover, the EP and the Economic and Social Committee too expressed severe concerns regarding the conditions in the TPA provisions. The EP had reservations towards unbundling as well as the TPA provisions. So instead, the EP proposed to leave existing monopoly companies intact by only introducing the liberalisation concepts to the supply of new demands, which should be up for bids in open tenders.⁹⁸

6.3 THE COMMISSION'S LEGAL STRATEGY: ENFORCING COMPETITION VIA THE EUROPEAN COURT OF JUSTICE

As mentioned, the Competition Directorate of the Commission was in charge of enforcing the competition rules laid out in the Treaty of Rome in the member states in close tandem with the ECJ in cases that require a court judgment. Despite the fact that these competences have been at the disposal to the Commission since the Rome Treaty was signed, it has not made much use of them prior to the creation of SEA and the new paradigm of deregulation and competition as elaborated on in section 5.1.3. From that point on, the Directorate took a more active approach towards national monopolies and targeted especially the telecommunications sector and the energy sector in order to dismantle those abusive companies.⁹⁹

While pursuing progress through the co-operation procedure in reaching a deal on the proposed electricity directive, the Commission simultaneously made use of the existing EC Treaty rules, notably article 31, 1. It stated that "*Member States shall adjust any State monopolies of a*

⁹⁶ Cameron 2002: 129

⁹⁷ COM 1993/643 final. General explanatory memorandum: 3

⁹⁸ COM 1993/643 final. General explanatory memorandum: 4-5

⁹⁹ Matlary 1997: 120

commercial character so as to ensure that no discrimination regarding the conditions under which goods are procured and marketed exists between nationals of Member States."¹⁰⁰ While putting forward the draft directive, the Commission did not try to underemphasise its willingness to pursue the application of existing competition rules on the energy sector while also working for new directives.¹⁰¹ With this Treaty basis in hand, the Commission targeted the member states' import and export structures which were characterised by exclusive rights to the national monopoly companies in electricity and gas trade. According to the commissioner of competition at the time, the aim of the legal action was to "*achieve competition in sectors previously characterised by state monopoly, and that only minimal norms would apply in sectors where a public service function such as gas, electricity, the postal service, transport, banks and broadcasting could be said to exist.*"¹⁰² For electricity and gas, this should be achieved with respect to security of supply as well. The Commission's powers are vested in article 226. It states that "*[i]f the Commission considers that a Member State has failed to fulfil an obligation under this Treaty, it shall deliver a reasoned opinion on the matter after giving the State concerned the opportunity to submit its observations. If the State concerned does not comply with the opinion within the period laid down by the Commission, the latter may bring the matter before the Court of Justice.*"¹⁰³ The Commission is thus empowered to ensure that member states do not violate the general provisions in the Treaty and is able to infringe in cases of violation.

In 1991, the Commission took legal action and began infringement proceedings against as many as nine member states, including France and the UK by asking them to either dismantle those companies' positions in the sector or justify the necessity of their positions. The UK, Belgium and Greece were able to do the latter and the cases against them were dropped. The remaining member states challenged the infringement move and questioned the legal grounds by the Commission arguing that article 31 did not cover the electricity sector, while also arguing that electricity was a service - not a good. Nevertheless, the Commission took further steps in pursuit of a legal decision arguing that the infringed member states' legislative statutes on exclusive rights created monopoly companies for electricity and or gas. However, in 1993, the infringement process was suspended to allow member states time to investigate properly the structure of their national energy industries and

¹⁰⁰ <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:12002E031:EN:HTML>

¹⁰¹ COM 1991/548 final, general explanatory memorandum: 5

¹⁰² Matlary 1997: 120

¹⁰³ <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:12002E226:EN:HTML>

how it affected energy trade due to positive signals from notably France to liberalise its sector. However, France did little to improve its legislation in both the electricity and gas sector. The Commission therefore resumed the proceedings, which was a way to put further pressure on the reluctant member states to agree on the new directive proposals. This move was used by the Commission to repeatedly reminding the member states of its treaty-based powers within competition and exclusive rights issues under article 31 and 86.¹⁰⁴

In the early part of 1994, after more than two years of fruitless negotiations on the draft electricity directive between the EP and the Council, the Commission chose to follow a more aggressive approach through the ECJ against five remaining member states. These were Spain, the Netherlands, France, Ireland and Italy. The basic claim by the Commission was that the public service function of the monopoly companies could not justify being exempted from the competition rules and neither could the considerations of security of supply.¹⁰⁵

6.4 REVISED PROPOSALS FROM THE COMMISSION IN 1993

Despite the application of the ECJ strategy, the Commission realised that abolishing exclusive rights in the energy sectors would not create a sufficient internal energy market without also incorporating a TPA model and unbundling of vertically integrated energy companies based on new directives. Therefore, the Commission set forward yet another revised set of directive proposals to the Council and EP in February 1994. These rested on four principal concepts of TPA, unbundling, rules for tendering and bidding and a harmonisation programme. Again, the Commission stressed that "*[e]nergy is a major production cost factor and the competitiveness of companies which consume energy is a precondition for turning round the current trends on the job market.*"¹⁰⁶

- With regards to the TPA, the model of negotiated access (nTPA) was introduced instead of the previous proposal of regulated access (rTPA). Negotiated access was regarded a softer requirement than regulated access and it also put more emphasis on services of general economic interest which was exempted from the general rules of competition.¹⁰⁷ The recital in the proposal explicitly states that "*[w]here the industrial consumer is connected to the distribution system, access to the system must be the subject of negotiation with the distribution*

¹⁰⁴ Cameron 2002: 133pp

¹⁰⁵ Matlary 1997: 123

¹⁰⁶ COM 1993/643 final. General explanatory memorandum: 5

¹⁰⁷ Cameron 2002: 135

company managing the system to which the consumer is connected. Similarly access to the transmission system must be negotiated with the system operator concerned."¹⁰⁸

- As regards the TPA provisions, the concept of Public Service Obligations (PSO) was also further enhanced in the Commission's revised proposal. While referring to the existing safeguards for activities of services of general economic interest in the existing Treaty framework, the new proposal explicit account of these activities in every aspect of the future competitive energy markets.¹⁰⁹
- The Commission also proposed lighter requirements for unbundling. While initially calling for management as well as accounting unbundling, only the latter requirement survived the revised proposal. And there was no mentioning of splitting up the vertically integrated company in separate divisions for its production, transmission and distribution activities. Instead, "*[v]ertically integrated undertakings shall, in their internal accounting, keep separate accounts for their production, transmission and distribution activities, as they would be required to if the activities in question were carried out by separate companies, and shall publish a balance sheet and a profit and loss account for each activity in their annual management report.*"¹¹⁰

In November the same year, the Council decided to split up the electricity and gas sector dossier. Instead, the two draft directives were to be negotiated separately with the electricity proposal taking priority over the gas proposal, which was temporarily put on hold. The reason was that the gas proposal had some further complications to solve including dependence on suppliers outside the Community and the specific security of supply issues it was believed to have. In contrast, the electricity sector was characterised by surplus of supply and no dependence on non-EU suppliers which left the security of supply issue much less relevant.¹¹¹

6.4.1 Introducing the Single Buyer concept

Splitting up the two proposals created progress in the negotiations on the electricity directive. Approaching 1995, the Council had reached an agreement on all of the key concepts and their requirements except for the TPA requirements, which the French government still opposed. Instead, France put forward its own Single Buyer model to incorporate as an alternative option in the

¹⁰⁸ COM 1993/643 final: art 21 para 2

¹⁰⁹ COM 1993/643 final. General explanatory memorandum: 8

¹¹⁰ COM 1993/643 final: art 20 para 2

¹¹¹ Cameron 2002: 138

directive alongside the TPA. The Council then instructed the Commission to decide if the Single Buyer System and the TPA would result in the same conditions for new entrants to the electricity grid and thus could work as two options to choose from in the directive. The central aim of the Single Buyer system is to allow for a continuing strong state control over the generation and supply activities. The control of the state is secured as the publicly-owned utility will enjoy monopoly status for generation and transmission and in practice also for the supply part in exchange for public service obligations imposed on the company by the state. The monopoly status still stands as the company remains responsible for buying and selling all electricity imported into the state or exported out of the state before it hits the transmission lines, which leaves the concept of TPA irrelevant.¹¹²

