Property Law and Free Movement of Capital Limits to the Implementation of the Ownership Unbundling in the Energy Sector

MAGDALENA OLESIEWICZ*

Abstract

In the efforts to liberalise the EU Energy Sector, the Third Energy Package has introduced Ownership Unbundling as the preferred measure to enhance competition in the sector. However, as under Ownership Unbundling one entity cannot exercise control over generation or supply undertakings at the same time as exercising any right over transmission systems, its introduction was met by opposition not only from Member States but also from the vertically integrated (at the time) energy sector in the EU. Given the invasive nature of the measure, this paper considers the question of its compatibility with the right to property and the free movement of capital under EU law. This debate is especially topical as the European Court of Justice considered some of the issues in 2014 when delivering judgement in the Essent case. This paper critically analyses these issues in the light of a possible Fourth Energy Package introducing compulsory Ownership Unbundling for all Member States of the European Union.

Keywords: Energy Law, Downstream Energy Law, Market Liberalisation, Ownership Unbundling, Free Movement of Capital, Property Law

1. Introduction

The road to liberalisation of energy markets in Europe started in the 1980s. Back then, electricity markets were dominated by Vertically Integrated Utilities (VIUs) that controlled generation, transmission and distribution of power within one company. In order to open up the sector for competition, the Commission introduced sector specific regulations,¹ the First Energy Package (1996-1998) and the Second Energy Package (2003).² These required unbundling on an administrative and further on a legal level of the Transmission System Operators (TSO), entities responsible for transmission of energy, as well as the Distribution System Operators

* The author is a 2014 LLB Honours Law graduate of the University of Aberdeen and currently working towards her Diploma in Professional Legal Practice (DPLP) at the University of Edinburgh. She also holds an LLM in Energy and Environmental Law from the University of Aberdeen.

¹ OU is also introduced via means of the general competition law. This, however, falls outside the scope of this work. For detailed discussion on this see for example: Manuel Braga Monteiro, ‘Ownership Unbundling - Sector Specific Regulation and Competition Law Perspectives’ (2011) 5 OGET <http://www.ogel.org/article.asp?key=3171> accessed 16 April 2014.

Ownership Unbundling in the Energy Sector

Ownership Unbundling in the Energy Sector

Ownership Unbundling (OU), responsible for the distribution system. However, the Energy Sector Inquiry exposed the shortcomings of the regime that were effectively hindering competition and which resulted in downfalls for consumers. The Final Report identified Ownership Unbundling (OU) as a measure that would help to avoid those shortcomings. According to the Third Energy Package, introduced in 2008, OU entails that one entity cannot exercise control over generation or supply undertakings at the same time as exercising any right over transmission systems. This proposal was met with objections from some Member States (MSs) during the drafting process. It was suggested that OU would be interfering with the property rights of the owners of VIUs, as it effectively forces them to sell part of their assets. Furthermore, MSs suggested that OU can be seen as a restriction on the free movement of capital, as effectively those who already invested in one company cannot invest in another, hence their decision on the investment is restricted. This problem was swept under the carpet by the introduction of alternatives available to countries that do not want to introduce full OU.

However, difficulties with OU can be seen in practice in countries that decided to introduce it. For example, Gazprom launched arbitration proceedings against Lithuania, as it feels that due to OU they are forced into the ‘fire sale of pipelines.’ Furthermore, the Third Energy Package can be seen as an interim measure, with a more radical approach requiring compulsory OU possibly being introduced in the Fourth Energy Package. In light of this, it needs to be established whether the existing property rights and free movement of capital provisions would not limit the introduction of compulsory OU.

In order to determine this, first, the history of liberalisation of the energy sector in the European Union (EU) will be considered, in order to understand the reasoning behind the introduction of OU. This paper will proceed with a critical analysis of property rights and free movement of capital provisions in relation to the OU regime under the Third Energy Package. It will be concluded that the

4 Ibid para 55.
7 Ibid.
8 Ibid.
9 Those alternatives are: Independent Transmissions Operator and Independent System Operator. See below in section 2C.
10 Denis Pinchuk and Nerijus Adomaitis, ‘Gazprom Takes on Lithuania in EU Policy Test Case’ (Reuters 2012) <www.reuters.com/article/2012/03/01/gazprom-europe-lithuania-idUSLSESEI26G20120301> accessed 16 April 2014. It needs to be noted, however, that Gazprom is relying on the BIT between Lithuania and Russia, rather than the EU Treaty provisions.
11 Inigo del Guayo and others, ‘Ownership Unbundling and Property Rights in the EU Energy Sector’ in Aileen McHarg and others (eds), Property and the Law in Energy and Natural Resources (Oxford University Press 2010) 348.
implementation of OU, in principle, should not be limited by property rights and free movement of capital provisions. However, before the introduction of OU as a compulsory solution, it would be desirable to see some concerns being addressed especially regarding compensation for entities, the proportionality of the measure and the relationship of the OU provisions with national constitutional traditions. Some conceptual recommendations for the areas that are causing problems will be suggested.

2. Liberalisation of the Energy Sector in the European Union

The Energy Sector in the EU has been subject to many fundamental changes in the last 30 years. The EU has progressively introduced policies that have been aiming at liberalisation of the energy market. This section will first outline the original situation in the energy sector before liberalisation commenced. This will be followed by discussing legislative changes under the First and the Second Energy Packages. This section will also introduce the analysis of the current regime under the Third Energy Package in order to explain the reasoning for the introduction of measures as intrusive as OU.

A. Beginning of Liberalisation of the Energy Sector

Back in the 1980s, before changes were introduced to the sector, electricity markets were almost completely controlled by VIUs that, to great extent, constituted regulated state monopolies. Those were dominating the energy chain on all levels: generation, transmission, distribution and supply. Such an arrangement of the sector arose from a perception of the energy industry as a natural monopoly, with no room for more than one player on the market. Furthermore, it was seen as the only solution guaranteeing a universal supply of energy to customers, being secure and effective at the same time. This model had been working for years and was seen at the time as the only reasonable way of addressing specifics of the sector.

However, the monopoly model started to be questioned by economists and policy-makers. The existence of the vertically integrated companies was challenged, as they were able effectively to discriminate against their competitors, hindering access of competing generators to the network by imposing discriminatory requirements, charging unreasonably high access and service fees

---

13 Del Guayo and others (n 11) 328.
15 Del Guayo and others (n 11) 329.
16 Geradin (n 14) 2.
or simply by refusing access altogether. Effectively competition was limited, as there was little, if any, chance for a new competitor to enter the business, as the network was owned by VIU. Secondly, the monopolistic structure was leading to distortion of competition. This was due to the lack of transparency in energy tariffs embedded into integration, leading to cross-subsidies among customers and activities. Thirdly, the customers were exposed to risks common to all monopolies: ie either charges above the marginal cost for the goods supplied or the services provided, or a lack of sufficient supply of the goods.

Due to developing EU integration, the VIUs started to be challenged by the Commission. In a working document on the Internal Energy Market in 1988 (1988 Working Document), the Commission pointed out that the vertical/horizontal integration of the industry was one of the main obstacles to the creation of the internal energy market. It also became clear that the energy sector should be arranged in compliance with general EC Treaty provisions, thereby guaranteeing implementation of the fundamental economic freedoms of the EU. From this point in time, however, it took 8 years before the EU decided to address those concerns via the First Electricity and Gas Directives.

