

The Gas Directive: Third party transportation rights - But to what pipeline volumes?

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The Gas Directive: Third party transportation rights - But to what pipeline volumes?

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Third party access is the key instrument by which competition shall increase in the European gas markets. But what pipeline volumes are available for third party transportation rights? The answer to this question represents the core of third party access by balancing the burdens put on the pipeline owner and the rights conferred on third parties. The subject is analysed on the basis of both the present Gas Directive and the proposals for and amended Directive currently discussed by the Council of the European Union.

I Introduction: The Gas Directive and third party access

1 Third party access and lack of capacity

Creating a “competitive market in natural gas” is the main objective pursued by the Gas Directive¹. The major instrument is third party access (TPA), giving natural gas suppliers and customers the right to have their gas transported through pipelines that they do not own or control. A prerequisite for increased competition through third party access is available pipeline capacity. But what capacities are the pipeline companies obliged to make accessible? This is an essential aspect of third party access and the subject of this article. The answer to this basic question represents the actual borderline between the right of third parties to make use of the existing facilities, and thereby increase competition, and the freedom of the pipeline companies to refuse access, thus restricting competition, at least on a short-term basis.²

The main feature of third party access is an obligation on the pipeline owner or operator to carry out a transportation service for third party shippers. This duty to contract³ and to perform corresponds with a right of access for both gas suppliers and gas purchasers. Being able to make use of the existing infrastructure, suppliers can sell gas directly to customers to which they themselves are not connected.

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¹ Directive 98/30/EC of the European Parliament and of the Council of 22 July 1998 concerning common rules for the internal market in natural gas, OJ 1998 L 204/1, based on the EC Treaty, particularly Arts. 57(2), 66, and 100 A (new Arts. 47, 55, and 95). The objective is, *inter alia*, expressed in Art. 3(1).

² For a discussion on short and long-term perspectives, see section 5.1.

³ It can be discussed whether the Directive establishes a duty to *contract* if the alternative of negotiated third party access is chosen (cf. Art. 15). It is rather a duty to *negotiate*. The freedom of negotiating is, however, limited, and a duty to contract can be imposed by the dispute settlement authority according to Art. 21 of the Directive.

This enlarges the market for each gas supplier and opens up for gas-to-gas competition, exposing, *inter alia*, the pipeline company's own supply division to competition. From the end users' perspective, TPA establishes a right to choose the supplier of gas.

Third party access implies a regulation of the market for gas *transportation*. The goal of the Gas Directive, however, is increased gas-to-gas competition, i.e. increased competition among *gas suppliers*. This regulative technique is mainly due to two fundamental economic and structural aspects of the European gas sector that have led to limited competition in the European gas sales markets.

The first important aspect is that pipeline transportation of gas constitutes what is commonly referred to as a *natural monopoly*. The costs of establishing the necessary infrastructure are high, and the operational costs are low compared to these fixed costs (capital costs). Consequently, economies of scale make the establishment of a competing gas pipeline financially difficult or impossible; it is less costly to satisfy demand with one rather than two or more firms operating in the market. Furthermore, duplication may be undesirable from society's perspective due to environmental concerns.⁴

Natural gas transportation is not a monopoly *per se*. There might occasionally be a realistic possibility of a competing pipeline being established, but this probably applies on the transmission level only, as opposed to the distribution level.⁵ The Directive abolishes exclusive rights to construct pipelines by requiring new infrastructure to be established on non-discriminatory conditions (Art. 4) and by enabling the establishment of pipelines directly from a natural gas undertaking to an eligible customer (Art. 20).⁶ Wälde and Gunst argue that the right to build new facilities will only be helpful "in exceptional cases".⁷

The second important aspect of the European gas sector is that *transportation* of natural gas traditionally has been regarded as *an integrated part of gas sales activities*. The large gas companies have transported gas to their customers through their own pipelines as part of their gas sales agreement. This has made it possible to monopolize, *de facto*, the *gas sales market* as well.

On this background, control over the transportation facilities has been crucial. Whoever needs gas has seldom had any choice other than buying from the owner of the pipeline to which he is connected. The end user has been bound to his local distribution company, which, in turn, has been forced to buy gas from the connected transmission company. Similarly, gas producers have had limited opportunity for selling gas other than to the transmission companies. By regulating the natural monopoly - the transport

⁴ Natural gas pipelines are described as natural monopolies by, *inter alia*, T W Wälde and A J Gunst: *International Energy Trade and Access to Energy Networks*, (2002) 36(2) J of World Trade, 191-218, at 195-197; R Ridyard, *Essential Facilities and the Obligation to Supply Competitors under UK and EC Competition Law*, [1996] ECL Rev, 438-452, at 448; and by M Albers, *Energy Liberalisation and EC Competition Law*, Fordham 28th Annual Conference of Antitrust Law and Policy, October 2001, in *International Antitrust Law & Policy*, 2002, 393-421, at 410. For an economic analysis, see O G Austvik, *Economics of Natural Gas Transportation*, Research Report no 53, 2000, available at <http://www.hil.no/biblioteket/fulltekst/omf53.html>. The concept of *natural monopolies* can be defined in somewhat different ways, see M A Bergman, *The Bronner Case – A Turning Point for the Essential Facilities Doctrine?*, [2000] ECL Rev, 59-63, at 62.

⁵ Council of European Energy Regulators, *Calculation methodologies and transparency requirements with regard to available capacities of gas transmission, LNG and storage facilities*, point 1.7, 5th meeting of the Madrid Forum, available at http://europa.eu.int/comm/energy/en/gas_single_market/madrid.html.

⁶ Both provisions do, however, contain modifications. Member States may decline to authorise further distribution pipelines in newly supplied areas if existing pipelines have sufficient capacity (Art. 4(4)), and authorisation to construct a direct line may be made subject to a refusal of system access (Art. 20(3)).

⁷ Wälde and Gunst, *supra* note 4, at 194.

market - through the system of TPA, the intention is to break up this static pattern and thereby increase competition in the neighbouring gas sales market.