The Commission published two reports during 1995 on the interoperation ability between the TPA system and the Single Buyer system in the directive. The reports concluded that the two systems could exist side by side if some adjustments were made. Nevertheless, the Council was not able to compromise on the directive due to disagreement over the degree of market opening in the provisions. However, the Single Buyer concept was received positively. Due to the continuing stalemate of the negotiations, the Commission once again publicly threatened member states to pursue its article 90 powers and issue administrative directives which did not need Council and EP approval.¹¹³ Only in July 1996, the Council overcame its disagreement on the eligibility criteria and was able to adopt the final directive.¹¹⁴

¹¹² Cameron 2002: 140

¹¹³ Matlary 1997: 129

¹¹⁴ Cameron 2002: 141

Table 3: The Commission's dual strategy

Date	Directive approach	ECJ approach
May 1998	The Commission working paper	
July 1989	The Commission publishes directive proposals on price transparency, transit, licensing and procurement	
June 1990	The Council adopts price transparency directive	
September 1990	The Council adopts procurement directive	
October 1990	The Council adopts transit directive for electricity	
May 1991	The Council adopts transit directive for gas	
July 1991/ February 1992	The Commission proposes directives on common rules for electricity and gas with regulated TPA	
August 1991		The Commission starts infringement proceedings against nine member states on import/export monopoly rights
November 1992		The Commission sends reasoned opinions to six member states
1993		Suspension of the legal proceedings
December 1993	The Commission proposes revised draft directive with negotiated TPA as an alternative to regulated TPA	
January 1994		The Commission refers cases of monopoly companies in five member states to the ECJ
May 1994	The Council adopts hydrocarbons licensing directive	
1994/95	France proposes the Single Buyer model	
July 1996	The Council reaches common position	
December 1996	The Council and EP adopt directive 96/92 concerning common rules for the internal market in electricity	

October 1997		The ECJ judgment in infringement cases on import/export monopolies. ECJ rules against the Commission and in favour of the infringed member states
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Source: Own production

6.5 PROVISIONS IN THE ADOPTED DIRECTIVE

The adopted directive on electricity was characterized by fierce opposition from member states and energy interests alike and the entire negotiation process took around five years. The directive included to a fair extent the Commission's ideas as set out in the proposal of 92 and the amended proposal of 1994 despite changes required by the EP and not least the Council. The latter two institutions' changes concerned the scope of public service obligations, provisions for the construction of new generating and transmission capacity, provisions for the operation and distribution system, unbundling and grid access.¹¹⁵ Overall, the directive defines rules for the generation, transmission and distribution of electricity. It does so by laying out rules "*for the organisation and functioning of the electricity sector, access to the market, the criteria and procedures applicable to calls for tender and the granting of authorizations and the operation of systems.*"¹¹⁶

6.5.1 Generation

For the production of new capacity for electricity generation, the directive sets out an authorisation procedure and/or a tendering procedure that member states can choose between. Whatever procedure is chosen, the member state is obliged to conduct them based on objective, transparent and non-discriminatory criteria.¹¹⁷ The aim is to open all new capacity-building to competition and the end result should be the same regardless of what procedure is chosen.

When choosing the authorisation procedure, the criteria that the member states must weigh applications for authorisation against relate to a number of issues. These include safety and security of the electricity system, installations, and associated equipment, environmental protection, energy efficiency, the nature of the primary energy sources, public service obligations. In cases of refusal to grant authorisations to applicants, member states must inform them of the reasons which must be

¹¹⁵ Council's common position 26 July 1996 SEC 1996/1409 final; in Cameron 2002: 144

¹¹⁶ Directive 1996/92, art 1

¹¹⁷ Directive 1996/92, art 4

based on objective and non-discriminatory grounds and the Commission must be informed of the reasons as well.¹¹⁸ The same conditions apply for the tendering procedure. In such case, member states must make an inventory list of new capacity to be built, including also replacement of obsolete existing capacity. Details of the tendering procedure must be made public within six months, and the tender specifications must include a detailed description of the project and of the attached criteria for selection of applicants. To this, the member states must appoint an authority independent of generation, transmission and distribution activities to carry out the control of the procedure.

6.5.2 Transmission system operation

The transmission activities are defined as the transport of electricity on the high-voltage interconnected system with a view to its delivery to customers, which are recognised as wholesale or final customers of electricity and distribution companies.¹¹⁹ The member states are to create or require the companies which own the transmission systems to designate a transmission system operator (TSO). The TSO is to be responsible for operating, ensuring the maintenance of, and, if necessary, developing the transmission system in a given area and its interconnectors with other systems, in order to guarantee security of supply.¹²⁰ Moreover, the TSO is responsible for dispatching the general installations within its area and for determining the use of interconnected systems with other systems. This should be done in a non-discriminatory manner based on objective and published criteria to ensure that the TSO does not "*favour generating facilities belonging to the same company or shareholders of the company in case the TSO is not totally separated from production.*"¹²¹ A measure to achieve this independence and neutrality was for the directive to include a provision that required the TSO to be "*independent at least in management terms from other activities not relating to the transmission system.*"¹²²

6.5.3 Distribution system operation

Distribution activities are defined as the transport of electricity on medium-voltage and low-voltage distribution systems with a view to its delivery to customers.¹²³ This provision is only included in

¹¹⁸ Directive 1996/92, art 5

¹¹⁹ Directive 1996/92, art 2. 5,7

¹²⁰ Directive 1996/92, art 7.1

¹²¹ Directive 1996/92. General explanatory memorandum: 4

¹²² Directive 1996/92. art 7.6

¹²³ Directive 1996/92, art 2.6

the directive following long and difficult negotiations and demands from incumbent actors on so-called "final wire competition". The result was that distribution companies were not part of the definition of eligible consumers despite opposing recommendations from the Commission.¹²⁴ As with the transmission activities, the member states must set up an operator for the distribution system (DSO) or require the company in charge of the distribution systems to establish one. Like the TSO, the DSO is responsible in a non-discriminatory matter "*for operating, ensuring the maintenance of and, if necessary, developing the distribution system in a given area and its interconnectors with other systems.*"¹²⁵ Also, article 11.2 dictates that the TSO must not discriminate between users of the grid to the benefits of own subsidiaries or shareholders.

6.5.4 Structure/Unbundling of accounts

As discussed previously in this paper, the aim of unbundling is to avoid discrimination against other suppliers by integrated companies. The directive defines integrated companies as being ones that conduct two or more activities within generation, transmission or distribution of electricity.¹²⁶ Therefore, integrated companies must keep separate accounts for the generation, transmission and distribution activities as they would do if they were individual companies, to avoid cross-subsidisation between the integrated companies' divisions and make them available to relevant authorities.¹²⁷

6.5.5 Third party access

In the much disputed concept of TPA, the directive ended with three different procedures for member states to choose from. The procedures are negotiated access, regulated access and the single buyer system. Regardless of the chosen procedure, it must be based on objective, transparent and non-discriminatory criteria. Moreover, the procedures "*must lead to equivalent economic results and hence to a directly comparable level of opening-up of markets and to a directly comparable degree of access to electricity markets.*"¹²⁸

Negotiated TPA is a procedure where the electricity producer and the supply companies or eligible consumers make supply contracts directly with each other following negotiations between the

¹²⁴ Cameron 2002: 149

¹²⁵ Directive 1996/92. General explanatory memorandum: 4

¹²⁶ Directive 1996/92. art 2.18

¹²⁷ Directive 1996/92. art 13 + 14.3

¹²⁸ Directive 1996/92. art 3.1

parties on the conditions and price for access to the system. For the regulated TPA, eligible customers have the right to access based on published tariffs for the use of the transmission and distribution systems. Hence there are no bilateral negotiations between the system operators and consumers regarding the price of access, but contracts for supply can still be made. For both procedures, dispute settlement procedures are set up and TSOs/DSOs are obliged to provide well-founded reasons in cases where they refuse access to third parties.¹²⁹ In the single buyer procedure, member states are to designate a legal person to be the single buyer in the area covered by the system operator and to publish non-discriminatory tariffs for access to the transmission and distribution systems. In the directive, the single buyer is defined as "*a legal person which is responsible for the unified management of the transmission system and or for centralized electricity purchasing and selling.*"¹³⁰ Like the negotiated and regulated access procedures, the single buyer system also requires separate accounting for the different activities of integrated companies as well as management unbundling of the single buyer activities from the production and distribution activities. This is to prevent excessive flows of information among the divisions.¹³¹