B. From the First Energy Package to the Final Report on the Sector Inquiry

In order to ensure liberalisation of the market, the EU decided to address the issue by adequate sector specific regulation of the network. In order to prevent the aforementioned issues, unbundling of the network was thought to be the fitting solution, as this would remove some incentives for discrimination against other entities in the sector. The process of unbundling of the sector started with the Directives of 1996 (electricity) and 1998 (gas). The 1996 Directive required an unbundling on the level of accounts as well as management; the 1998 Directive introduced only the accounting unbundling for the internal market in natural gas. Under both Directives the VIUs were obliged to keep separate accounts for each of

---

18 Van Koten and Ortmann (n 12) 3130.
19 Cabau (n 17) 88.
20 Del Guayo and others (n 11) 329.
21 ibid.
22 ibid.
23 ibid.
25 Del Guayo and others (n 11) 327.
26 ibid.
27 ibid 329. The importance of such regulation can be observed in the example of the New Zealand experience, where the initial lack of a proper regulatory network led to the failure of liberalisation and the eventual adoption of such a network. See Geradin (n 14).
their activities in the energy chain (generation, transmission and distribution), thereby providing more transparency.\textsuperscript{31} This practice of keeping separate accounts, as if activities were carried out by the separate undertakings, was to prevent discrimination, cross-subsidization and distortion of competition.\textsuperscript{32} Unfortunately, the insufficiency of these Directives became apparent in the years following their implementation.\textsuperscript{33} This led to the adoption of the second package of Directives in 2003 and introduction of minimum obligations with regard to legal and functional unbundling, both on gas and electricity companies.\textsuperscript{34}

According to the Second Energy Package, TSO and DSO had to be separate legal entities.\textsuperscript{35} Furthermore, the Directives required independent management structures to be put in place between the TSO and DSO and any general supply companies.\textsuperscript{36} Moreover, a principle of transparency and non-discrimination was introduced. TSOs were obliged to treat all system users alike when it came to access to information.\textsuperscript{37} Furthermore, in order to ensure that the unbundling regime was ‘successful in ensuring fair and non-discriminatory access (…) and equivalent levels of competition’,\textsuperscript{38} the Commission made it subject to reassessment.

Accordingly, after three years from the introduction of the legal unbundling, the Directorate-General for Transport and Energy carried out the Sector Inquiry. The Final Report published by the Commission made ‘uncomfortable reading for many energy companies’.\textsuperscript{39} The report clearly pointed out three main limitations of the unbundling regime under the Second Energy Package possibility of discrimination, information leakage and distorted investment incentives.\textsuperscript{40} It was underlined that

\begin{itemize}
  \item \textsuperscript{32} ibid.
  \item \textsuperscript{33} Cabau (n 17) 89.
  \item \textsuperscript{37} To ensure the effectiveness of this measure, the undertakings were obliged to create so called ‘Chinese Walls’ (information barriers) between supply and network activities effectively introducing ‘information unbundling’. For more detailed discussion see, for example, P Lowe and others, ‘Effective Unbundling of Energy Transmission Networks: Lessons from Energy Sector Inquiry’ [2007] 1 Competition Policy Newsletter 23, 24.
  \item \textsuperscript{40} Final Report (n 3) para 13-39.
\end{itemize}
due to these shortcomings customers were suffering.\footnote{Press Release ‘Competition: Commission Energy Sector Inquiry Confirms Serious Competition Problems’ (10 January 2007) <http://europa.eu/rapid/press-release_IP-07-26_en.htm?locale=fr> accessed on 17 April 2014.} Firstly, there was nothing under the legal ownership unbundling that would stop a TSO from treating its affiliate companies preferentially to competing parties.\footnote{ibid; Neelie Kroes, ‘Introductory Remarks on Final Report of Energy Sector Competition Inquiry’ (Press Conference, Brussels, 10 January 2007) <http://europa.eu/rapid/press-release_SPEECH-07-4_en.htm?locale=en> accessed on 17 April 2014.} Secondly, the investment incentives within an integrated company were still present, by reducing the incentives for incumbents to trade on a wholesale market and leading to a sub-optimal level of liquidity in these markets.\footnote{ibid.} Thirdly, the non-discriminatory access to information could not really be granted, as nobody could prevent TSOs from passing on market sensitive information to its affiliates.\footnote{ibid para 23.} Furthermore, decisions regarding investment in infrastructure (that would help granting access) were based on the supply interest of the integrated companies.\footnote{ibid para 54.} In the light of those facts, the natural conclusion was that mere legal unbundling does not cure the malfunctioning of the energy sector that had been pointed out in the 1988 Working Document.\footnote{ibid para 55. Later the European Parliament expressed political support for OU as it considered it to be the most effective tool to promote investments in infrastructure on the transmission level. See: Parliament, Resolution of 10 July 2007 for the internal gas and electricity market (Text Adopted) P6 TA (2007) 0326.}

The Commission’s report concluded that introduction of OU would allow for the resolution of the aforementioned shortcomings of the regime at the time.\footnote{Final Report (n 3) para 26.} The recommendation in the report was based on economic evidence, as well as the fact that OU would help avoiding detailed and complex regulation.\footnote{ibid para 23.} The Commission pointed out that the main objective was to ensure that consumers, businesses and the economy were benefitting fully from the opening up of the European energy markets in terms of lower prices and better choice of services.\footnote{ibid para 55.} In that sense the Final Report was ‘not the end of the story, but more the beginning of a new one’.

C. The Current Regime under the Third Energy Package

OU had already been recognised as the ultimate way of preventing discrimination at the time of the introduction of the Second Energy Package.\footnote{ibid para 55.} Therefore, it had not been the Commission’s first encounter with the idea of OU when proposing a draft for the Third Energy Package. However, the first time around, the Commission had decided not to introduce this measure, as it would have been politically contentious
Ownership Unbundling in the Energy Sector

and further could have been questioned as to its legality under the proportionality as well as the subsidiarity principle.52

It seems however, that some of these concerns evaporated when legal unbundling proved to be ineffective. Consequently, under the Third Energy Package provisions, OU is the preferred position for TSOs.53 According to the OU provisions in the Directives, one entity cannot exercise control over generation or supply undertakings at the same time as exercising any right over transmission systems.54 The Directives also stipulate alternatives, also seen as derogations,55 that can be used by countries that do not want to introduce OU.56

The first alternative is the use of an Independent System Operator (ISO), which allows the vertically integrated companies to retain ownership of their network assets, on the condition that the transmission network be managed by an ISO (entity separated from the vertically integrated company).57 Such a regulatory mechanism would have to be constituted in order to ensure that the operator remains and acts independently of the vertically integrated company. However, the use of an ISO was not the preferred solution by the Final Report as it was thought that it might lead to prescriptive, more detailed and costly regulation, compared with OU.58 It also does not address the disincentive to invest in the network as effectively as OU does.59 The second alternative is that of the Independent Transmission Operator (ITO), whereby a company can remain vertically integrated, albeit with special rules introduced to guarantee ITO independence.60 This option was added to the Directives as a consequence of pressures from some MSs which demanded amendments to the Commission’s original proposal.61 In January 2007, eight countries, led by Germany and France, sent a letter to the European Parliament expressing their concerns regarding legality, proportionality and efficiency of OU.62 The MSs saw OU as incompatible with their constitutional laws and free movement of capital provisions. Due to the pressure from the European Council (the Council)

52 ibid.
54 ibid.
56 Del Guayo et al (n 11) 335.
58 Final Report (n 3) para 55.
59 ibid.
61 That proposal stipulated only the OU and the ISO as options.
62 EurActive (n 6).
Ownership Unbundling in the Energy Sector

that adopted a common position in this regard, in January 2008 the Commission was forced to introduce a third option.\(^{63}\)

In the final shape, therefore, there are two alternatives to OU available to MSs. Those are equally valid, as effectively there is no hierarchy between the options available.\(^{64}\)

D. Controversy around Ownership Unbundling as the Ultimate Solution

The European Energy policy is aiming at achieving a competitive and efficient energy sector.\(^{65}\) The OU regime was pointed out as an ultimate solution for the conflict of interest that was inherited in the vertical integration of supply and network activities.\(^{66}\) Furthermore, it has been argued that OU increases promotion of competition, increases efficiency, simplifies market and company structures, allows privatisation, reduces the risk of arbitrary government intervention and advances the security of supply.\(^{67}\) It was also pointed out that it would ensure efficient and timely investment in capacity.\(^{68}\) However, the most important potential advantage of unbundling may be the creation of a level playing field for supply companies.\(^{69}\)

Nonetheless, OU is questioned as to its effectiveness and appropriateness from economic, political and legal perspectives. It is argued that OU causes direct cost due to the associated reorganisation of business activities and renegotiation of contracts,\(^{70}\) which in consequence can decrease the creditworthiness of commercial companies and may lead to higher capital costs.\(^{71}\) Furthermore, there seems to be no empirical evidence at the moment that OU brings benefits to consumers.\(^{72}\) Also, political concerns exist, as some fear that OU facilitates acquisition of parts of the strategic sector by foreign companies (by this having consequences for the security of supply).\(^{73}\)

As can be observed the benefits of OU are not without costs. Therefore it is unclear whether on balance it will actually bring the anticipated effects.\(^{74}\) However, OU on the EU level is not only being challenged as to whether it is the most effective


\(^{64}\) Johnson and Block (n 55) 37.