Understanding the regulation of TPA requires a thorough legal analysis of the Directive.⁸ The extent to which third parties may be *denied* access is an important part of this analysis, and legal issues related to denial due to *lack of pipeline capacity*, cf. Arts. 17(1) and 23(2), are, for several reasons, of special practical significance.

First, access to transportation capacity is an absolute necessity in increasing gas-to-gas competition, and capacity scarcity is expected to increase, especially regarding interconnectors between the network systems of different Member States. This is due to an expected dramatic increase in natural gas consumption. The share of natural gas in the EU's primary energy supply was 24 % in 2000, a figure expected to increase to 40 % by 2020.⁹

Second, most Member States copy, more or less directly, the text of the Directive when implementing capacity regulation. National rules, which are the legal basis for the rights and obligations of the market players,¹⁰ must therefore be interpreted in conformity with the Directive provisions. By interpreting the *Gas Directive*, we thus find the rules that in most cases actually determine the relationship between the market players across the EU and the EEA. Contrary to several other aspects of the regulation in the Directive, this makes a detailed analysis of the capacity-related provisions important from a *practical* point of view, and not mainly as a *theoretical* exercise.

Considerable discretion has been awarded the Member States in implementing the TPA system in their national legislation. For instance, they may limit the introduction of competition by opening the market for third party gas intended at large-consuming end users only (the so-called eligible customers, cf. Art. 18). However, all but two Member States (France and Denmark) have chosen to exceed the minimum solution of the Directive,¹¹ and a detailed analysis of the minimum requirements for *eligibility* is thus of minor practical importance for most market players. Similarly, only two countries (Germany and Austria) opted for a model of negotiated access to both distribution and transmission, i.e. that most terms and conditions for access are fixed through negotiations between the involved companies. Other Member States have chosen regulated conditions, often fixed or approved by the authorities, or a combination of regulation and negotiation.¹²

⁸ For a legal analysis, see K B Moen and S Dyrland: *EUs gassmarkedsdirektiv* (in Norwegian), Bergen 2001. For a broader perspective on energy markets, competition, and regulation, but with less analysis of the *Directive*, see M M Roggenkamp et al (eds), *Energy Law in Europe: National, EU and International Law and Institutions*, Oxford 2001; P Cameron, *Competition in Energy Markets: Law and Regulation in the European Union*, Oxford 2002.

⁹ *European energy infrastructure*, COM(2001) 775 final, 10-12 and 36. More than 60 % of the gas consumed in the EU has been transported through one or more internal or external EU borders.

¹⁰ Cf. Art. 249(3) EC and Art. 7(b) EEA. Without national regulation, a *private* pipeline company cannot be obliged to offer access according to the Directive (so-called *horizontal* direct effect), see general comments in case C-91/92, *Paola Faccini Dori v Recreb Srl*, [1994] ECR I-3325, paras 19 *et seq.* Direct effect is, on the other hand, possible against pipeline companies owned or controlled by the *State* if the relevant provisions are *sufficiently precise and unconditional*, case C-188/89, *A. Foster and Others v British Gas plc*, [1990] ECR 3313, paras 16 *et seq.* However, it is questionable whether these conditions are fulfilled as long as the Member States may choose between regulated and negotiated access (cf. Art. 14 of the Directive). More positive, N Charbit, *Country Report: France* in D Geradin (ed), *The Liberalization of Electricity and Natural Gas in the European Union*, The Hague 2001, 123-153, at 126. Within the EEA, directives are not directly effective, see case E-4/01, *Karl K Karlson hf v Iceland*, 30 May 2002, paras 28 and 29.

¹¹ Commission working paper, *Completing the internal energy market*, SEC(2001) 438, 13-14.

¹² For an overview, see SEC(2001) 438, 12 and 16. Both the Austrian and German systems have elements of regulation, see Cameron, *supra* note 8, at 265, and Wälde and Gunst, *supra* note 4, at 198. The choice between

France, however, is yet to adopt the proposed national legislation, and Germany has only partially implemented the Directive. As a result, the Commission has initiated enforcement actions before the European Court of Justice (ECJ) against France and Germany according to Art. 226 of the EC Treaty.¹³ The Norwegian Parliament has recently accepted the Directive as a part of the EEA Agreement and has adopted a short framework law to implement the Directive. The legislation is expected to enter into force this autumn together with supplementing regulations.¹⁴

A third reason for focusing on capacity issues is the dynamic character of the community regulation. Today's legal regime is an intermediate stage on the way towards a more fully competitive gas market.¹⁵ In June 2002, the Commission launched an amended proposal for a Directive amending the Gas and Electricity Directives, taking into consideration comments from the European Council and from the European Parliament.¹⁶ Important amendments, reducing the national discretion by accelerating the liberalization process, are thus soon expected to make parts of the present Directive text outdated.¹⁷ Capacity issues are, however, only to a limited extent affected by these changes.

Three of the proposed amendments are worth mentioning here. First, the market opening shall include *all* customers as from 2005,¹⁸ whereas the present Directive only requires a market opening of 33 % by 2008. Second, all terms and conditions for access to distribution and transmission shall be published, and the tariffs or methodologies underlying their calculation shall be approved *ex ante* by the national authorities, whereas access to upstream networks and ancillary services (e.g. storage facilities) can still be negotiated.¹⁹ Third, all transmission companies and the larger distribution companies are required to operate gas transportation in a separate company, legally and functionally independent from the gas supply activity (Independent System Operator).²⁰ Today, only separation of *accounts* is required.

Although there are no indications that the Commission is preparing substantial changes to the Directive as concerns refusal of access due to lack of capacity, these proposed amendments, notably the duty to legally separate the transport operations in vertically integrated gas companies, will have an impact on capacity issues, see section 5.2.

Lack of capacity legitimates a denial of pipeline access. This presupposes that third parties can require access to spare volumes, whereas access can be denied to a fully utilized pipeline. But what does "spare"

negotiated and regulated access follows from Art. 14, cf. Arts. 15 and 16 (access to the system), and from Art. 23(2) (access to upstream networks).

¹³ Commission press releases IP/01/654, 8 May 2001, and IP/01/799, 6 June 2001. The case against France is now at the ECJ. The Advocate General concluded that France has failed to fulfill the obligation to implement the Directive, see Opinion in case C-259/01, 11 July 2002. Implementing legislation is, however, expected shortly in both France and Germany (information from Klaus Geil, the European Commission).