6.5.6 Market opening

The directive takes a gradual approach towards market opening and sets up three steps with deadlines for the first step on 19 February 1999, the second step on 19 February 2000 and the third step 19 February 2003. For each of the three steps, member states are obliged to open the minimum demands that is spelled out in the directive, but are allowed to open their markets further than that and even to full liberalisation. The share of opening is measured in GW consumption and corresponds to around 26 % market opening in the first step, 28 % in the second and 33 % in the third and final step. Member states are in charge of defining the eligibility of the consumers that are to be included in the market opening except for very large consumers which must be included as eligible.¹³² The directive does not include a clear definition of eligibility unlike in the Commission's previous draft directives. Therefore, it is left to the member states to define consumers in that category. This was the result of member states' disagreement in the Council and the need for a softer compromise on this issue.¹³³

¹²⁹ Directive 1996/92. art 20.3

¹³⁰ Directive 1996/92. General explanatory memorandum: 6

¹³¹ Directive 1996/92. General explanatory memorandum: 6

¹³² Directive 1996/92. General explanatory memorandum: 7

¹³³ Cameron 2002: 155

6.5.7 Public Service Obligations

Public service obligations in the electricity sector have traditionally been quite common in most member states, especially where the industry has been state-owned. Nevertheless, the concept is not evenly defined across the member states and no single European definition exists. However, mechanisms have been implemented in the industries to take into account the public's needs and service needs exceeding what may be honoured in a purely competitive market.¹³⁴ The directive therefore sets up five categories of public service obligations that the member states are allowed to impose on their industry in the name of general economic interest. They include security (including security of supply), regularity, quality and price of supplies and environmental protection. As with other principles in the directive, the PSO's imposed by the member states must be clearly defined, transparent, non-discriminatory, verifiable and made public and notified to the Commission for check against Treaty violations.¹³⁵

6.5.8 Transition

The directive takes into account the various difficulties that may arise in the member states' transitional process to the new liberalised regime in the electricity sectors. However, most strikingly, it also foresees that some problems will remain even after the full implementation of the directive. Moreover, the directive includes the possibility of introducing further proposals for more liberalisation of the market based on the experiences of the first directive. The Commission is granted the responsibility of surveying the sector on the experiences gained from the first directive, which will then be up to the EP and the Council to decide on new legislation.¹³⁶

6.6 The applied mechanisms of change

Learning from the account of the political process of passing through the electricity directive, it becomes clear that several mechanisms had been dealt with to a greater or a lesser extent. The following sections will discuss the application of the various mechanisms.

6.6.1 Mechanism of institutional compliance

One of the visible mechanisms of change induced by the EU-level was the adaptation pressure on member states. That pressure emanated at various times during the process and from different

¹³⁴ Cameron 2002: 158

¹³⁵ Directive 1996/92. art 3.2-3

¹³⁶ Directive 1996/92. initial recital 39 + art 26

sources, but the Commission's deliberate threat of forcing through an internal energy market by applying competition law on the national sectors - even by use of the European Court of Justice definitely stands out. The Europeanization theory highlights the concept of coercion of policy templates on member states and ECJ judgments is an indication of that against the infringed member states that are obliged to abide the outcome.

The directive itself also contains provisions that imply a certain degree of adaptation pressure by the member states' governing bodies and authorities. Among other things, the directive sets up specific transition deadlines for member states to adjust the national settings to the objectives of the directive. More importantly however, the directive introduced a whole new market-based philosophy from which the existing strong state-control of the energy sectors would be replaced by new regulation and system operators exercising its duties with an arm's length principle vis-à-vis the state. To many member states, this signalled a radical new course for a sector traditionally subject to much political control and intervention. The operators in question are the transmission and distribution system operators.

While the directive calls for some rather radical shifts in domestic energy sectors, it also includes some discretion regarding how member states are allowed to implement this new course. As stated in the first draft directive by the Commission in 1991, the concept of subsidiarity and avoidance of excessive regulation meant that the potential adaptation pressure on national political institutions and their sectoral interests would be less severe for those member states facing the biggest overhauls. The directive allows gradual opening of the markets and leaves it also to the member states to define the more precise details of the eligibility criteria of customers. This again eases the potential main worry of the public institutions, namely that of security of supply and public service obligations towards all customers. The directive's five criteria for PSO fulfil the states' obligations towards its citizens to secure a stable supply of electricity.

6.6.2 Mechanism of changing domestic opportunity structures

Changing domestic opportunity structures in the national energy sectors was the single most important motive for pushing ahead with the liberalisation process. Moreover, the Commission's proposals and the final directive bear many hallmarks of this line of thinking. New opportunity structures within the field of electricity meant improved conditions for European businesses that

would enjoy cheaper energy and improved international competitiveness. And to European consumers who would benefit from cheaper European goods. Within the energy sector, new opportunity structures would emerge by breaking down national barriers to production, transportation and trade with electricity across borders and within borders. This is recognisable in the central provisions of the directive regarding the introduction of TPA and unbundling that should provide a level playing field for all actors in the market. Especially those previously discriminated against or excluded from entry into the market due to the structure of exclusive rights for transportation and the bundled structure of the incumbent supply companies. So the introduction of a market-based energy structure with fair access for all suppliers to serve the eligible industrial customers qualifies in terms of what Europeanization identifies as an attempt to change the distribution of power and resources between domestic actors.

6.6.3 Mechanism of learning and framing domestic beliefs and expectations

The EU-level's ability to frame the beliefs and expectations to what the internal energy market could bring about in terms of benefits has been an important one in the case of electricity liberalisation. As described above, the whole process from formulating the ideas of liberalisation to the adoption of the final directive was a process lasting from 1988 to 1996. During that time, both member states' governments in the Council and the market-actors active in the hearing process and in lobby activities had time to discuss and consider the consequences of the Commission's policy ideas. This is due to the unique structure of the EC/EU as a political system and the special style of negotiations, which allows the parties to learn more of the implications of the proposed industrial settings, but also how the existing settings affect opportunity structures domestically and across borders. It is here that the Commission's agenda-setting powers become part of the framing and learning process. Before even submitting official draft directives on the matter, the Commission engaged in extensive hearing consultations, including the four hearing committees consisting of industrial actors, public officials and industrial consumers to discuss the question of TPA. This was a deliberate way by the Commission to let affected parties digest and come to terms with the concept. Also, as Europeanization notes, by persistently pushing for liberalisation and TPA, the Commission gave the impression to sceptical and opposing actors that they were fighting purposelessly by trying to remove the concept completely rather than engaging constructively in trying to find solutions for its implementation. In addition to this argument, the first liberalisation package of four relatively uncontroversial directives on transit, procurement, transparency and

exploitation served as an indicator of the fact that the liberalisation agenda was not to be taken off the political table after that point. Moreover, introducing liberalisation in steps improved the change of member states as governments acquire more knowledge on the idea of liberalisation and gradually come to embrace it. Finally, the notion of learning holds even more ground when looking at the Commission's preparatory work in connection to policy development. Before and during the negotiations on electricity liberalisation, the Commission issued a number of reports and communications outlining the implications of the draft proposal. This was with the aim of helping the member states to gain a better basis for developing a constructive position.

6.7 MEMBER STATE POSITIONS ON THE DIRECTIVE

This section analyses the positions of the governments and industrial interests in key member states throughout the entire process of the internal energy market progression in the electricity and gas sectors. The period stretches from the mid-1980s, through the Commission's 1988 working document and to the final adoption of the electricity directive in late 1996. As stated previously in this paper, the remaining negotiations on the gas directive adopted in 1998 will not be included in this analysis. Nevertheless, as also indicated, it is difficult to separate the negotiations on the two directives as they were not split in two individual dossiers before 1994 by the Council. This means that prior to 1994, whatever concerns the member states had relating to the gas sector would also influence its position in the discussions concerning the electricity sector as they were negotiated together. It is the task of this section to present the individual member states' interests and positions during the negotiations in order to identify the member states' changes in positions, if any, during the process. The empirical variables will then be tested against how Europeanization explains those variables and their influence on policy change. By using those empirical and theoretical findings, the thesis aims at explaining what states that were the prime movers and the reason for the changes in the individual member state.