\(^{66}\) Monteiro (n 1) 6.

\(^{67}\) M Pollitt, ‘The Arguments For and Against Ownership Unbundling of Energy Transmission Networks’ [2008] 36 Energy Policy 704, 706; Johnson and Block (n 55) 66.

\(^{68}\) ibid.


\(^{70}\) Monteiro (n 1) 7.

\(^{71}\) Baarsma and others (n 69) 1788.


\(^{73}\) Pollitt (n 67) 706.

means for stimulating competition, but also as to whether it complies with fundamental rights and freedoms in EU law. The next sections will try to address the latter concerns.

3. Property Law Limits of the Ownership Unbundling

As pointed out in the previous section, the possible incompatibility of OU with rights of property had raised concerns already at the stage of drafting, especially from the German perspective.\(^75\) It is argued that addition of the ISO option in the final version of the Directives can be attributed to the intensive discussion about the question as to whether the position preferred by the Commission satisfies requirements of property protection principles.\(^76\) This is due to the fact that OU entails effective change in the ownership structures of VIUs. The right to peaceful enjoyment of property is one of the fundamental rights recognised on a national, as well as an EU, level. Such potential interference with property rights by public authorities needs to be balanced against the rights of individuals.\(^77\) In this section it will be analysed whether such a balancing exercise was performed correctly with regard to OU. First, sources of protection of the right to property in the EU will be identified, which will be followed by a confrontation of those protection measures with the OU regime in the Third Energy Package.

A. Protection of Right to Property in the EU

Property protection is a common tradition within the essential European constitutional framework.\(^78\) Protection of the right to property has a broader purpose than just serving the individual owner; it also has a social purpose as it encourages innovation, investment and technical development.\(^79\) There are three main sources of property law rights in the European legal order. Firstly, the right to property is recognised in the Charter of Fundamental Rights (the Charter) in Article 17.\(^80\) Secondly, the European Convention on Human Rights (the ECHR) in Protocol One recognises the right to property as a fundamental human right.\(^81\) Even though the EU accession to the ECHR has not been ratified yet, all freedoms protected by the ECHR are accepted as a general principle of European Law according to Art 6(3) TFEU. Furthermore, protection of property is a constitutional tradition common to MSs, and is recognised as a national fundamental right.\(^82\)

\(^75\) EurActive (n 6).
\(^76\) Del Guayo et al (n 11) 358.
\(^78\) Del Guayo and others (n 11) 337.
\(^79\) ibid.
\(^80\) Provisions found in the Charter are given the same value as the Treaty ones by art 6(1) of the TFEU.
\(^81\) The European Convention on Human Rights, Protocol 1, art 1.
\(^82\) TFEU, art 6(3). The technique of comparative evaluation is used to determine whether a certain right is a part of the common tradition of MSs. It is rare for the Court to refer to a specific
Regarding the subject of protection, the ECJ understands the notion ‘property’ in a broad sense, as ‘all proprietary interests exclusively attributed to a given person.’\textsuperscript{83} It is a common position that owners are entitled to undisturbed enjoyment of their property, with almost absolute prohibition of interference with these rights by a national government.\textsuperscript{84} However, some limitations on the effect should be introduced to take account of fundamental rights’ social functions.\textsuperscript{85} A state’s power may interfere with the right to property, either by simply restricting the use of it or by deprivation.\textsuperscript{86} To illustrate, expropriation is the most obvious example of deprivation where the property is transferred to a state or a third party.\textsuperscript{87} A state can restrict the use of property via regulations that are prohibiting a certain use of an asset, however it does not entail the transfer of ownership.\textsuperscript{88}

However, if peaceful enjoyment of the property is interrupted by deprivation it must be pursued in the public interest; the measure taken needs to be proportionate and under conditions provided by law.\textsuperscript{89} Furthermore, it needs to be subject to fair compensation for loss.\textsuperscript{90} In cases of restriction of the use of property, this can only be done to the extent that it is necessary for general interest.\textsuperscript{91}

Some aspects of property protection will be dealt with in more detail in the following sections. These will be considered in the light of the OU restrictions on the right to property.

B. Ownership Unbundling in the Light of Property Rights Protection

In the light of the OU provisions it has been questioned whether the right to undisturbed use of owners’ assets is respected.\textsuperscript{92} Under the new regime the companies are effectively forced to demerge, thus giving up the use of their assets, namely networks (which can constitute up to between 70\% and 80\% of the balance-sheet value of companies).\textsuperscript{93} However, severity of this measure must be balanced against the fact that regulation is aiming at introducing competition in the energy sector, which in the long-term would benefit consumers, businesses and the
Ownership Unbundling in the Energy Sector

economy in general. In this section it will be studied whether these objectives can justify such a far-reaching interference with the enjoyment of property rights.

i. Type of restriction: deprivation or mere restriction of the use of property?

As aforementioned, both the ECHR and the Charter differentiate between the mere restriction of property (which bears less severe consequences) and deprivation, which not only has to be justified, but also has to be appropriately compensated. Due to different tests being applied for different types of infringement, this needs to be considered as a first step in examining the legality of the infringement to which the OU allegedly amounts.

Regarding infringement via restriction of the use of property, examples can be found in case law dealing with situations where legislation imposed was controlling how to produce and how much to produce. In the case of OU, however, we deal with a situation where regulation addresses access to property and excludes energy producers from ownership of network assets. It has been suggested that OU should be understood as ‘compulsory sale at market value, executed in the interests of the public good of market liberalisation’. Labelling it differently, however, does not change the fact that OU amounts to more than mere restriction of the use of property. A legal obligation is imposed on entities either to sell all shares in a transmission company or at least to sell so many of them that their control over the network is effectively disabled. This has the effect of depriving entities of their property.

Furthermore, it has been pointed out that in order for the infringement to amount to de facto expropriation (rather than mere restriction of use), one needs to be deprived of any meaningful use as well as the possibility to dispose of the property. Echhart refers to the Hauer case and claims that the ECJ took a formalistic view in that, due to the mere fact that the owner is able to dispose of his property (even for a much reduced price), the intervention of a state should only amount to the extensive restriction of the use of property. If this were accepted then OU would amount to mere restriction of the use of property, as it would allow an undertaking to sell assets at market price. However it is submitted that what is left out by Echlers is that in Hauer disposal of assets was only one of the options, as the owner could still use the land for other non-prohibited purposes. This is not

---

95 Baarsma and others (n 69) 1792.
96 Becker (n 82) 275.
99 Del Guayo and others (n 11) 337.
100 Becker (n 82) 288.
101 ibid.
103 Ehlers (n 87) 403.
104 Liselotte Hauer (n 102) para 23.
afforded to entities in the OU regime, as disposal of assets is the only option they have, further confirming that OU should amount to deprivation. This conclusion would be in compliance with the European Court of Human Rights (ECtHR) case James v UK,\textsuperscript{105} where it was stated that such compulsory transfer of property effectively amounts to deprivation of the property.\textsuperscript{106} The position favoured in this paper is therefore that, under the Charter and the ECHR, OU effectively amounts to deprivation in the light of the protection of property provisions.