¹⁴ Lov 28.06.2002 nr. 61 om felles regler for det indre marked for naturgass mv. For comments, see St.prp. nr. 42 (2001-2002) and Ot.prp nr. 81 (2001-2002), available at <http://www.odin.dep.no/odin/norsk/publ/index-b-n-a.html>.

¹⁵ See recital (4) to the amended Gas Directive, COM(2002) 304 final: "The freedoms which the Treaty guarantees the European citizens (...) are only possible in a fully open market, which enables all customers freely to choose their suppliers and all suppliers freely to deliver to their customers."

¹⁶ COM(2002) 304 final of 7 June 2002. See the initial proposal in *Completing the internal energy market*, COM(2001) 125 final of 13 March 2001. Both the European Council and the European Parliament welcomed, in large, the Commission's proposals, see *Presidency Conclusions*, Barcelona European Council 15 and 16 March 2002, available at <http://europa.eu.int/council/off/conclu/index.htm>.

¹⁷ A common Council position according to Art. 251(2) EC is expected 25 November 2002.

¹⁸ Proposal for new Art. 18, COM(2002) 304 final. Seemingly contrary to this, the Barcelona European Council summit reached a compromise limiting the market opening to non-household customers only.

¹⁹ Proposal for new Arts. 14(1) and 22(2), COM(2002) 304 final. Compare COM(2001) 125 final, Art. 14(1) and 22(1), requiring approval of detailed tariffs.

²⁰ Proposal for new Arts. 7, 7a, 9, and 10, in particular Arts. 7a(2) and 10(4), COM(2002) 304 final.

volumes available to third parties mean, and when is the pipeline already “full”? Answering these questions requires an examination of three different situations, cf. Parts II, III, and IV of this article.

In the first situation, the pipeline to which access is requested, has spare, non-contracted volumes. Access to these volumes is the core of third party access. The crucial issue is to find what constitutes “contracted volumes”, i.e. the volumes out of the reach of third parties seeking access. The most important part of this analysis is the relationship between the pipeline owner’s supply branch and other suppliers: Can the pipeline owner give priority to its own supply interests when allocating transportation capacity, meaning that the volumes available to third parties would be limited correspondingly?

The definitive answer to the question of whether access can be required is not, however, found by establishing that non-contracted transport volumes exist at the time of the request for access. To some extent, the Directive accepts denial of access *despite* spare, non-contracted volumes, and the scope of this limitation of the right of access is examined in Part III.

Even if the pipeline *is* full, either because all the capacity is contracted or because the seemingly free capacity is legitimately “reserved” as discussed in Part III, TPA is not necessarily excluded. Two questions arise in this third situation analysed in Part IV. Can third parties invoke the Directive rules in requiring so-called interruptible transportation rights to these volumes if they, *de facto*, are unused? And finally, can third parties in certain cases require the pipeline company to enhance the pipeline capacity, making TPA possible despite the fact that the pipeline is “full”?

Before turning to these three situations, two general questions underlying the analyses must be answered (sections 2 and 3). First, what does it mean that a third party has a “right of access”? And second, what role does general competition law play when interpreting the Gas Directive?

These indicated issues are relevant to all types of gas transportation pipelines accessible to third parties. However, “special economic, technical and operational characteristics”²¹ relating to the so-called *upstream pipeline networks*, basically offshore pipelines, have resulted in a separate regulation of access to these pipelines, cf. Art. 23.²² Art. 23 leaves more discretion to the Member States and opens up for other, and generally speaking, more extensive grounds for refusal of access than is the case with Arts. 14-19 on access to transmission and distribution pipelines (the *system*). The two sets of access rules differ, *inter alia*, as regards capacity priority between different pipeline users. A parallel treatment is nevertheless feasible, the similarities being more striking than the differences.

The concepts of “upstream pipeline network”, “transmission”, and “distribution” are defined in Art. 2(2), (3), and (5), respectively. The crucial definition is that of upstream pipeline networks, comprising pipelines forming a part of a production project and pipelines used to “convey natural gas from one or more such projects to a processing plant or terminal or final coastal landing terminal” (Art. 2(2)).²³ This includes pipelines transporting unprocessed gas from the production field to the processing facilities (largely the British, Dutch, and Danish systems, and partly the Norwegian) and pipelines transporting already processed gas from the field to a “terminal” (the Norwegian system).

²¹ Preamble, recital (25).

²² Art. 23 is analysed in Moen and Dyrland, *supra* note 8, at 151-176. See also M M Roggenkamp, *The Gas Directive and the Implications for Offshore Pipelines in the North Sea*, (2001) *International Energy Law and Taxation* Rev 6, 120-131, at 122-123.

²³ “Transmission” means “transport of natural gas through a high pressure pipeline network other than an upstream pipeline network” (Art. 2(3)), whereas “distribution” is defined as transport through “local or regional pipeline networks” (Art. 2(5)).

Further, the wording “final coastal landing terminal” in Art. 2(2) indicates that pipelines carrying processed gas from a processing plant in one country to the transmission system of another country, are upstream pipeline networks (also the Norwegian system).²⁴ If the gas has previously entered a national transmission system, it remains a transmission pipeline even though it is an offshore pipeline. This is the case for the UK Interconnector between Bacton and Zeebrugge.

2 The nature of the right of access: a physical transportation right

Some comments should be made concerning the description of the right of access according to the Directive as a *transportation* right. This requires an examination of the *nature* of this fundamental right, a right not explicitly defined in the Directive.

Formally, TPA is described as a right of access to the *system* and to the *upstream pipeline networks*, cf. Arts. 15(1), 16, and 23(1). These concepts are defined as pipelines and other physical facilities.²⁵ It could, in principle, be up to the third party shippers to make use of the facilities by performing the necessary services themselves. However, this is not how the right of access must be understood. It seems to be a prerequisite for a functional third party access regime that transportation and ancillary services are performed in a co-ordinated way by the pipeline owner or operator, and not by each user individually. The right of access is therefore not simply a right to *use* the infrastructure, it implies a duty on – and a right for – the pipeline company to perform the services necessary to transport the gas from the entry to the exit point, of course against reasonable remuneration.