6.7.1 Germany

6.7.1.1 German government

When the Commission began its active enforcement of the competition rules in the late 1980s and when it prepared the first package of directives, two concerns were at the top of the German government's agenda. TPA for gas transportation and the apparent influence of EC competition rules on the domestic subsidy schemes for coal production were especially pressing. Subsidised coal

production was important in the price formation of domestic electricity production. Moreover, the German government feared that the Commission's TPA models would bring additional bureaucratic powers in Brussels. This was due to the fact that the TPA proposals were to be enforced by the Commission. Germany had at the time two major schemes regarding coal. The Jahrhundertvertrag scheme regulated 55 per cent of all German coal production and obliged electricity producers to use German coal and thus violated the rules of free trade. The Kohlenpfennig scheme added tax to the consumers' electricity bill and was also rendered contrary to EC rules by the Commission.¹³⁷

From the outset of the negotiations on the electricity directive, the German government's interests concerned the existing sector structure. This encompassed few major companies and several regional level utilities, numerous local electricity providers, both public and private, which mostly relied on coal and nuclear power.¹³⁸ The government, the opposition and the various ministerial departments at the federal and regional level were sceptical towards liberalisation moves. This was due to the complex structure of the German electricity sector and the complexity of the Commission proposals. The concerns regarding security of supply, economic and environmental priorities, and the maintenance of the existing sectoral structure won over the uncertain consequences that liberalisation could bring.¹³⁹ In 1991, the government's impression was that the sector worked well. It did not require further competition despite the fact that the Federal Economics Ministry was keen on introducing a degree of liberal reforms in the sector at that point, but not whole-heartedly. Besides, the Ministry had no substantial supporters of its ideas. Moreover, the federal governance system meant that the Ministry was responsible for overall energy policy formulation, while actions regarding regulation of the electricity sector were in the hands of the länder governments' ministries of economics and the Federal Cartel Office.¹⁴⁰

Nevertheless, only two years later, the same ministry was in support of EU-level liberalisation. During the negotiations on the Commission's proposal the Ministry now saw it as a chance to introduce liberalisation reforms in the German sector inspired by the EU-level talks.¹⁴¹ In that time of EU-negotiations, the energy working groups in the Council had intensified its meeting from four times a year to twice a week. In that process, the German participants gradually came to be

¹³⁷ Matlary 1997: 80-81

¹³⁸ Eising 2002: 96

¹³⁹ Eising 2002: 99

¹⁴⁰ Eising & Jabko 2001: 756

¹⁴¹ Eising 2002: 100, Cameron 2002:142

compelled by the EU ideas on the proper industry settings.¹⁴² The EU-reforms suited well with the wish of the government to phase out its national support schemes for the industry. This it had already indicated at an earlier point. The government had previously suggested its domestic industry that the EC rules on competition would eventually apply, but it did not act on it due to strong pressure from the affected industry.¹⁴³ The learning by the German negotiators at the EU-level meant that competition was now regarded as a positive tool to make the sector more competitive and efficient.¹⁴⁴ In 1994, the Federal Economics Ministry even proposed its own proposals to open the German sector for competition based on the inputs from the EU-negotiations. However, it was backed also by the blossoming support from domestically organised interest groups. Importantly, any German restructuring was made contingent on a similar solution at the EU-level because reciprocity in market openings was a key condition from legislators and the sector interests combined. These would not risk a unilateral opening in Germany which would not be followed in the rest the EU.¹⁴⁵

6.7.1.2 German industry

At the sectoral level, the EU and domestic debates on how to structure the sector had an impact on and helped altering some actors' preferences. The German sector was at the time made up of three types of actors. There were nine dominating utilities with transmission and distribution activities encompassing around 60 smaller regional utilities along with several local utilities. On top of that came more than 700 municipal utilities.¹⁴⁶ A key characteristic of the sector was the close connection of the utilities to the municipals and länder politicians, rendering them with substantial political weight due to their economic size and importance.¹⁴⁷ From the beginning, the sector was united in its opposition to the EU-liberalisation ideas due to concerns over security of supply and special technical factors not in congruence with liberalisation. Nevertheless, pressure for reform from both the EU and the domestic level led to a split between the industrial actors during the 1990s. While the municipal utilities feared any form of liberalisation, the large and regional utilities such as Bayernwerk, PreussenElektra (which had both already been privatised), RWE EVS and Badenwerk embraced the strategy of opening up for competition as a lesser evil and found that there

¹⁴² Eising & Jabko 2001: 757

¹⁴³ Matlary 1997: 81

¹⁴⁴ Eising 2002: 100

¹⁴⁵ Eising & Jabko 2001: 759

¹⁴⁶ Eising & Jabko 2001: 756

¹⁴⁷ Eising & Jabko 2001: 756

were some advantages of European liberalisation.¹⁴⁸ One of the perceived opportunities of liberalisation was the change to become "*European super-utilities*".¹⁴⁹ They also feared that the local utilities would be exempted from competition due to strong ties to municipal and national legislators, and they saw the chance of stripping the municipalities of their control of local area supply, which would not be a part of a purely national sector reform.¹⁵⁰ The renewed support by the two levels of electricity suppliers, along with the support of the industrial producer organisations listed below, the German government was given a new coalition platform to support the government's own preferences in the Council negotiations. On the other side, the municipal utilities with their strong ties to *länder* governments and municipalities feared that liberalisation would result in a pick-and-choose situation where the eligible industrial consumers received bargaining prices from the suppliers, while leaving private consumers with higher prices. Nevertheless, in the middle of the 1990s, the municipal utilities' opposition to the general principle of competition faded. However, they still had issues with the eligibility criteria leaving some without the right to choose suppliers freely like large users were.¹⁵¹

6.7.1.3 German socio-economic actors

German organised industrial interests such as the Federation of German Industry (BDI), the association of large users and auto-producers (VIK) and the German Federation of the Chambers of Commerce became active following the Commission's work to put it on the European agenda. However, as the first draft directives were put on the table in Brussels, their demand for liberalisation was not very outspoken.¹⁵² Nevertheless, the same organisations and others included energy in their greater objectives for the threatened competitiveness of German industry following reunification and international pressure. The conditions for "production site Germany" included liberal reforms.¹⁵³

¹⁴⁸ Bartle 2002: 9

¹⁴⁹ Bulmer et al 2003: 262

¹⁵⁰ Eising 2002: 100

¹⁵¹ Eising & Jabko 2001: 759

¹⁵² Bartle 2002: 14

¹⁵³ Eising & Jabko 2001: 758

6.7.2 France

6.7.2.1 French government

The French government was very much interconnected with the national electricity monopoly Electricité de France (EDF) and the physical infrastructure at the start of the liberalisation attempts. This had been so since World War II in order to carry out the national plans for nuclear power.¹⁵⁴ In the 1970s, the French government initiated a large-scale nuclear electricity programme unparalleled to any other Western European country to secure its security of supply after a period of scarce resources. This meant that electricity supply was plenty from the late 1970s and in the early 1980s.¹⁵⁵ At this time, the opinion towards European-wide liberalisation was positive as it suited French export interests well. Since the introduction of the nuclear programme, the French electricity sector now generated considerable surplus which surpassed the domestic consumers' demand. Therefore, the anticipation of new export opportunities of cheap nuclear sourced electricity to other European countries following liberalisation made the initial French position positive towards liberalisation.¹⁵⁶ The strong ties between EDF and the Ministry of Industry were the reason that these two actors dominated the formulation of the national position towards the Commission's plans. They were largely in full agreement on that position. Specifically, the more firm enforcement of the EC's competition rules by the Commission after the beginning of the Internal Market Programme after SEA against the German coal subsidy schemes added to the French export opportunities. In fact, Germany had accused France of being a little too eager to remind the Commission of the schemes' potential conflict with EC rules.¹⁵⁷ Like EDF though, the Ministry of Industry changed its position from supportive to opposing already in 1989, when it became clear that the Commission's directive proposal would mean changes in the French electricity sector set-up and challenge the monopoly status of EDF. The TPA proposal was the cornerstone of this scepticism. From that point on, the French argued that the proposals would endanger the preferred ability of central planning, security of supply, and an equal treatment of all consumers. This, EDF was obligated to secure under its public service obligations.¹⁵⁸ On the other hand, the French government found it difficult to back down from its previous pro-liberalisation positions. Moreover, both the government and EDF were concerned about the Commission's legal strategy that could