If one accepts the assumption that OU amounts to deprivation, what needs to be considered next is the type of deprivation. Deprivation can amount to formal expropriation (transfer to the State or third party) or \textit{de facto} expropriation where the formal position regarding ownership remains the same, but the owner loses all rights attached to his position.\textsuperscript{107} It is submitted that even though the party remains free to sell property as s/he wishes, OU effectively requires a transfer of assets to a third party (simply not specifying to whom), and therefore it should be classified as expropriation. However, \textit{de facto} expropriation can be observed when introducing ISO, as even though a party remains the owner, somebody else is making all the important decisions via management.\textsuperscript{108}

Therefore, it can be concluded that OU amounts to formal expropriation. What adds an extra dimension to this problem is the fact that protection of property rights is not only a long-standing tradition on an EU level but constitutional in each MS.\textsuperscript{109} For example, in Germany full implementation of EU energy regulations would require a partial breach of national constitutional law.\textsuperscript{110} Due to the alternatives available in the Third Energy Package, however, those issues have not had to be dealt with yet. However, if OU were to be introduced as compulsory, this issue would have to be addressed accordingly.

\textit{ii. Conditions provided by law: competence issues}

In order for the deprivation to be legal, it has to be done in accordance with conditions provided by the law. For this to be true with regard to the Third Energy Package, the EU has to have competence to legislate for changes in the energy sector as well as for property ownership allocation.\textsuperscript{111}

At the time of introduction of the Third Energy Package, powers of the EU in the energy sector were not expressly recognised. It was therefore argued at the time that provisions are found to fall under the umbrella of Art 95 of the European Community Treaty (EC).\textsuperscript{112} What facilitates the issue now is the enactment of the

\textsuperscript{105}James and others v The United Kingdom [1986] 8 EHRR 123.
\textsuperscript{106}ibid para 32.
\textsuperscript{107}Ehlers (n 87) 403.
\textsuperscript{108}For more detailed discussion see Pielow and others (n 74) 96; Del Guayo and others (n 11).
\textsuperscript{109}Ehlers (n 87) 403.
\textsuperscript{110}This is due to the sophisticated system of fundamental rights protection that can be found in the German Constitution. Due to the scope of this work this issue will not be covered in detail. For full discussion see: Del Guayo and others (n 11) 348; Lowe and others (n 37) or E Bohne, ‘Conflicts between National Regulatory Cultures and EU Energy Regulations’ [2011] 19 Utilities Policy 255.
\textsuperscript{111}Becker (n 82) 290.
\textsuperscript{112}Michael Hunt, ‘Ownership Unbundling: The Main Legal Issues in a Controversial Debate’ in Bram Delvaux and others (eds), \textit{EU Energy Law and Policy Issues} (ELRF Collection, 1st edn, Euroconfidentiel
Lisbon Treaty in 2009. Article 194(2) of the Treaty on the Functioning of the European Union (TFEU) stipulates that the energy sector is a field of shared competence, falling within the meaning of Article 5 EC. However, as the energy policy is still not an exclusive competence, it falls under the principle of subsidiarity, which restricts the EU from taking action unless this cannot be achieved sufficiently by MSs. Some suggest that, in order to ensure achievement of an EU integrated energy market, all measures at the national level should first be exploited. However it was also suggested that objectives behind OU, especially the need to ensure a level playing field across the EU energy market, meet conditions set by the subsidiarity principle. Due to the scale of the project this seems to be a more convincing argument.

While this may solve the problem of EU competency in the field of the energy policy, however, the property related competences are set out in Article 345 TFEU (formerly Article 295 EC). The relationship of OU with this provision is not as clear and may introduce barriers for the exercise of competence.

Article 345 TFEU stipulates that the TFEU and the Treaty on European Union ‘shall in no way prejudice the rules in MSs governing the system of property ownership.’ The scope of the provision is far from clear. It was suggested that the wording of Art 345 TFEU supports a broad applicability. Wide interpretation of the provision would assume that ‘system of property ownership’ entails ‘all constitutional provisions concerning private ownership, in particular expropriation’. This view is supported by a group of academics, who submit that the EU is not competent to legislate when a measure results in expropriation, consequently questioning the legal basis of OU.

However, as many point out, some degree of unification of property law is unavoidable in view of economic integration. Wide interpretation of Art 345 TFEU was objected to by the European Court of Justice (ECJ) in the Golden share cases, where the Court limited the powers enjoyed by MSs. National property law measures had been made subject to the principles of the Treaty. Moreover,
exercise of property functions was allowed to be restricted by the Community action in order to advance the goals of the Treaties. As OU is motivated by a specific public interest (enhancement of competition in the energy industry), this could be argued to be a reason why allocation of property should be allowed.

However, this paper argues that the narrow interpretation of the scope of Art 345 TFEU should be considered, especially given that recent case law suggests crystallisation in that direction. According to the drafting history of the provision, Art 345 TFEU was introduced to prevent the EU from interfering in property status, that is changing it from public to private and vice versa. Therefore, some argued that Art 345 TFEU should be seen as protection of the principle of neutrality with regard to ownership, public or private, for forbidding the EU from forcing one to privatise or nationalise property. This was confirmed in the Essent case, where the ECJ stated that ‘Art 345 TFEU is an expression of the principle of neutrality of the Treaties in relation to the rules in MSs governing the system of property ownership.’ Therefore, it can be validly argued that the EU should not be precluded from taking action with regard to expropriation.

Thus, as OU does not require MSs to privatise if this is felt to be undesirable, it is submitted that the provisions should not be seen to be outside the competences of the EU, as the principle of neutrality is not interfered with. In the light of the above it can be concluded that the EU has a competence to regulate property allocation, including deprivation, hence interference with property rights, which arises from OU, is under conditions provided for by law.

iii. Proportionality of the Ownership Unbundling
Some suggest that the most difficult criteria to be met by the OU with regard to the test for restrictions on the right to property, is the proportionality requirement. Based on case law the proportionality test consists of three parts: suitability of measure (appropriateness), least restrictive measure (necessity) and proportionality stricto sensu. Each of these elements will be considered in turn.

---

121 Case C-309/96 Daniele Annibaldi v Sindaco de commune di Guidonia and Presidente Regione Lazio (1977) ECR I-7493.
122 Del Guayo and others (n 11) 338.
123 See: Joined Cases C-105/12, C-106/12 and C-107/12 De Staat der Nederlanden v Essent NV and Essent Nederland BV, Eneco Holding NV, Delta NV (ECJ, 22 October 2013).
124 Angelos Dimpopoulos, EU Foreign Investment Law (Oxford University Press 2011) 110.
125 Joined Cases C-105/12, C-106/12 and C-107/12 De Staat der Nederlanden v Essent NV and Essent Nederland BV, Eneco Holding NV, Delta NV (ECJ, 22 October 2013), Opinion of AG Jaaskinen, para 41.
127 Essent case (n 123) para 29.
128 Dimpopoulos (n 124) 111.
129 Baarsma and others (n 69) 1791.
130 Del Guayo and others (n 11) 342.
Ownership Unbundling in the Energy Sector

OU brings across-the-board systematic regime change applicable to all MSs.\(^\text{132}\) Some authors point out that OU attempts to generalise the differing national property concepts with regard to MSs’ energy undertakings.\(^\text{133}\) Due to differences between property concepts in MSs, the appropriateness (first prerequisite) of the regime change in all instances can be challenged.\(^\text{134}\) However, lack of appreciation of differences between default positions of MSs would be of smaller importance to the court if it were proven that OU is able to achieve the objectives it pursues.\(^\text{135}\) On the other hand, it has already been questioned whether OU will have positive effects on competition.\(^\text{136}\) As aforementioned, some MSs expressed concerns in this regard during the drafting process and it remains questionable whether OU could bring the desired effects.\(^\text{137}\) Nevertheless, in Portugal, encouraging effects followed the introduction of OU.\(^\text{138}\) This could potentially overturn arguments against the introduction of OU as an ineffective measure.\(^\text{139}\) Therefore, the key to establishing the appropriateness of the measure is the economic and empirical evidence that OU is enabling achievement of effective competition in the electricity markets.\(^\text{140}\)