A further and important characteristic of the right of access according to the Directive is the relationship with the underlying gas sales agreement. The Directive seems to presuppose that the gas volumes are physically transported from the suppliers to the customers, and that TPA is the instrument by which the supply agreement is carried out. On this background, Member States may probably limit the right of access to certain end users, the eligible customers²⁶, and to those suppliers intending to enter into a supply agreement with one of these customers.²⁷ This indicates that the right of access should be

²⁴ See Moen and Dyrland, *supra* note 8, at 73-78; Roggenkamp, *supra* note 22, at 121-122. This corresponds with the British and Norwegian interpretation, see Department of Trade and Industry, *Implementation of those provisions of Directive 98/30/EC of the European Parliament and of the Council of 22 June 1998 concerning common rules for the internal market in natural gas which relate to access to upstream pipeline networks*, Consultation Document, March 2000, point 3b), and the Norwegian Government in St.prp. nr. 42 (2001-2002), at 3.

²⁵ A “system” is for instance “any transmission networks and/or distribution networks and/or LNG facilities owned and/or operated by a natural gas undertaking, including its facilities supplying ancillary services and those of related undertakings necessary for providing access to transmission and distribution” (Art. 2(12)).

²⁶ This is the key concept in understanding the limited market opening. The eligible customers are the end users with “the legal capacity to contract for, or to be sold, natural gas in accordance with Articles 15 and 16”, cf. Art. 18(1). Additionally, distribution companies can buy gas on behalf of their eligible customers, cf. Art. 18(8). For an analysis of the complicated regulation in Art. 18, see Moen and Dyrland, *supra* note 8, at 83-103. For a brief overview, see Cameron, *supra* note 8, at 178-179; L Hancher, *Delimitation of Energy Law Jurisdiction: the EU and its Member States: From Organisational to Regulatory Conflicts*, (1998) 16 JERL 42-67, at 55.

²⁷ As for the limitation of the access right to those gas sellers targeting an eligible customer, see Moen and Dyrland, *supra* note 8, at 98-103; H D Jarass, *Europäisches Energierecht*, Berlin 1996, 59.

described as a right to have gas *transported*, or simply as a *transportation* right²⁸, rather than a *capacity* right.

It is important to notice that this is the description of the minimum requirements of the Directive. The Member States may choose to further open up their gas markets, for instance by allowing suppliers to book “pure” capacity, i.e. capacity without some kind of an underlying gas sales agreement. Such free capacity booking may be more pro-competitive than the system of the Directive, facilitating the creation of secondary commodity markets and corresponding financial markets. However, this argument can hardly mean that the Member States *cannot* follow the system of the Directive with TPA as a transportation right.

What seems unquestionable following the minimum requirements of the Directive is that suppliers cannot *make use* of the right of access to deliver gas to an *ineligible* customer. This is a consequence of one of the the major features of the Directive; giving each Member State the freedom to choose a limited and gradual market opening, cf. Art. 18. With this starting point, it does not seem unreasonable to allow the Member States to limit the right to *conclude* an access agreement to those suppliers already *having* a gas sales agreement with an eligible customer or *intending* to enter such an agreement.

This limitation of the right of access is also in conformity with the wording of the provisions on access, even though they are somewhat ambiguous. Art. 15 states that “natural gas undertakings and eligible customers [shall] be able to negotiate access to the system *so as to conclude supply agreements with each other (...)*” (my italics). The purpose of the access agreement is not primarily to get control over parts of the pipeline capacity, but to facilitate the performance of the desired supply agreement with the eligible customer. This must apply for regulated access (Art. 16) and access to the upstream networks (Art. 23) as well.

The link between natural gas undertakings and the chosen end users also indicates that the gas companies have limited possibility to require access as gas *buyers*, even though the term “natural gas undertaking” covers buyers other than end users as well, cf. Art. 2(1). This is confirmed by Art. 18(8), giving distribution companies the right of access as buyers, but only for volumes consumed by their eligible customers, i.e. customers who could themselves have required access. Art. 18(8) only makes sense if natural gas companies, *beyond* this positively mentioned situation, do not have the right of access in their capacity as buyers. This is of practical importance, especially as regards access to upstream networks, implying that EU and EEA States may exclude the transmission companies from access.²⁹

It should be mentioned that the Gas Transit Directive³⁰ and the Energy Charter Treaty³¹ may be helpful for transmission companies seeking access to the transmission network of another State. Neither of the two gives the transmission company an explicit *right* of access comparable to the regulation of the Gas Directive, but both the Transit Directive and the Energy Charter Treaty require the States to *facilitate* the transit of natural gas based on non-discrimination.

²⁸ The term “transportation right” is thus describing the *third party’s* right to have gas transported, and not, as perhaps more common within general transport law, a right conferred upon the *transporter*. The transportation rights of third parties rather correspond with the *duty* on the pipeline company to transport the third party gas.

²⁹ Moen and Dyrlund, *supra* note 8, at 96-98. See, however, the next section on TPA according to competition law.

³⁰ Directive 91/296/EEC, OJ 1991 L 147/37. The Transit Directive is incorporated into the Gas Directive in the proposed amendments from the Commission, see Art. 14, COM(2002) 304 final, and COM(2001) 125 final, 34 and 40.

³¹ Energy Charter Treaty, Article 7 “Transit”, available at <http://www.encharter.org>.

Understanding TPA according to the Gas Directive as a transportation right for gas volumes supplying eligible customers has some implications as regards the question of available capacities analysed in this article. Despite the freedom for the Member States to prevent the booking of pure capacity, the concluded transportation volumes will not always be utilized. This is the case both if the underlying gas sales agreement is *not* concluded at the time for the performance of the transportation agreement, and if the committed transportation volumes are only *partly* used by the parties in the underlying supply contract. The question is then if the capacity not used must be made available to other third parties, see sections 4.2.2 and 9.