¹⁵⁴ Eising 2002: 96

¹⁵⁵ Bartle 2002: 10

¹⁵⁶ Eising 2002: 98

¹⁵⁷ Matlary 1997: 83

¹⁵⁸ Bartle 2002: 11

drive liberalisation through the European Court of Justice based on its authority as competition-watch dog.¹⁵⁹ For the government, changing the monopolistic position of EDF would be troublesome. It would be uncertain how EDF would manage in a liberalised home-market with multiple competitors, and the government needed insurance that its huge investment in the nuclear programme would not have been in vain. Moreover, EDF had turned into a money-making machine for the state as EDF earned big profits. This was an important source of revenue for the state, not least in the wake of entering into the economic and monetary union of the EU, in which the participating member states were to keep public budgets and debts in check.¹⁶⁰ Also, EDF was considered by the public as a proud institution in the French society and was iconic as an example of the French model of public service. The Government was hence unwilling to alter the position of EDF and leave it vulnerable to critique on how it would abandon this model in exchange for the EU-induced neo-liberal models.¹⁶¹

The unwillingness led to the later French proposal, drafted by the Ministry of Industry in the Council of Ministers, of a Single Buyer system. This would shield the French sector from TPA and maintain the option of central planning by the EDF and the government.¹⁶² The Commission and the rest of the Council only hesitantly accepted the Single Buyer model if it guaranteed the same results as the TPA models. From then on, the French government realised that further opposition to the directive, would risk isolating France in the negotiations where QMV was applied.¹⁶³ For this reason, French President Chirac decided to deal with the matter bilaterally with Germany's Chancellor Kohl and discuss the remaining issues in the directive which formed the basis for the Council's agreement in 1996.¹⁶⁴ It is in this regard noteworthy to mention that the national transposition of the directive into French law was only achieved a year after the directive's set deadline which is a testimony to the controversy of the directive in France.

6.7.2.2 French industry

Prior to electricity liberalisation, cross-border exchange of electricity vested on voluntary cooperation between the European providers. In that system EDF faced considerable trade barriers

¹⁵⁹ Eising & Jabko 2001: 752

¹⁶⁰ Eising & Jabko 2001: 752

¹⁶¹ Eising & Jabko 2001: 752

¹⁶² Bartle 2002: 11

¹⁶³ Eising & Jabko 2001: 753

¹⁶⁴ Eising & Jabko 2001: 755

from incumbent suppliers in other countries, which hampered EDF's exporting efforts.¹⁶⁵ In 1986, EDF put pressure on the government to push actively in the Council for opening up neighbouring markets for competition, but EDF only focused on a rather narrow feature of securing rules for electricity export and did not contemplate the consequences of opening up for a liberalisation debate in general.¹⁶⁶

Therefore, when the Commission published its proposals for the first package of directives in 1989, EDF changed its position as it began to realise the consequences it would pose to its own role as monopoly provider on its home market in France. Instead, while the Ministry of Industry fought against the directive proposals in the Council, EDF took charge in fighting the Commission's proposal at the industrial lobby level. This was in the newly formed European association of electricity utilities, EURELECTRIC, which task was to secure the preservation of the national sector regimes.¹⁶⁷ EDF now argued that liberalisation of the markets should happen in full cooperation with the other European utilities. The reason for this was based on the experience with the liberalisation process in the telecom sectors previously, which showed that it could lead to unpredictable results.¹⁶⁸

In the latter part of the directive negotiations, EDF full-heartedly supported its government's fight in the Council for the Single Buyer model that would increase cross-boarder trade with electricity, but leave the domestic French sector unchanged.¹⁶⁹

6.7.2.3 French socio-economic actors

From the beginning, actors supporting substantial liberalisation in the French electricity sector in line with the Commission's thinking were not able to influence the Ministry of Industry and EDF in the development of the French negotiation position before the later stage of the negotiations. Those actors included the competition directorate in the Ministry of Economics and Finance which favoured to end EDF's monopoly status. Compagnie Generale des Eaux and Compagnie Lyonnaise des Eaux, potential competitors to EDF, were heavily in favour of liberalisation along with a range of large industrial businesses and some city councils that were getting annoyed with the continuing

¹⁶⁵ Eising 2002: 98

¹⁶⁶ Eising & Jabko 2001: 750

¹⁶⁷ Eising 2002: 93

¹⁶⁸ Eising & Jabko 2001: 751

¹⁶⁹ Bartle 2002: 15

monopoly status of EDF. It went to show that the sanctity of the special French model of dirigisme and public service was not unquestionable¹⁷⁰

6.7.3 The UK

6.7.3.1 UK government

The United Kingdom had already prior to the Commission's move towards opening the markets liberalised and privatised its own electricity sector during the last half of the 1980's and the first part of the 1990's unlike Germany, France and the rest of the EU member states.¹⁷¹ Prime Minister Margaret Thatcher introduced a broad privatisation agenda which included the gas and telecommunications sectors. The British government believed that electricity supply was up for privatisation after a period of public ownership and control in the post-war period. The liberalisation and privatisation programme in Britain was characterised as very ambitious and was met with strong opposition from the political levels as well as the sectoral actors. Nevertheless, the British government was able to disregard the opposition and complete the programme in 1992.¹⁷²

On that basis, both the British utilities and the Department of Trade and Industry, which was the responsible government department, tried to apply similar liberalisation to the rest of the EU and thus from the start supported the Commission's plan to do so.¹⁷³ So on the face of it, the British government was supportive of promoting the internal energy market, but it showed some degree of scepticism towards increasing bureaucracy in Brussels and that it would be implied in the draft ideas on how to implement liberalisation. Later on, Britain was against the French Single Buyer model and instead the country argued that only the TPA model would ensure equal and open access to the networks.¹⁷⁴

6.7.3.2 UK industry

The national monopolistic electricity company, CEGB, was active in the debate regarding the government's agenda for the electricity sector. Despite supporting the general principle of competition, CEGB warned against splitting up the company due to security of supply and technical

¹⁷⁰ Eising & Jabko 2001: 754

¹⁷¹ Eising 2002: 96

¹⁷² Bartle 2002: 11

¹⁷³ Eising 2002: 97

¹⁷⁴ Matlary 1997: 86

concerns. However, its concerns did not come across to the government, which proceeded with its own preferences for the industry's settings.¹⁷⁵

6.7.4 EU-level interest groups

The multi-level governance structure of the EU political system renders the formation of EU-level interest representation highly relevant by national interest groups or individual companies. The pan-European organisations make up useful forums for engaging in political discussions with the official EU-institutions. Most notably the Commission and the EP that are both open to hearing the views from relevant civil society actors who are affected by the European legislation. EU-level organisations play significant roles in the policy-making process besides the traditional lobbying of the Commission and the Parliament. This is due to the fact that their permanent presence in the political system in Brussels allows them to participate in working groups and committee work. Moreover, since they are also well equipped to submit positions in hearings on proposals and the like. This is especially the case in the early and informal phase of policy-making where the Commission often consults them in order to gain valuable technical knowledge on the sectors. These EU-level organisations were active on behalf of their national members in the discussions and negotiations surrounding the development of the internal energy market and the electricity and gas market liberalisation in particular. Since the views of those organisations are in fact a compromise between the national members they can be viewed as a platform relevant to use in order to scrutinise the change of positions of the national energy sector actors. Of this reason, they are relevant to include in this analysis. It seems that every energy source has its own political association. However, in connection with this analysis, the European associations for electricity, Eurelectric, and partly also Eurogas representing the gas companies are the most important represents from the industry.