With regard to the necessity of the measure (second prerequisite) it has to be demonstrated that the same effect could not be achieved by other means. However, one has to look no further than the provisions of the Directives, where ISO and ITO are set out as alternatives to OU. They might be seen to suggest, as the Commission itself is implying, that a similar, if not the same, effect, can be achieved by less restrictive means. If the same level of competition can be achieved by those means, it would render OU not ‘necessary’ and, by the same token, disproportionate.\(^\text{141}\) However, what needs to be pointed out is that the Directives stipulate that alternatives are equally ‘valid’; it is not stipulated that they are equally ‘effective’. Furthermore, as aforementioned, when drafting the Second Energy Package OU had already been considered. However, such a measure could have been legally questionable under the principle of proportionality ‘at least until all other options had been tried and demonstrated to be inadequate.’\(^\text{142}\) The Final Report suggests that this is what indeed happened. The reason for the introduction of alternatives could be better understood when looked at in the context of political pressure from some MSs at the time of the proposal. Alternatives have been clearly left as measures for those countries that do not feel comfortable with the prospect of OU.\(^\text{143}\) Still, it has been pointed out that OU is the only solution that does not fail to rectify the problem inherent in conduct-related rules: commercial incentives of companies and the level

\(^{132}\) Del Guayo and others (n 11) 342.
\(^{133}\) Ibid.
\(^{134}\) Ibid.
\(^{135}\) Hunt (n 112) 81.
\(^{136}\) See supra section 2D
\(^{137}\) See supra section 2C.
\(^{138}\) Monteiro (n 1) 18.
\(^{139}\) Ibid.
\(^{140}\) Pradroux and Talus (n 131) 18.
\(^{141}\) Del Guayo and others (n 11) 343.
\(^{142}\) Cabau (n 17) 90.
\(^{143}\) Becker (n 82) 294.
Ownership Unbundling in the Energy Sector

... playing field objective.\textsuperscript{144} Even the originally introduced alternative, ISO, is less effective as it leads to prescriptive and burdensome regulation.\textsuperscript{145}

On the other hand, it was suggested that the new Directives had been introduced prematurely, as the Final Report had been published based on the situation up to 2005. This was just two years after the introduction of the Second Energy Package, giving little time to see definitive effects.\textsuperscript{146} The report was also criticised after its publication in 2007 due to defects in its database and empirical findings.\textsuperscript{147} However, taking under consideration the nature of the shortcomings pointed out in the report,\textsuperscript{148} it might be questioned whether allowing more time would result in any changes.

When it comes to proportionality \textit{stricto sensu} it would have to be considered whether the burden that OU imposes is not excessive with regard to pursued objectives.\textsuperscript{149} Ehlers points out that the application by the ECJ of the principle of proportionality to fundamental rights restrictions as a result of EU legislation has not occurred so far.\textsuperscript{150} EU provisions will be held as proportionate if they are not ‘manifestly unreasonable’, which is the test used by the ECJ when questioning EU legislation.\textsuperscript{151} This is because the ECJ is very unwilling to enquire into the EU legislature’s motivations and detailed reasons/evidence for the decision that EU level action was necessary.\textsuperscript{152} Becker adds that the ECJ may rely on the Community institutions’ own assessment rather than evaluating necessity on its own.\textsuperscript{153} It is submitted that it will probably not be different in the case of the Third Energy Package. The ECJ would probably be reluctant to engage itself in the discussion regarding the measure’s suitability. This is especially because OU constitutes a key element of the EU’s Energy Policy.\textsuperscript{154} Therefore, it must be concluded that it is not really likely that OU would be successfully challenged based on non-proportionality of the measure.

\textit{iv. Compensation}

It is settled case law that the substance of the right to property is protected if the compensation provided takes into consideration the value of the investments made.\textsuperscript{155} At first sight, it seems that the requirement to compensate is satisfied by the price that is received by the incumbents when selling the network.\textsuperscript{156}

However, even though OU does not force owners to give away their assets (rather it effectively requires them to sell them off), some issues in relation to

\begin{footnotesize}
\begin{enumerate}
\item Praduroux and Talus (n 131) 18.
\item See section 2C.
\item Piełow and others (n 74) 104; Hunt (n 112) 88.
\item Del Guayo and others (n 11) 343.
\item See shortcomings pointed out in section 2B.
\item Hunt (n 112) 89.
\item Ehlers (n 87) 411.
\item ibid 425.
\item Hunt (n 112) 89.
\item Becker (n 82) 294.
\item Hunt (n 112) 89.
\item Talus and Johnston (n 97) 153.
\item Becker (n 82) 294.
\end{enumerate}
\end{footnotesize}
Ownership Unbundling in the Energy Sector

compensation can arise.\(^\text{157}\) It has been pointed out that the responsibility of a state cannot be shifted on private investors.\(^\text{158}\) Therefore, it remains the state’s duty to ensure that owners are compensated (for example in the case of the purchaser’s insolvency).\(^\text{159}\) Furthermore, the purchase price of the networks may, in practice, be lower than the market value.

However, it seems that there is a wide margin of discretion in determining what fair compensation is.\(^\text{160}\) As there is no jurisprudence in the ECJ on this level, it was suggested to consider the ECtHR case law, wherein compensation is one of the elements of the proportionality principle.\(^\text{161}\) It has been pointed out that ‘legitimate objectives of “public interest” such as pursued in measures of economic reform or measures designed to achieve greater social justice, may call for less than reimbursement of the full market value.’\(^\text{162}\) However, as the Charter makes compensation a separate requirement, it can be suggested that its significance is greater than in the ECHR. As the Charter calls for ‘fair compensation paid in good time’, the ECJ may hesitate more before holding that the compensation requirement has been satisfied. It remains to be seen how the ECJ would approach this issue.

C. Conclusion

With regard to property rights and the OU relationship, it was established that OU amounts to deprivation of property, which is forbidden unless the threefold test is met. It was concluded that OU is likely to meet the first two conditions. The EU has competence to regulate property allocation; therefore deprivation is in accordance with conditions provided by law. Furthermore, it was held that OU would probably meet the proportionality test applied to such cases. It was noted, however, that whether a ‘suitable compensation’ can be provided by the sale price can be questioned (even though according to ECtHR case law compensation would be ‘suitable’ even if assets were sold at less than their value). Furthermore, it was noted that conflict may arise between the OU and national constitutional laws.

4. Free Movement of Capital

Limitations to the Ownership Unbundling Directives, as a secondary EU law, are required by the Court to uphold and respect EU Treaty provisions.\(^\text{163}\) In light of this, concerns have been expressed that OU is not compatible with free movement of capital, as stated in Art 63 TFEU.\(^\text{164}\) Supporters of this view argue that the freedom granted by the TFEU would be compromised, as

\(^{157}\) Del Guayo and others (n 11) 342.
\(^{158}\) Becker (n 82) 294.
\(^{159}\) ibid.
\(^{160}\) ibid 295.
\(^{161}\) Talus and Johnston (n 97) 153.
\(^{162}\) James and others v The United Kingdom [1986] 8 EHRR 123.
\(^{163}\) Case C-15/83, Denkavit [1984] ECR-2171. Of course national measures are subject to this provision as well.
\(^{164}\) Ehlers (n 87) 432; Hunt (n 112) 85.
the Energy Directives are banning energy production and supply undertakings from investing in unbundled energy transmission network operators.\textsuperscript{165} Effectively it would impact the attractiveness of investment in the affected undertaking.\textsuperscript{166} The first part of this section will examine the free movement of capital provisions. Later, there will be an attempt to analyse OU, to see if violation of the fundamental freedom arising as a consequence of the new regime can be justified in the light of the TFEU provisions.