3 The Gas Directive and competition law

EC competition law³² and the gas-specific secondary legislation are independent sets of rules, but they are nevertheless legal measures supplementing each other and having much the same objective: the creation of a competitive internal market.³³ Even though the Gas Directive is part of the *internal market legislation*, the concept of third party access is primarily a *competition* instrument, derived from competition law considerations. Thus, in interpreting the Gas Directive, due respect must be paid to EC competition law; secondary legislation cannot limit the application of primary law.³⁴ The special characteristics of the gas markets are, on the other hand, taken into account in the Directive, and these characteristics are important when applying the general competition law provisions as well.³⁵

More concretely, competition law supplements the TPA regulation of the Directive in two ways. First, the EC competition rules may be an *independent legal basis* for third party access to gas infrastructure; the concept of TPA was not introduced by the secondary legislation. Most importantly, it may constitute an abuse of a dominant position contrary to Art. 82 EC to deny one competitor access to a facility if another has gained access (discrimination contrary to Art. 82(2)(c)) or if access to the facility is an absolute necessity in creating competition in the adjacent commodity market (known as the *essential*

³² Reference is made to the EC competition law only, but the corresponding EEA provisions must be interpreted similarly, see Art. 6 EEA and the homogeneity objective in recital 15 of the preamble. For an overview, see S Norberg et al, *The European Economic Area. EEA Law*, Stockholm 1993, 175-208.

³³ Application of competition law to the energy sector is discussed by, *inter alia*, B Devlin and C Levasseur, *Energy* in J Faull and A Nikpay (eds), *EC Law of Competition*, Oxford 1999, 689-751; E Cross et al, *EC Energy Law* in Roggenkamp et al, *supra* note 8, 213-320, at 229-245; and by Cameron, *supra* note 8, at 203-246 and 311-344.

³⁴ As for “primary” and “secondary” EEA law, see H Bull, *Det indre marked for tjenester og kapital*, Oslo 2002, 82-86.

³⁵ For comments on the interaction between competition law and sector-specific regulation in the energy sectors, see M Haag, *Der Netzzugang Dritter aus der Sicht des Europäischen Wettbewerbsrecht* in J Schwarze (ed), *Der Netzzugang für Dritte im Wirtschaftsrecht*, Baden-Baden 1999, 57-68, at 66-67; A Palasthy: *Third Party Access in the Electricity Sector: EC Competition Law and Sector-Specific Regulation*, (2002) 20 JERL 1-26, at 7-8; Cameron, *supra* note 8, at 311 *et seq*; Wälde and Gunst, *supra* note 4, at 201-202; and several papers on the subject by members of the European Commission, available at http://europa.eu.int/comm/competition/speeches/index_theme_13.html. Many commentators draw heavily on the Commission’s *Notice on the application of the competition rules to access agreements in the telecommunication sector*, OJ 1998 C 265/2, see, in particular, paras 57-59. E Rudolf, *Das Recht auf Netzzugang in der Telekommunikation*, Baden-Baden 2001, 67-71, offers a good analysis.

facilities doctrine).³⁶ The much debated essential facilities doctrine has never been applied explicitly to energy infrastructure. However, the general case law of the European Court of Justice on refusal to deal, including the Bronner case indirectly acknowledging the essential facilities doctrine, seems to open up for third party access according to Art. 82 to these network-dependent industries.³⁷

In the Bronner case, the ECJ refused to grant access according to Art. 82 EC for a daily newspaper to the home-delivery system run by a competitor. The Court reserved the possibility for TPA to situations where a denial of access, at least, would “be likely to eliminate all competition” in the relevant market, meaning that there would not exist any “actual or potential substitute”.³⁸ TPA thereby seems limited to the natural monopoly cases (or close to this), where a denial of access would not lead to a competing facility.

The second and practically most important interaction between the Gas Directive and competition law is that the Directive must be *interpreted* and *complemented* by competition law principles. The Directive can be seen as clarifying the extent of the rights according to the EC Treaty, but also as extending these rights in some respects. The legal basis for third party access will in most cases be the Directive rules, as implemented in the national legislations. However, numerous situations are not, or only to a limited extent, regulated in the Directive, making a supplementing application of competition law significant in securing a competitive market with real, non-discriminatory TPA. Examples are the validity of long-term supply agreements and capacity reservation agreements, acceptable access tariffs, and methods for allocating scarce capacity.

Another aspect should be mentioned as well. The application of EC competition law puts the Commission behind the steering wheel, influencing the pace and direction of liberalization, ensuring market opening also in Member States that hesitate to implement or enforce the Directive.

The Marathon case offers an example of the role of competition law in respect of third party access. The case concerns an alleged joint refusal to grant access to continental European gas pipelines by a group of European gas companies. The German transmission company Thyssengas committed itself to offer more efficient network access, and the Commission closed the case against this company, while continuing to investigate the remaining companies.³⁹ See further comments in sections 4.2.2 and 9.

It has been indicated that the Marathon case “was not a competition case at all but a case involving the enforcement of terms of an existing law”⁴⁰ (i.e. the Gas Directive). This is misleading, *inter alia*, because the Directive, with some exceptions only, is enforced by the *national* authorities alone and not by the Commission.

II Access to non-contracted volumes - the core of third party access

³⁶ Among comprehensive analyses of the essential facilities doctrine, see J Temple Lang, *Defining Legitimate Competition: Companies' Duties to Supply Competitors and Access to Essential Facilities*, (1994) 18 Fordham International L J, 437-524; B Doherty, *Just What are Essential Facilities?*, (2001) 38 CML Rev, 397-436; and P Larouche, *Competition Law and Regulation in European Telecommunications*, Oxford-Portland 2000, 165-217.

³⁷ Moen and Dyrlund, *supra* note 8, at 54-58; Palasthy, *supra* note 35, at 19-20. Similarly, but without using the essential facilities doctrine, Cameron, *supra* note 8, at 32-35.

³⁸ Case C-7/97, *Oscar Bronner GmbH & Co. KG v Mediaprint Zeitungs- und Zeitschriftenverlag GmbH & Co. KG and Others*, [1998] ECR I-7791, para 41.

³⁹ Commission press release IP/01/1641, 23 November 2001.