For the various interest groups within the energy sector, the question of TPA was the overshadowing issue. Moreover, it was the one that sparked most opposition and as a testament to that opposition, the national energy industry associations and individual companies formed European-level associations with the sole purpose of working against the internal energy market agenda. One of those associations was Eurelectric, whose members represented the national utilities involved with the generation, transmission, distribution and supply of electricity. Spearheaded by

¹⁷⁵ Bartle 2002: 11

EDF, Eurelectric worked aggressively against the liberalisation moves at the beginning and was one of the key associations to provide inputs to the first, unofficial draft directive on electricity that the Commission passed around in 1991. Eurelectric succeeded in cutting off the top of the proposal before it was officially sent to the EP and Council.¹⁷⁶

Nevertheless, during 1992, Eurelectric reformulated its position on the fundamental concept of liberalisation. It took a more positive stance towards the overall objective of the internal market programme in general and for the internal energy market in particular by being in favour of more competition in generation and investments in the industry with the aim of creating a level playing field for all competitors. Still, Eurelectric did not find that the TPA model presented the best way to achieve that and argued that it should remain an option - not a requirement in the directive.¹⁷⁷ The change of position on TPA from negative to positive was the result of two things. First, the Dutch electricity industry had hired the consulting firm McKinsey to write about the negative consequences of European liberalisation and TPA in the Dutch sector. However, the report ended up recommending that both the sector and consumers would benefit from a liberalised market. Based on the conclusion of the report, the Dutch industry changed position on TPA, which again turned the position of Eurelectric.¹⁷⁸ The other reason, which was interlinked with the first one, was the accession to the EU of Sweden and Finland in 1995. This changed the internal balance of power in Eurelectric into a more positive stance on liberalisation or at least to admit that more than one opinion existed on TPA among its industrial membership. Eurelectric ended up supporting the draft electricity directive in 1996 and called on the EP and the Council not to amend the proposal further.¹⁷⁹

The European Federation of Local Public Energy Distribution Companies (CEDEC) was another association formed to fight against TPA was CEDEC. With a membership consisting of public distribution companies, CEDEC argued against TPA in the Commission's 1992 proposal on the grounds that it would not secure security of supply for all customers. Later on, it also highlighted what it saw as negative effects of liberalisation to the employment in the sector and called for a slower and more gradual pace of liberalisation. This was in order to let its members adjust to

¹⁷⁶ Greenwood 2002: 275

¹⁷⁷ Cameron 2002: 129

¹⁷⁸ Matlary 1997: 98

¹⁷⁹ Greenwood 2002: 276

competition from larger competitors.¹⁸⁰

It is also among the European-level interest groups that viewpoints of the industrial end-users of electricity and other socio-economic actors can be found. These end-users and actors had positive stands on the internal energy market and hence support the Commission's agenda. As a representative of the European chemicals industry, which has huge electricity consumers, CEFIC also supported TPA as a way to secure lower prices and UNICE (today BusinessEurope), the European industrial and employers federation, who supported the liberalisation agenda to have a level playing field and improved competitiveness of businesses. The European Roundtable of Industrialist, ERT, supported liberalisation as well for the same reasons as UNICE. Finally, there was ENERG8, a group of large-scale industrial consumers like Bayer, BASF, Ford, Mercedes Benz, Enron, which was formed to support the Commission's strive towards a liberalised market with lower prices.¹⁸¹

6.8 Variables affecting the domestic response to EU-induced reforms

All in all, the three respective segmental variables reacted differently to the EU-pressure to reform, but must all be given some attention for their contribution to the outcome of the electricity directive.

6.8.1 Institutional fitness

In terms of institutional fit with the proposal from the EU-level, the governments in Germany, France and Britain acted in accordance with the preferred traditions for policy-making which left them in different positions to act. The German government was fundamentally positive towards the liberalisation ideas in the energy sector, but was constrained by pressure from organised sectoral interests. In France, the tradition of dirigisme in sectors like energy was in severe conflict with the market-based liberalisation models with arms-length principles as leading guidelines. In Britain, the situation was rather different with a government eager to liberalise and had thus issued a liberalisation and privatisation programme even before those principles had formalised in the rest of Europe. Bartle differentiates the three positions of the governments in concepts of the will to reform and the capacity of the state to act.¹⁸² For Germany, the will of the government to reform was present, but its capacity to act was limited due to the federal and cooperative traditions and the

¹⁸⁰ Matlary 1997: 100, Greenwood 2002: 279

¹⁸¹ Greenwood 2002: 281-282; Matlary 1997: 100

¹⁸² Bartle 2002: 8

impact of strong sectoral interests. For the French government, however, the capacity to act was strong as it already enjoyed a big influence in the sector, but its will to reform was not present of the exact same reason. This is again unlike Britain, which had a government with both the will to reform and the capacity to act due to the majority system of governance.

6.8.2 The impact of the Commission's legal strategy on member states' preferences

In prolongation of the discussion on policy-making traditions in the member states, the Commission's ability and active use of the European Court of Justice against those same member states becomes a factor as well. As explained in section 3.3 on the Commission's role in the political system of the EU, and from viewing the complex negotiating process of the electricity directive, it is clear that the Commission has substantial resources to push political agendas in certain directions. Moreover, to some extent it is able to pose results in the Council that may exceed its formal powers as merely an agenda-setter and proposer of proposals. One of the measures that help the Commission to make the Council proceed in political negotiations is the use of the ECJ. By having the option of referring member states to the Court for violations of the Treaty provisions, member states are forced to consider the consequences of the directive approach and the court approach respectively. The latter may be more difficult due to the fact that the Court's judgments are not known beforehand. This is unlike the planned process of negotiation on a solution by means of directives, which the member states themselves are able to follow and make compromises on, and hence being able to limit the affects of the political outcome on its national settings. In other words, member states are able to choose the lesser evil by compromising on directives, which they would otherwise not have agreed to. On the contrary, the member states would have to await an unknown court judgment, which might bring about more radical changes in a process that member states have little control over, but are obliged to follow.¹⁸³ The lack of knowledge on the outcome of the court cases is an extremely bad situation for any stakeholder in the industry. This is based in the fact that the stakeholder has little chance of foreseeing the impact on investments and market status and governments will be unable to see ahead on a longer scale in terms of issues general security of supply and public service.

As described in table 3 above, the Commission engaged in infringement procedures against ten member states for import/export monopoly violations shortly after having started its deliberations

¹⁸³ The notion of "lesser evil" is borrowed from Schmidt 2000: 50

on the internal market for energy and the publishing of the draft directives on electricity and gas in 1991. The Commission was of the opinion that electricity and gas were products as any other products and hence should be subject to the same rules concerning free movement in the Community. Thereby, the energy industry should not be awarded the existing monopoly status. Despite its opening moves in 1991, the Commission did not proceed until 1994 when it referred five member states, including France, to the ECJ. The remaining five member states had either been able to reject the Commission's ground for infringement or they had instead conformed the national settings to the Commission's satisfaction as for instance Denmark chose to do. These actions imply that judicial pressure has a noticeable impact on member states' actions. In addition to that conclusion is the fact that France turned more forthcoming in the directive negotiations when the Commission reactivated the judicial procedure in 1994. It was at that time that France came up with the single buyer system, which would allow some liberalisation in the sector and end the monopoly on imports and exports on electricity and gas. Ultimately, the final agreement on the directive in the Council was made prior to the judgment of the ECJ, and France and the other member states were able to prevent a potentially much more disruptive breakdown of the import/export monopolies in the industry.

France had a de facto veto in the Council even though the formal decision-making procedure was the one of co-decision. France was able to attain this because of its importance to the electricity sector in most of Europe and because it was the biggest exporter and due to its general status as a key member state of the EU. The issue of electricity liberalisation was considered to be too important and far-reaching to leaving a key member state like France isolated and out-voted. Instead, the Council acted out of unanimity.¹⁸⁴

It is also noteworthy to stress the many sectors besides energy that the Commission was engaged in at the time. It serves a testimony to the general liberalisation agenda formed by SEA, but it could also serve as a strategic tool by the Commission, which was to put pressure on the seemingly controversial energy sector by already having applied the competition rules on the transport and the telecommunication sectors, among other sectors. This proved that the Commission's legal strategy for the energy sector should be taken seriously by the industry and the member state governments. But it also made it easier for the governments to support liberalisation in the energy sector since they had already approved the application of competition rules in the similar sectors previously dominated by public monopoly companies.