A. Free Movement of Capital Provisions in EU law

The right to invest freely can be found in Art 63 TFEU according to which ‘all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited.’ Therefore, national measures that could prevent or limit the acquisition of shares or deter investors from other MSs from investing the capital in an undertaking should be regarded as restrictions within the meaning of Art 63(1) TFEU.\textsuperscript{167} This provision prohibits measures that are both directly and indirectly discriminatory as well as non-discriminatory measures which hinder access to the market.\textsuperscript{168} When it comes to the definition of ‘capital’, the ECJ has recognised that it can constitute an investment into real property.\textsuperscript{169} Also, direct investment in a company by means of shareholding and portfolio investment can constitute ‘capital’ for the purpose of Art 63 TFEU.\textsuperscript{170}

The freedom is, however, not an absolute one. In the Treaty it is recognised that MSs may have an interest in limiting free movement of capital; consequently Art 65 TFEU outlines express derogations. Furthermore, restriction can also be accepted if the measure in question is justified by compelling reasons of public interest.\textsuperscript{171} In \textit{Commission v Belgium}, it was held that possibilities to restrict the principle of free movement of capital are subject to rigorous requirements.\textsuperscript{172} A measure needs to be justified by an overriding requirement of general interest within the meaning of the ECJ’s case law.\textsuperscript{173} Furthermore, restriction by national legislation must ‘be suitable for securing the attainment of the objective which they pursue, and they must not go beyond what is necessary in order to attain it.’\textsuperscript{174} Also, the restrictions must be non-discriminatory.\textsuperscript{175}

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{165} Ehlers (n 87) 431.
\item \textsuperscript{166} It needs to be noted that in a similar matter OU can affect freedom of establishment. For detailed discussion on this aspect please see: Hunt (n 112) 75-81.
\item \textsuperscript{167} Opinion of AG Jaaskinen (n 125) para 56.
\item \textsuperscript{168} Catherine Barnard, \textit{The Substantive Law of the EU} (4th edn, Oxford University Press 2010) 570.
\item \textsuperscript{169} ibid 563.
\item \textsuperscript{170} Joined Cases C-282/04 and C-283/04 \textit{Commission v Netherlands} [2006] ECR I-9141, para 19; Case C-171/08 \textit{Commission v Portugal} [2010] ECR I-6817, para 49.
\item \textsuperscript{171} Case C-388/01 \textit{Commission v Italy} [2003] ECR I-721, para 22; Case C-109/04 \textit{Kranemann} [2005] ECR I-2421, para 34.
\item \textsuperscript{172} Case C-503/99 \textit{Commission v Belgium} (2002) ECR 04809.
\item \textsuperscript{173} Case C-463/00 \textit{Commission v Spain} (2003) ECR I-4581, para 35; Case C-271/09 \textit{Commission v Poland} [2011] ECR I-0000, para 55.
\item \textsuperscript{174} Case C-367/98 \textit{Commission v Portugal} (2002) ECR I-4731, para 37.
\item \textsuperscript{175} Baarsma and others (n 69) 1792.
\end{itemize}
\end{footnotesize}
All in all, the free movement of capital is one of the cornerstones of EU policy. However, it has been recognised that there should be a possibility legally to restrict the freedom if this is justified, proportionate and non-discriminatory. The next section will critically analyse the relationship between free movement of capital and the OU regime.

B. The Ownership Unbundling and Free Movement of Capital Provisions

Concerns have been expressed regarding the potential restrictions imposed on the free movement of capital. This is because, in consequence of OU, a company that owns transmission or generation assets cannot invest in or has to disinvest from other assets.\textsuperscript{176} The Dutch Council of State expressed concerns in this regard by stating that OU ‘limits investors from other MSs from combining investment in network management and production and supply and it places limitations on the ability of the present shareholders to sell shares to (foreign) private investors.’\textsuperscript{177} Here, the other angle of the problem is noticed as, if private ownership is already allowed under a national system, any restrictions upon the free disposal of shares in such assets may breach provisions on the free movement of capital.\textsuperscript{178} These concerns were confirmed in the \textit{Essent} case, where ‘the group prohibition’\textsuperscript{179} and ‘the prohibition of unrelated activities’,\textsuperscript{180} introduced in order to implement OU, were discussed in the context of capital movements.\textsuperscript{181}

In light of this, it needs to be examined whether freedom of capital restrictions may be justified with regard to OU. In the following part it will be considered whether OU should be justified by overriding the requirement of general interest and whether it is proportionate and non-discriminatory, thus satisfying the test for lawful restriction of capital movements.

i. Justification of limitations imposed by Ownership Unbundling

As aforementioned, Art 63 TFEU allows limitations on the fundamental freedoms in cases where those can be justified. In the light of the provisions of Art 65 TFEU and the possible justification on the basis of overriding public interest, it will be examined whether OU limitation of the free movement of capital can be justified.

After the proposal of the Third Energy Package, the possibility of justification of OU was examined in the context of existing ECJ jurisprudence. It was noted that the ECJ in the past had recognised energy policy potential as the background to

\textsuperscript{176} Hunt (n 112) 74.
\textsuperscript{177} As quoted in Johnson (n 114) 284.
\textsuperscript{178} ibid 288.
\textsuperscript{179} Entailing that a ‘system operator shall not be a member of a group of which a legal person or company which generates, supplies or trades in electricity in the Netherlands is also a member.’ See \textit{Essent} case (n 123) para 19.
\textsuperscript{180} Entailing that ‘If a system operator which is not the system operator of the national high-voltage grid is a member of a group within the meaning of Article 24b of Book 2 of the Civil Code, that group may not engage in transactions or activities which may adversely affect the operation of the system concerned’. See \textit{Essent} case (n 123) para 20.
\textsuperscript{181} \textit{Essent} case (n 123).
imposing justifiable restrictions on capital movements.\textsuperscript{182} This was allowed due to recognition of the need to ensure energy security.\textsuperscript{183} However, this justification must be interpreted strictly (only if there is a ‘genuine and sufficiently serious threat to fundamental interest of society’\textsuperscript{184}). Threat to energy security in the context of OU was suggested by Ehlers not to be ‘sufficiently serious’.\textsuperscript{185} This is because OU leads to security of supply in the long term (via attracting investment), however not in a direct or immediate manner.\textsuperscript{186} It was also argued that the main purpose behind OU provisions is to strengthen a competitive structure in the energy market.\textsuperscript{187} This objective of increasing competition, however, has been explicitly recognised as a non-valid basis for justified restriction, due to its purely economic nature.\textsuperscript{188} In light of this statement OU could not be justified as a restriction on capital movements.

This, however, could be challenged in light of suggestions that a need to achieve a more competitive and open energy market, which protects consumers against abusive practices, may be regarded as a plausible justification.\textsuperscript{189} It was pointed out that those potential benefits to consumers could probably be regarded as being in the general interest.\textsuperscript{190} At the time, however, it remained uncertain whether and on what basis OU should be justified.

However, recently the judgement in the \textit{Essent} case, which concerned Dutch legislation introduced in order to implement OU, clarified this point of law.\textsuperscript{191} It was held that objectives underlying the OU regime, as an ‘overriding reason in the public interest’, constituted a justification for a restriction of the free movement of capital.\textsuperscript{192} The Court stated that the limitation was allowed if legislation dictated by reasons of economic nature was in the pursuit of an objective in the public interest.\textsuperscript{193} In such cases the interest underlying the choice of legislation is to be taken into consideration as an overriding reason in the public interest.\textsuperscript{194} Such a development with regard to ‘economic objectives’ had been suggested earlier by academics.\textsuperscript{195}

In light of this, the Court had to decide whether the national measures at issue introducing OU ultimately pursue, by means of objectives behind the introduction of legislation, overriding objectives in the public interest.\textsuperscript{196} The Dutch government

\begin{thebibliography}{99}
\bibitem{185} Ehlers (n 87) 168.
\bibitem{186} ibid 169.
\bibitem{187} Opinion of AG Jaaskinen (n 125) para 82.
\bibitem{188} C-174/04 Commission v Italy [2005] ECR I-04933.
\bibitem{189} Monteiro (n 1) 8; Hunt (n 112) 81.
\bibitem{190} ibid.
\bibitem{191} \textit{Essent} case (n 123).
\bibitem{192} ibid para 66.
\bibitem{193} ibid para 52.
\bibitem{194} ibid para 53. The route that the Court chose was in accordance with the first of three justifications suggested by the AG in this case. See the AG’s opinion at para 85.
\bibitem{196} \textit{Essent} case (n 123) para 57.
\end{thebibliography}
introduced prohibitions in order to transpose the 2003 Directives’ provisions, which suggests that there is a need to look at EU legislation in order to establish objectives behind the introduction of the national measure.\textsuperscript{197} The Court ultimately looked at objectives behind the 2009 Directives, as it was claimed that those were designed to achieve the same objectives.\textsuperscript{198}