⁴⁰ *Market Access (Gas Pipelines) The Marathon Case*, (2001) 24 Competition Law in the European Communities, 281.

4 Contracted and non-contracted volumes

4.1 Introduction

Denial of third party access due to lack of pipeline capacity is explicitly accepted in Art. 17(1) as regards access to the system, and more indirectly in Art. 23(2), stating that Member States shall take “into account (...) capacity which is or can reasonably be made available” when implementing rules on access to upstream pipeline networks. The balance between the right of access for third parties and the opportunity for the pipeline company to deny access largely depends on two fundamental premises that may be derived from this starting point. First, the pipeline company must be obliged to make all spare capacity available to third parties; access can only be refused if there is “lack” of capacity. Second, Member States are not required to implement a TPA system that interferes with already contracted transport volumes; a fully contracted pipeline is regarded as “lacking” capacity.

The core of third party access is the duty of the pipeline companies to transport third party gas as long as there are unused pipeline volumes. This will increase the gas volumes in the market and at the same time expose the previous gas supply monopolies to competition. Access to these spare volumes will be so-called *firm* transportation rights, i.e. rights that are guaranteed in the sense that they must be carried out irrespective of the transportation contracts of other parties.⁴¹ Access must be given on equal terms and conditions for all shippers, including the related undertakings of the pipeline company, cf. Arts. 7(2), 10(2), and 14.

The choice not to let TPA interfere with existing contracts has been a premise for the numerous discussions about TPA within the EU system throughout the 1990s. This means that third parties are unable to require access to a fully contracted pipeline and therefore unable to compete with the existing pipeline users. The existing shippers, traditionally the pipeline owners themselves, are not required to reduce their contracted gas volumes. The same, however, goes for all third party shippers already having concluded a transportation agreement with the pipeline company.

The impact of TPA on existing contracts was discussed by the two consultative committees on third party access to natural gas networks created by the Commission in 1991, one made up by representatives of the Member States (known as the CCEMG Committee) and the other of representatives of gas companies and consumers (the PCCG Committee). Both committees unanimously rejected to implement the common law concept of “common carriage” into the Directive, *inter alia*, because it would “undermine (...) existing contracts”.⁴² The principal idea of this doctrine is that certain providers of services have a duty to provide transportation to all who wish to make use of it. Applied to the transportation of natural gas, the common carriage doctrine would have implied that all who so wished would have the right to have their gas transported through the pipeline owner’s system. If the pipeline capacity had been reached, it is assumed that current and new users of the pipeline would have been required to

⁴¹ Alternatively, transportation rights may be *interruptible*, meaning that they have priority after firm rights of other parties, see section 9.

⁴² See Commission of the European Communities, *Report of the Consultative Committees on Third Party Access to Natural Gas Networks*, May 1991, at 4 and 12 in the CCEMG rapport and 17 in the PCCG rapport (quotation). Initially, however, third party access was referred to as “the common carrier system”, see *The internal energy market*, COM(1988) 238 final, at 66.

reduce their gas volumes pro rata, making no difference between new customers and existing customers with concluded supply and transportation contracts.⁴³

The more precise scope of the right for third parties to conclude firm transportation agreements depends on the answer to the following three main questions: What volumes are already “contracted” and therefore out of the reach of third parties seeking access (section 4)? Can the pipeline owner and operator give priority to their own transport needs when allocating scarce capacity (sections 5 and 6)? And to what extent can access be denied *despite* non-contracted volumes being available (Part III, sections 7 and 8)? The second question, that is both important and controversial, can be seen as part of the first one. If the supply arm of the vertically integrated pipeline company can require a preferential position to scarce capacity, it will always be able to conclude a transportation contract as long as there is some spare capacity. The non-contracted volumes available for firm transportation rights for *third parties* will be limited correspondingly.

Before turning to the question of what constitutes “contracted” volumes beyond the reach of third parties, one general remark should be made. The pipeline company is normally in a *dominant* position, having, as formulated by the European Court of Justice, “a special responsibility not to allow its conduct to impair genuine undistorted competition in the common market.”⁴⁴ This responsibility becomes even greater when the company enjoys a *monopoly* position.⁴⁵ As a consequence, the pipeline owner and operator must arrange the activities so as to contribute to maximising the available volumes for third parties in order to create a real competitive market. It is, for instance, fair to require necessary maintenance to be performed in periods with limited demand for gas.

Capacity for third parties is limited by contracted and de facto gas flow in one direction (from A to B). If the operator is taking part in swaps “counterdirected” to the gas flow (from B to A), the volumes actually transported are reduced. As an example of the duty to allow “undistorted competition”, it can be argued that the pipeline company must make capacity available to third parties corresponding to its swap volumes.⁴⁶

4.2 “Contracted volumes” restricting firm transportation rights

4.2.1 Contracted transportation and supply volumes

The objective of this section is to identify what precisely constitutes *contracted* gas volumes. These are the volumes already ensured transportation capacity, legitimating a denial of access according to Arts. 17 and 23 if there is insufficient non-contracted capacity.

Pipeline capacity is reserved by *transportation* contracts, and the volumes in the *transportation* agreements between the shippers and the pipeline company must therefore, as the starting point, be the

⁴³ See also Wälde and Gunst, *supra* note 4, at 197; Roggenkamp, *supra* note 22, at 123; and J P Stern, *Third Party Access in European Gas Industries: Regulation-driven or Market-led?*, London 1992, 24.

⁴⁴ Case 322/81, *NV Nederlandsche Banden-Industrie Michelin v Commission*, [1983] ECR 3461, para 57.

⁴⁵ R Whish, *Competition Law*, 4th ed, Bath 2001, at 162 with further references.

⁴⁶ An explicit regulation of this situation is proposed as regards transmission of *electricity*, see Art. 6(5) of the amended proposal for a Regulation of the European Parliament and of the Council on conditions for access to the network for cross-border exchanges in electricity, COM(2002) 304 final.

“contracted volumes” in the present context. Further, the *maximum* volumes in these contracts must be the decisive factor. By respecting already concluded contracts, the Directive recognizes the right of all shippers, be it the pipeline owner himself or third party shippers, to increase their transport volumes to the maximum contractual levels. Consequently, third parties cannot require firm transportation rights within the contractual maximum, even if the volumes *de facto* are unused.