¹⁸⁴ Schmidt 2000: 51

All in all, there is reason to believe that the Commission's infringement cases against several member states has acted as an incentive for the member states to stretch its willingness to compromise further in the directive negotiations than would be the case if the Commission could not make use of its court strategy. Also, it was crucial that the Commission at the start of the liberalisation process contemplated and continuously made the member states aware of the alternative legal strategy if the negotiation strategy was fruitless and ultimately also actively pursued that approach in the infringement cases. This made the legal threat that failure to compromise politically would not necessarily secure status quo in their domestic industrial settings, but perhaps rather the opposite at an unknown pace and scope credible to member state governments and industry stakeholders.

National governance traditions

When analysing the goodness of fit of national institutions against EU-reform in terms of regulation of the sector, one important aspect is to look at the individual member state's governance traditions. In other words, the preferred way of doing politics. With respect to this analysis, it is noteworthy to examine what Matlary labels as the German geordner markt, the French tradition of dirigisme and the British laissez-faire market.¹⁸⁵

In the case of Germany, the notion of a geordner markt means that the preferred policy style is to seek political and socio-economic compromises. This is the offspring of a complex political system in Germany with a federal structure, coalition governments combined with a constructive parliamentary system. In addition, interest groups are also highly active in the political process. All put together, the German way of making policy becomes that of cooperative federalism.¹⁸⁶ In this type of system, the 16 länder governments have a big say and so do the different interest groups, which often have close ties to the political levels.

This type of system is not the case in France. Here, a tradition of dirigisme that leaves room for intervention and influence by the state in economic and industrial matters is preferred. State policies tend to focus on grand, nation-wide projects which often include the creation of a national industrial

¹⁸⁵ Matlary 1997: 46

¹⁸⁶ Bartle 2002: 7

champion in the given sector. Unlike in Germany, not much influence is given to organised interests, instead, policy is developed from compromises within the government departments and government parties who come to agree on sharing preferred interests to promote. In comparison to France, there are strong veto points in the German system restraining the actions of the federal government if there is a mismatch of political preferences.

The British policy-making traditions are markedly different from the two others. Here, the government is in a much more dominant position to execute its preferred policy unilaterally, since it holds the majority of seats in basically a two-party parliamentary system little known for its cooperative and compromising approach. Hence, the ruling government can in fact disregard the political and sectoral opposition leaving it with no significant veto points to overcome.

All in all, these different traditions of conducting politics have an impact on the goodness of fit test on the national institutions. Moreover, depending on the level of fit, EU-pressure to reform leads to either inertia and a defensive approach as in the case of France or absorption by national institutions as in Germany. Britain was obviously in a good position to fit to the EU-reforms as it had already conducted the reforms on a national basis. Therefore, there was little that the British government had to alter to fit, but could largely work for the duplication of its own sector setting to the rest of the EC/EU.

6.8.3 Changing domestic opportunity structures

The idea behind liberalising the European electricity sectors was to secure better opportunities for actors in the industry other than the incumbent monopolies, thereby letting them supply the consumers with electricity, and moreover let the consumers choose the desired supplier freely. The way to do that was to break that monopoly tradition and allow third parties to enter the market by the TPA principle. At the same time, the vertically integrated companies that had generation activities as well as being in control of the transportation grids were to give separate accounts of those activities. This was in order to create a transparent market and to avoid discrimination against other users of the grid.

These measures were all developed to foster new opportunity structures in the domestic sectors. As a consequence of that, the ideas at the EU-level forced the affected actors to consider the pros and cons of the proposals. This left supporting and opposing actors in two separate groups. Since veto points towards the political decision-makers and the relative power between them decide the extent

to which the governments negotiating in the Council opt for a preference of change in line with EU proposals or inertia to the current industry settings. The outstanding goal of the liberalisation process for the Commission was to secure lower electricity prices to industrial consumers across Europe. This was to benefit the relative competitiveness of European businesses against US and Japanese competitors and private households, which would come to enjoy lower prices on goods. Therefore, an overall division of interest groupings would place the consumer industries on the supporting side of liberalisation. On the other hand, incumbent electricity suppliers would have to face a new and uncertain competitive environment. This led to variations over full-force opposition to at least scepticism on the part of those affected sectoral companies.

In Germany, the initial position of the government in the Council towards the Commission's proposals for liberalisation was sceptical. The idea of liberalisation did not correspond well to the existing structure of the sector even if the Federal Economics Ministry would not rule out the benefits of liberal changes. However, the institutional structure of the German system posed a coalition of inertia against the new ideas and preferred the existing structure. The inertia in Germany was further strengthened by united sectoral actors, who exploited their close ties to the political system. Nevertheless, the anti-liberalisation coalition began to crumble as the Ministry of Economics and the major utilities began to see positive opportunities from EU-liberalisation. Backed also by the general industrial organisations, a change in opportunity structures therefore occurred. Of this reason, the pro-liberalisation coalition was able to tip the scale resulting in a positive approach to the ongoing EU-negotiations on the electricity directive.

In France, on the other hand, the strong presence of the state in the national electricity sector through EDF entailed that the chances of changing domestic opportunity structures were low once the initial supporting approach by both the government and EDF towards liberalisation turned even more negative when the process started rolling faster. Despite the re-emergence of support for liberalisation in the French Ministry of competition, the general industry and supply competitors during the end of the negotiations, there was never really a decisive shift in influence on the two coalitions of actors. So the inertia towards the EU-ideas coming from the ruling coalition between EDF and the Ministry of Industry prevailed.

Britain distinguished itself from the two other member states by already having liberalised its

electricity sector and did not have much to alter in its domestic settings. Of the same reason, the industrial actors were not either confronted with demands for restructuring. All in all, there were no opportunity structures to change at the domestic level since they had already been changed from national reforms. Instead, a combined coalition of government, industrial actors and the general industry could now benefit from similar open markets in the rest of the EU.

6.8.4 Framing domestic beliefs and expectations

In the framing process of domestic beliefs and expectations of what a given policy objective might help achieve, the grand idea is a central framework within which policy-makers develop concrete policy-making. Therefore, ideas on a given policy matter can foster legislation from the beginning or be an active variable in shaping the outcome of legislation. Its importance is further enhanced in the special political system of the EU with a strong agenda-setting Commission and institutional norms and belief systems. In this system, ideas can easily be adopted by member states during debates from argumentation, advocacy and sharing information between the participants. In this regard, ideas become a legitimising source for the introduction of new legislation or in shaping already progressing proposals.¹⁸⁷

With regards to the liberalisation agenda led by the Commission, the impact of certain ideas on member states' shifting positions is huge. This is due to liberalisation being a guiding principle of the European idea of how the energy markets should be structured. It is an idea which the Commission developed from the grander neo-liberal paradigm of market-based alternatives in network sectors in many fields. This was displayed in more detail in section 5.1.3. The above illustrates a paradigm that was nurtured by the creation of the Single Market Programme, which the member states themselves developed and promoted from 1985. And so in essence all member states fundamentally supported the free-market principles behind the single energy market as well.

For Britain at least, it was easy to support the Commission's principal vision for future settings of the electricity sectors in Europe and the idea in general. Britain, as illustrated above, had already carried out what the Commission promoted to the rest of the Community, so its fundamental belief system was already in line with the Commission. In fact, much of the Commission's initial inspiration came from the British mindset and practical experience. In Germany, the initial scepticism among the political levels and the industrial actors was transformed into support of the ideas behind the European liberalisation plans. As negotiations in the Council progressed, the

¹⁸⁷ Bartle 2002: 19

rationale for introducing competition in the sector became clear to at least the Federal Economics Ministry responsible for the Council negotiations and the large and private utilities. Moreover, also the industrial end-users began to voice their support for liberalisation more clearly. In France, however, the political traditions of dirigisme and the close ties between the Government and EDF meant that the Commission's fundamental ideas of a liberalised market with equal access for all actors in the form of TPA did not find good ground. Instead the existing beliefs on how the electricity market should be structured prevailed. This is best illustrated by the Single Buyer alternative that the French government had included in the final directive much supported by EDF. EU-framing, mostly delivered by the Commission in its repeated arguments for creating liberalised electricity markets, had a big role to play in two ways. It was a legitimising factor for those member states already contemplating national reforms such as in Germany. However, most importantly it made member states change their belief systems towards what to expect from liberalised markets helping to tip the scale of supporters in the Council.