Firstly, the Court made a reference to EU jurisprudence where it was stated that an objective of undistorted competition (being one of the objectives of TFEU) can constitute an overriding reason in the public interest, as it is to be achieved in order to protect consumers.\textsuperscript{199} The court also, in contrast to Ehlers, recognised that guaranteeing adequate investment in the electricity and gas distribution is aiming at ensuring the security of energy supply and should be taken under consideration as an overriding reason in the public interest.\textsuperscript{200} AG Jaaskinen explained that system operators are important to security of supply as the entity controlling the distribution of electricity (as well as gas) controls modern society in all its functions.\textsuperscript{201} It is submitted that AG’s view is more convincing than Ehlers’, as it takes into account not only long-term benefits to security, but also immediate benefits.

Further, as aforementioned, the Court ultimately looked at the objectives behind the introduction of OU in the Third Energy Package. The court referred to recitals to the 2009 Directives, underlining that the EU legislature is aiming at:

- ensuring non-discriminatory access to electricity or gas distribution systems and transparency in the markets, to prevent cross-subsidisation, to ensure adequate investment in networks in order to guarantee the stable security of supply of electricity and gas and to prevent exchanges of confidential information between system operators and the generation/prod

It was concluded that those objectives might, in principle, justify the identified restrictions on the fundamental freedom as overriding reasons in the public interest.\textsuperscript{202} It is regrettable, however, that in light of the criticism of OU and its effectiveness, no time was taken to examine whether the objectives stated in the preamble to the Directives can actually be met by OU. On the other hand, to an extent this can be linked to the discussion about the proportionality of the measures, and consideration of the appropriateness of such measures, issues which were, in this case, explicitly reserved to the referring court.\textsuperscript{204} The question of whether OU complies with the principle of proportionality and non-discrimination remains open. These aspects will be discussed in the next section.

\textsuperscript{197} ibid para 60.
\textsuperscript{198} ibid para 65. Even though the 2009 Directive did not constitute a legal basis for the case at hand the ECJ had made reference to the objectives that the legislation is aiming to achieve as support for implementation of OU in the Netherlands back in 2003.
\textsuperscript{199} ibid para 58.
\textsuperscript{200} ibid para 59.
\textsuperscript{201} Opinion of AG Jaaskinen (n 125) para 65.
\textsuperscript{202} Essent case (n 123) para 65.
\textsuperscript{203} ibid para 66.
\textsuperscript{204} ibid para 67.
ii. Non-discrimination principle and Ownership Unbundling

The next issue that has to be discussed is compliance of OU with the principle of non-discrimination. In this regard, some argue that, based on a reading of provisions of the directives, OU is not discriminatory in its character as, via uniform application to all concerned undertakings within the EU, it aims at achieving approximating legislation in the different MSs.\(^{205}\) In light of this, OU should be qualified as an ‘indistinctly applicable measure.’\(^{206}\)

However, Hunt pointed out that under the OU provisions, private operators established in one MS may find themselves in a less favourable situation than public operators established in another MS.\(^{207}\) This would be due to provisions in the Directives, which permit public entities to remain in public hands (by the same token avoiding a situation wherein OU imposes compulsory privatisation breaching Art 345 TFEU).\(^{208}\) State bodies are ‘deemed not to be the same person’ for OU purposes.\(^{209}\) This is allowed on the condition that a public entity or state ‘transfer the control rights to another publicly or privately owned legal person’.\(^{210}\) Hunt argues that discriminatory effects arise from the application of OU, as, in light of the above-mentioned distinction for public entities, private operators established in some MSs could find themselves in a less favourable position than public operators established in another MS.\(^{211}\)

It is undeniable that in light of this OU could lead to a ‘distinctly uneven playing field’ created for private sector companies and state owned undertakings.\(^{212}\) However, in the author’s opinion Hunt goes too far in qualifying the effects of OU as ‘discriminatory’ in the free movement of capital context. This is because discrimination in this context is prohibited on three grounds: nationality, the place of residence of the parties and the place where capital was invested.\(^{213}\) The situation described by Hunt does not appear to fit into the above-mentioned categories. It seems that a private undertaking from one MS will be in the same situation as a private undertaking from another. Therefore it can be argued that the alleged discrimination occurs only on the ‘structure of ownership’ level, rather than the

\(^{205}\) Monteiro (n 1) 8.

\(^{206}\) Hunt (n 112) 85.

\(^{207}\) ibid 86.

\(^{208}\) Ehlers (n 87) 418.


\(^{210}\) This is in contrast to the general position of EU law where different organizational layers and subdivisions of a state are viewed as one entity. See Ehlers (n 87) 418.

\(^{211}\) Hunt (n 112) 86.


\(^{213}\) Barnard (n 168) 569.
national level, for this falls outside the scope of the principle of discrimination in the capital movements context. What appears to be more suitable in this situation is to argue non-equal effects, as done by Ehlers et al and Becker.\textsuperscript{214} Private sector companies are not treated in the same manner as state owned companies, as the latter are allowed to unbundle by ‘merely allocating each activity to different state organisation[s].’\textsuperscript{215}

Notwithstanding which position one takes, the ECJ is likely to find that OU is not formally discriminatory as it applies uniformly to undertakings from each MS.\textsuperscript{216} The potential discriminatory/non-equal effects should not stop implementation of OU. It is therefore concluded that in principle national measures implemented in order to introduce OU are in compliance with the non-discrimination principle.

\textit{iii. The proportionality principle}

As aforementioned, the question remains whether OU constitutes a measure in accordance with the principle of proportionality. The answer to this question cannot be found in the \textit{Essent} case, as there the Court left the decision on the issue of proportionality to the referring court. It remains to be seen how the Supreme Court of the Netherlands will interpret the facts in this case.

One may look for clues in decisions of the courts in the Netherlands in \textit{Essent} before the referral to the ECJ. In the first instance it was decided that ‘group ban’ measures were a necessary, appropriate and proportional remedy.\textsuperscript{217} However, in the appeal case in the Hague it was decided that these measures constituted a disproportionate restriction upon the free movement of capital within the EU.\textsuperscript{218} Therefore, some uncertainty remains in this regard. However, it needs to be remembered that at the time when the claim was brought to the court, Dutch legislation imposing OU was voluntary.\textsuperscript{219} Therefore, measures introduced by the Dutch government could be seen as disproportionate as at the time the EU Directives were achieving a goal of introducing competition in the energy sector in a less restrictive manner (via legal unbundling).\textsuperscript{220} Now that the rules on OU are provided as the default position in the Third Energy Package, it should be more difficult to declare national pieces of legislation implementing the OU to be disproportionate.