Pipeline transportation of gas connects the supplier and the purchaser in a gas supply agreement. Not surprisingly, there is often a direct link between a specific transportation agreement and an underlying gas sales agreement, for instance by having similar provisions on maximum and minimum quantities. This link is particularly evident for the pipeline owner himself, traditionally performing both supply and transportation activities, especially if the network is 100 % owned by one company. Transportation capacity for the contracted gas volumes has been taken for granted without having a separate transportation agreement. An important question is thus whether the owner, even under the TPA regime, can require capacity on the basis of the supply volumes concluded prior to the Directive.

None of the provisions of the Directive addresses this question explicitly, but it should be seen as a part of the question of refusal of access due to lack of capacity.⁴⁷ Automatic capacity for the pipeline owner under these circumstances will potentially reduce the volumes for third parties and slow down the liberalization process. Decisive, however, is in my opinion an acknowledgement of the fact that these supply agreements are validly concluded under another legal regime in which pipeline capacity was unquestioned. Without further regulation, it therefore is difficult as well as unreasonable to interpret the Directive so as to imply a risk for the owner not to be able to fulfill his commitments.⁴⁸

Giving the pipeline owner capacity for his concluded supply volumes, even without a transportation agreement, should not cause too many practical problems for third parties. In order to facilitate a realistic TPA system, the pipeline owner should be required to follow the same procedure as other users of the pipeline system when requesting for capacity. The important modification from the general principles of capacity allocation is the right for the owner to have priority to scarce capacity.

Regarding the owner’s gas sales agreements concluded *after* the adoption of the Directive, automatic priority to scarce capacity cannot be implemented. The duty to treat all shippers equally, including the pipeline owner himself, must mean that the owner now has to conclude a separate transportation agreement, see section 5 on capacity reservation and non-discrimination.

Third party access implies that some of the customers of the pipeline company switch their gas supplier, while still using the pipeline company as a transporter. Of practical importance is therefore the question whether this change of supplier automatically releases capacity for the new shipper. The decisive factor must again be the pipeline company’s already contracted *transport* volumes since these

⁴⁷ The take-or-pay derogation in Art. 17, cf. Art. 25, concerns supply agreements directly. However, this derogation is only due to expected economic and financial difficulties for companies having concluded supply agreements with a contractual *take-or-pay clause*, and focus is on the difficulties on the *resale* market, see, *inter alia*, Art. 25(3). Art. 25 cannot, therefore, be decisive for the much more general question of capacity for concluded supply volumes, irrespective of the contractual terms of the supply agreements.

⁴⁸ The same view seems implied by F von Burchard, *Netzzugang im Bereich der Gasversorgung* in Schwarze, *supra* note 35, 191-208, at 198. Probably contrary to this, the Brattle Group, *Methodologies for Establishing National and Cross-Border Systems of Pricing of Access to the Gas System in Europe*, London 1999, at 40.

volumes bind up the pipelines capacity. The pipeline company is entitled to maintain its contracted volume and may use this capacity to supply new customers.⁴⁹ The actual utilization of the pipeline will, however, often decline, which may result in free capacity for interruptible transportation rights, see section 9. The change of supplier will, additionally, imply a reduction of the transported gas volume for the pipeline company if the transportation capacity is directly linked to the switching customer. In this situation, there will nearly always be sufficient capacity for firm transportation rights for the new shipper.

Claiming that “it should (...) be considered automatic that the pipeline provides the required capacity” when the customer chooses to switch supplier, “with exceptions allowed only under extraordinary circumstances”, as done by the Brattle Group,⁵⁰ is, however, not quite to the point. Neither does it take sufficiently into account the already concluded transport volumes, nor the fact that the capacity must be allocated between *all* parties on non-discriminatory conditions, making it possible that the new supplier will fail to achieve the desired capacity.

4.2.2 *Trading of transportation rights and/or “use-it-or-lose-it”?*

As explained in section 2 above, the Member States can limit the market opening to those suppliers targeting an eligible customer. But what if no supply agreement is concluded before the gas transportation is to be performed: Is the capacity still beyond the reach of (other) third parties, or is it now once again to be considered as spare capacity?

Two different, though related, situations make this question topical. First, a supplier and buyer may fail to reach an agreement that they had *intended* to make when contracting for transportation capacity according to the Directive rules. This situation will probably, as a standard procedure, be regulated in the transportation agreement, but the perspective is here whether the *Directive* obligates the *Member States* to implement binding regulation on the matter. The second situation arises when a player in the gas market purchases a pure capacity right, i.e. capacity without even *intending* to supply a specific customer. No provision in the Directive *prohibits* such capacity rights according to national legislation, see section 2 above.

Explicit regulation in respect of the indicated situations is absent in the Directive. This silence must imply that the Member States have considerable discretion in forming their national rules, in line with the principle of subsidiarity, cf. Art. 5 EC, underlined in Art. 3(1) of the Directive, and with the general characteristics of a directive, leaving the “choice of form and methods” to the national authorities, cf. Art. 249(3) EC and Art. 7(b) EEA.

The national discretion is, however, not total. The very system of the Directive, with TPA as a transportation right, may indicate that the shipper should not contractually be allowed to block third party gas transportation. The same may be said to follow from the general obligation of the States to implement rules likely to achieve the fundamental goal in the Directive; the creation of a competitive internal market in natural gas. A competitive market presupposes efficient utilization of the pipeline capacity without unnecessary capacity blockage. However, as long as the Directive provides very limited

⁴⁹ Cf. Burchard, *ibid*, at 198, who claims that the capacity is still fully at the disposal of the pipeline company, without making the following modifications which in my opinion are necessary.

⁵⁰ The Brattle Group, *supra* note 48, at 40.

guidance, and as long as several different measures seem more or less suitable in securing the real availability of sufficient capacities for third parties, it is difficult to interpret the Directive so as to require the Member States to implement one or more *specific measures*.