All in all, on basis of the above, it seems that the member states' support for the grander idea of the EU's internal market prevailed over the sector-specific differences such as in electricity. Therefore, the negotiations in the Council and among interest actors rather quickly centred on finding the appropriate pace and degree of introducing the principles of the internal market to the national electricity sectors. This was done rather than discussing whether the specific sector should be included in the programme at all. Moreover, as regards the electricity directive itself, it is noteworthy to point out that Germany, along with several other member states, chose to go beyond the minimum requirement for market opening. On the contrary, France, Greece, Ireland and Portugal stuck with the minimum requirements.¹⁸⁸ This suggests that learning from the benefits of liberalisation fundamentally changed the belief systems of the former mentioned group.

¹⁸⁸ EU-Commission SEC (2001) 1957: 3

7. CONCLUSION

This thesis sets out to investigate why a range of liberalisation measures were introduced in the European electricity sectors despite opposition from a majority of member states and key sectoral actors. The case of analysis was the adoption in 1996 of directive 96/92 concerning common rules for the internal market in electricity. It is clear from the analysis of the complex and long-stretched negotiation process on the directive that member states struggled to defend their positions. These seemed, at the outset of negotiations, entrenched in inertia towards the existing equilibrium of the industry's settings and against a reorganisation that would allow more competition the way the Commission suggested. Nevertheless, the directive became a reality and many of the measures of competition envisioned by the Commission in the earliest draft became the focal points in the industrial settings to come in Europe. The principles of TPA, models for unbundling, eligibility criteria and flexible schemes of transition were at the end of the negotiation process merely discussions of technical character. It did not go against the grand idea of introducing competition in the electricity markets and thus of including the sector in the general internal market programme on equal footing with other network industries previously, such as telecommunications, transport and banking.

Reforming the European electricity sectors was a process that affected a key feature of modern societies and hence it involved a range of powerful industrial actors. Notably was the existing utility companies of which many enjoyed monopoly status on the domestic markets actively controlled by the state. The involvement of those actors and the general industrial segments in the member states makes the applied theoretical framework of Europeanization very useful in determining the reasons for the change in member state preferences regarding the directive. From the theory, this thesis has applied the mechanisms of institutional pressure, changing domestic opportunity structures and framing domestic beliefs and expectations. It has identified the measures available to the EU-level to induce pressure on the national level to reform. One outstanding measure was the Commission's active use of its powers of competition control from which it could pursue a legal solution through the ECJ on liberalisation. This created substantial pressure on the member states in question, particularly France, to consider the prerogative of controlled liberalisation from negotiated directives. Member states chose that rather than risking an uncertain situation in the sector following ECJ judgments which could leave them with no chance of modifying that outcome to accommodate its national sector settings.

The second level of Europeanization deals with the variables decisive for the impact of the mechanisms and thus the direction and volume of the EU-impact on the national level. The Analysis holds that the national traditions for policy styles in Germany, France and Britain showed signs of accommodation, inertia and full support in terms of the goodness of fit of the respective domestic institutions. Framing domestic belief systems and expectations is closely linked to changing the domestic opportunity structures and both variables offer an explanation to the possible realisation of the directive. The analysis shows that the idea of competition in the sector was increasingly viewed as workable and even desired by parts of member state government departments and an increasing number of sectoral actors and industrial consumers. They changed their beliefs on what liberalisation could help achieve and thus became part of the prevailing coalition for reforms over the coalition favouring status quo.

All in all, the mechanisms and variables can to a different degree account for the shift in member states' position on the electricity directive during the course of the five-year-long discussions. Those were adaptation pressure on the national institutions, new opportunity structures among key sectoral actors resulting in new actor coalitions and finally the development of a shared understanding of the underlying idea of an internal electricity market based on liberalisation and competition in the member states. Together, the mechanism and variables made it possible to introduce the liberalisation measures despite initial opposition from the same member state governments and sectoral actors.

It may seem uninteresting to today's observers of EU-politics to focus on a negotiating process on a directive that was concluded on twelve years ago. However, the case of the matter is that there is a direct line to the later amendments of the second directive on electricity liberalisation in 2003 that saw a strengthening of the provisions of the first directive. Even at the very present, when this thesis is concluded, the Commission has launched a draft proposal on a third directive to further strengthen the provisions of the second directive. It is currently passing through the legislative mill in the Council and in the EP where it has been up for just as intense discussions this time round. Now the single most important issue is not about TPA but rather on the models for unbundling of the vertically integrated companies. Based on numerous reports and impact assessments conducted by the Commission on a continuing basis, it argues that only total ownership unbundling of the generation and transportation activities will help eradicate the remaining discrimination of third

parties and thus achieve a level playing field.

A theoretical conclusion on the current draft proposal for a third directive is still premature, but indications of the same mechanisms and variables are visible here as well. Above all, a full-length analysis would have been able to illustrate all relevant actors' shifting position over time. For instance that the German government is still deeply entangled with the national energy sector actors as it viciously defends the ISO model over the pure ownership unbundling model and thus ensures that its huge internationally dominating companies, the national champions, such as E.ON will not be forced to sell off its grid activities. The same goes with France which has aligned its position with that of Germany on this issue. Both E.ON, fellow German energy giant RWE, and EDF have protested hard against ownership unbundling which they believe would not lead to lower prices, more competition or investments.¹⁸⁹ Though, an interesting development in this regard occurred with the improbable statement from E.ON in February 2008 that it would sell off its network possessions to a non-competitor. Moreover, it would "*structurally change the electricity sector in Germany and could spur competition in the sector to the benefit of domestic and industrial customers*".¹⁹⁰ E.ON's public turnaround, which was also an attempt to accommodate to impending infringement cases on market power abuse prepared by the Commission, happened just hours before the Energy Council met to discuss the third directive proposal. In the discussions, the German government still fought against this model. The move by E.ON has been copied by Vattenfall Europe, one of the other four major companies in Germany, which have decided to sell off its transmission grids as well.¹⁹¹ This goes to show that in the case of Germany and France, the two countries are still attached to their national energy actors albeit in different ways. The process of the third directive also shows that the Commission still uses its dual strategy of directive law and the exploitation of the primary law in the treaties. Therefore, it can reasonably be assumed that the mechanisms and variables emphasised in the Europeanization theory still provides a workable framework for future analysis of the current negotiation process and expected adoption in late 2008.

Nevertheless, turning the attention of this thesis to the EU-level's pressure on domestic interests in a top-down approach may entail that other mechanisms were left out or downplayed. It makes good

¹⁸⁹ <http://euractiv.com/en/energy/third-energy-package-stakeholder-reactions-broadly-positive/article-166908>

¹⁹⁰ <http://www.eon.com/en/presse/news-show.do?id=8450&back=%2fen%2findex.jsp>

¹⁹¹ <http://afp.google.com/article/ALeqM5hbac4Z5e-U0LVB8kOec4bvp3BYYg>

sense to investigate the liberalisation process from a top-down perspective as this specific process was arguably pushed forward by the European Commission, while the national governments and sector actors were much more hesitant. Nevertheless, neither the analysis nor the theoretical framework put much emphasis on the level of pressure that the national levels put on the EU-level. In other words, the level of bottom-up pressure is arguably not fully taken into account in the analysis either. The same goes to the affected variables during that period. As the conclusion indicates, many member states as well as many energy companies are now in favour of further liberalisation, while others remain foot-dragging. Analysing the negotiations on all three successive directives from 1996, 2003 and the forthcoming within the coming months would reveal a sector that have changed dramatically due to the implementation of the directives with new actor opportunities and coalitions.

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