Without a definite answer in the case law, we are drawn back to the academic discussion regarding the proportionality of OU. This has already been discussed in this work in the context of protection of property rights.\textsuperscript{221} It was pointed out that OU can be seen as appropriate and necessary, bearing in mind the simplifications

\begin{footnotes}
\footnotetext[214]{Ehlers (n 87) 418; Becker (n 82).}
\footnotetext[215]{Pielow and others (n 74) 107.}
\footnotetext[216]{Hunt (n 112) 86.}
\footnotetext[218]{\textit{Essent, Delta and Eneco v Dutch State} (22 June 2010) as referred to in Johnson and Block (n 55) 68.}
\footnotetext[219]{The 2003 Directive set out the minimum harmonization, however MSs were free to proceed with stricter unbundling. This is what happened in the Netherlands where ownership unbundling was introduced as a consequence.}
\footnotetext[220]{Johnson and Block (n 55) 68.}
\footnotetext[221]{See supra section 3.B.3.}
\end{footnotes}
and transparency that it introduces, in comparison to its predecessors. Furthermore, as aforementioned, the ECJ is likely to apply a ‘manifestly unreasonable’ test, therefore it is unlikely that the ECJ will actually be involved in a detailed discussion over the proportionality of a measure. However, even if it did become involved, the leeway given by the ECJ can be substantial, as OU is the key element of the Energy Policy in the EU.222

Therefore, even though some uncertainty remains as to what will be the final verdict on the proportionality of the measures in the Essent case, it is concluded that in principle the proportionality requirement will not be challenged when establishing possible interference with movement of capital within legal limits.

C. Conclusion

In the light of the above it is submitted that despite the fact that OU may impose restrictions on the free movement of capital, those should be held to be lawful. This is because the measure can be justified to be an overriding reason in the public interest, and so is in principle non-discriminatory and will satisfy the proportionality test. It ought therefore to be concluded that free movement of capital most likely will not be seen as imposing limitations on the OU regime.

5. Conclusion and Some Conceptual Recommendations

The process of liberalisation of the energy market has come a long way since the 1980s. In effect some positive changes have been seen as the energy market has begun opening up for competition. However, none of the undertaken measures in the First and the Second Energy Package had led to significant improvement, with shortcomings of the regime at the time being identified in the Final Report. The solution suggested by the Commission was the introduction of OU (as one of three options available) in the Third Energy Package in 2009. Over those years, what could be observed was a change of attitude, as the EU no longer relied on market forces to increase competition, rather taking the issue into its own hands and uncritically believing in its capacity to impose market competition by command and regulations.223

This work looked into the possible legal obstacles that can be identified to the current regime of OU. Such an analysis is of importance, as measures introduced via the Third Energy Package can be seen as interim measures, with a more radical approach requiring compulsory OU on the horizon if the Fourth Energy Package were to be introduced. Before that can happen, it needs to be established whether the existing property rights and free movement of capital provisions would not limit the EU’s ability to introduce such a far-reaching solution.

In the academic debate, conclusions on the limitations of OU could not be more antagonistic. On the one hand, it has been concluded that no insurmountable legal obstacles could be found if the EU legislature were to decide to adopt

222 Hunt (n 112) 89.
223 Bohne (n 110) 256.
ownership unbundling as the only model. On the other hand, a group of academics suggests that further OU would be unlawful. This present work agrees more with the first opinion, at the same time noticing some problems with the OU regime that should be addressed before introducing it as compulsory. This part will conclude on the findings of this paper and attempt conceptual recommendations in the areas that are causing problems.

With regard to property rights it was established that OU amounts to deprivation of property, which is forbidden unless the threefold test is met. First of all, interference with rights needs to be done in accordance with conditions provided by law. It was noted that the Treaty imposes limitations on EU competences with regard to property rights, as Art 345 TFEU prohibits any interference with a national property system. However, it was concluded that Art 345 TFEU in and of itself is unlikely to stop OU. Case law suggests that the reading of this provision should be limited to the ‘neutrality principle’ (ie not forcing privatisation or nationalisation). As OU does not infringe the ‘neutrality principle’, the EU has a competence to introduce legislation that regulates ownership of assets, hence it satisfies the first requirement.

Regarding the second requirement, the proportionality of the measure, it was pointed out that OU can be seen as appropriate and necessary, as it brings simplifications and transparency in comparison to its predecessors. However, arguments were noted that there is no satisfactory economical or empirical evidence that would prove that OU would bring benefits to consumers. In consequence it could be argued that such a measure as far reaching as OU should not be seen as a proportionate solution if its effectiveness can be questioned. However, the ECJ when asked to review the EU policy is using a ‘manifestly unreasonable’ test. It would be most unlikely for OU’s proportionality to be questioned, taking under consideration that it is a key element of the EU’s energy policy. Even though OU is likely to be seen as proportionate by the ECJ, before introduction of compulsory OU it would be seen as desirable for the Commission to order another report. This report should, in a comprehensive manner, compare results achieved in those countries that have decided to introduce OU under the Third Energy Package and those that have chosen alternatives, in order to provide economic and empirical evidence that potentially could end this discussion.

Some problems were also noted regarding the compensation requirement. At the moment it seems that ‘suitable compensation’ can be provided by the sale price (which according to the ECtHR case law would be ‘suitable’ even if assets were sold at less than their value). It was pointed out, however, that the responsibility to ensure that compensation is provided remains on the state, as it cannot be imposed on a private person. Therefore, it is claimed that there is a need to establish a system of compensation. However, what needs to be asked is: who would be liable to take care of this, the EU or national governments of MSs?

---

224 Talus (n 98) 88.
225 Ehlers (n 87) 427; Becker (n 82) 296.
226 Ehlers (n 87) 426.
227 Becker (n 82) 294.
228 Ehlers suggests that the EU was responsible as it initiated the process. See Ehlers (n 87) 414.
up be similar to state aid schemes, or perhaps exemptions? Could time extensions be granted to individual projects? Those questions will need to be considered before any further development of the regime.

It was noted that OU limits capital movements via, *inter alia*, prohibiting a company that owns transmission or generation assets investing in, or forcing it to disinvest from, other assets. It was noted, however, that such interference could be held legal if the measure were justifiable due to general public interest, non-discriminatory and proportionate. After a long academic debate, clarification as to the potential justification of the limitations came with the *Essent* case. The ECJ held that OU, in principle, despite having *prima facie* purely economic objectives, can be justified based on the general public interest if one looks at the interest underlying the choice of legislation. It was also concluded that OU is non-discriminatory in principle as it aims at uniform application of the regime to all MSs, in order to achieve a ‘level playing field’. The same conclusions were reached as regards the proportionality of OU as those reached when discussing property rights protection. Therefore, it needs to be concluded that free movement of capital provisions should in principle not constitute an obstacle to the implementation of OU in the EU.

In summary, it can be observed that free movement of capital limitations are causing fewer concerns than property rights protection. What adds an extra dimension to this problem is that protection of property rights is not only a long-standing tradition on an EU level but also constitutional in each MS. On the one hand, when creating an internal market some level of harmonization is unavoidable; on the other hand the Treaty’s other objectives include respect for the constitutional traditions of MSs. It will be interesting to see how the balancing exercise between those two objectives will be performed if OU becomes compulsory.

It was, however, pointed out that some aspects of OU may amount to a breach of the ‘equality’ principle according to which the same situations must be treated in the same manner. The uneven playing field is achieved due to the fact that Art 345 TFEU blocks the Commission from ordering privatisation of the state-owned electricity markets, which results in unequal treatment of public and private sector operators. This seems, however, to be irresolvable without an agreement between MSs to grant the Commission broader competency in the field of property law.

It was suggested that the process of liberalisation of the EU energy market changed the landscape of the energy sector to such an extent that if the Fourth Energy Package provided for compulsory OU, the change may be small enough to be digestible from a property protection and proportionality perspective. The author of this paper believes the contrary: that it will be the most difficult step to take. This is due to the fact that the issues that caused controversy when proposing the Third Energy Package resulted in the introduction of more exemptions and derogations to the EU energy acquis, and hence have not been properly addressed so far.

---

229 A later solution was suggested by Michael Diathesopoulos in Diathesopoulos in Diathesopoulos (n 182).
230 Ehlers (n 87) 444.
231 Inigo del Guayo and others (n 11) 359.
232 Talus (n 98) 88.
It can be argued that the biggest problem at the moment is that of political hurdles;\textsuperscript{233} however, those, to an extent, are simply expressions of concerns as to the ‘edgy’ relationship between OU and fundamental rights as well as freedoms, in addition to its questionable effectiveness. Therefore, the future of potential compulsory OU in the EU energy sector will depend on how well the Commission addresses those concerns.

\textsuperscript{233} ibid.