One opportunity for the Member States is to create a secondary market by requiring the transportation capacity to be *tradable*. The new shipper cannot have a more extensive right than his legal predecessor, and the Member States may therefore require that only shippers targeting an eligible customer (or a distribution company acting on behalf of its eligible customers) can purchase the transportation capacity.

A liquid secondary market for transportation rights or pure capacity rights will normally be *pro-competitive*.⁵¹ However, the present European gas markets are characterized by long-term contracts, vertical integration, and danger of insufficient pipeline capacity. Under these circumstances, there is a danger that reserved capacity volumes will be withheld and thus used, or abused, as a *barrier* to increased competition, but competition law rather than the Gas Directive must be the primary addressee for these concerns, see below.

Tradability of transportation and capacity rights implies much freedom to the initial shipper. Alternatively, the Member States may implement a system of “use-it-or-lose-it”, meaning here that the contracted transportation capacity automatically reverts to the pipeline company if the shipper cannot deliver gas for transportation. The pipeline company is, in turn, obliged to offer the capacity to other third parties.⁵² As with the former alternative, this may secure an efficient utilization of the capacity, but it puts the pipeline company, not the initial shipper, behind the steering wheel. It can be argued that this is more in line with the system in the Gas Directive, giving the operator the responsibility for a coordinated operation of the network.

A combination of the two mentioned alternatives is to make the transportation rights tradable until the time for contractual performance, but requiring the pipeline company to offer the capacity to other third parties if neither the initial nor the new shipper can or want to make use of the relevant network. This is perhaps the most pro-competitive alternative, which, at the same time, respects that third party access according to the Directive can be implemented as a *transportation* right.

The different alternatives can apply both to the system and to the upstream network. The features of upstream activities, however, imply a more comprehensive co-ordinating role for the pipeline operator. This is directly reflected in the considerations that can be taken into account when implementing upstream access, cf. Art. 23(2). For instance, the gas qualities differ a lot upstream (cf. Art. 23(2)(a)), making an unconditional right to trade capacity difficult and undesirable.⁵³

Without further regulation of a situation that can successfully be dealt with in different ways, it must be up to each Member State to choose how to regulate. Neither of the indicated systems, tradable transportation rights and “use-it-or-lose-it”, seems, as a general rule, to have been implemented by the

⁵¹ *ibid*, at 38.

⁵² The term “use-it-or-lose-it” often describes the slightly different situation where the supply contract *is* concluded, but not used to its maximum, see section 9 on interruptible transportation rights.

⁵³ Of more practical importance is a right for the shipper to have gas transported even though the gas is sold under another gas sales agreement than originally intended (substitution of gas under gas transportation agreements).

EU Member States,⁵⁴ and the States may probably choose *not* to regulate the issues further if other mechanisms are sufficient to secure the available transportation capacities for third parties. Two measures supplementing the Directive on this point should be mentioned.

First, enforcement of the general competition rules will reduce the possible anti-competitive effects of limited sector-based regulation. Agreements between undertakings resulting in capacity blocking may infringe the prohibition against anti-competitive agreements in Art. 81 EC. Additionally, capacity blocking by the supply arm of the pipeline company may constitute an abuse contrary to Art. 82 EC.⁵⁵ The Commission has, as regards the electricity market, stressed the significance of enforcing the competition rules to avoid unnecessary contractual capacity blocking.⁵⁶

The Marathon case, presented in section 3, exemplifies how the Commission, through competition law, can contribute to pro-competitive procedures in offering capacity to third parties. Among other measures, Thyssengas committed itself to offer tradable capacity rights and to introduce a “use-it-or-lose-it” principle for capacity reservations of Thyssengas’ own gas trading branch.⁵⁷

A second measure supplementing the Directive on this point is a softer approach based on voluntary business standards. The questions discussed in this section are to some extent regulated in the “Recommendations on Guidelines for Good Practice in relation to TPA Services, Tarification, Balancing etc.”, adopted by that European Gas Regulatory Forum (the Madrid Forum) in February 2002.⁵⁸ Even though these recommendations are not legally binding, they must be expected to have significant impact on the market, especially as they are agreed in a forum consisting of representatives from the industry, including the Association of European Gas Transmission bodies (GTE), as well as from national regulatory authorities, EU and EEA Member States, the European Commission, and of representatives of suppliers, traders, and consumers.⁵⁹

According to point 6 in the Recommendations on Guidelines, the transmission system operators should “[a]llow TPA capacity rights to be freely tradable in a secondary market” and “[e]ndeavour to discourage capacity hoarding and facilitate reutilisation of un-used capacity”. An efficient reutilization of unused capacity can be achieved by requiring a “use-it-or-lose-it” system as outlined above, and/or by offering interruptible services to capacity that de facto is unused, see section 9.

4.2.3 Long-term transportation contracts

⁵⁴ The Brattle Group, *Third-Party Access to Natural Gas Networks*, London 2001, 45-46.

⁵⁵ The pipeline company can be abusing its dominance on the gas transport market to gain profit on the neighbouring gas sales market by excluding competitors, see more generally, Whish, *supra* note 45, at 173-175.

⁵⁶ *Second report to the Council and the European Parliament on harmonisation requirements, Directive 96/92/EC concerning common rules for the internal market in electricity*, SEC 1999/470, at 9-10. The same can be expected within the gas market, see Cameron, *supra* note 8, at 304-305.

⁵⁷ Commission press release IP/01/1641, 23 November 2001. See also section 9.

⁵⁸ Fifth meeting of the Forum, Madrid 7-8 February 2002, available at http://europa.eu.int/comm/energy/en/gas_single_market/madrid.html.

⁵⁹ Cameron, *supra* note 8, at 301-311, discusses the Forum in general, including its purpose, composition, and the results achieved until early 2002.

Gas transportation contracts are traditionally long-term, often directly or indirectly linked with long-term supply contracts. Large pipeline volumes are therefore, and will still for several years be, bound by already committed volumes. This slows down the actual speed of liberalization. The legality of such contracts, whether concluded prior to or after the adoption of the Gas Directive, is not addressed in the Directive. Long-term transportation contracts must be evaluated against the competition rules on a case-by-case basis, and the Commission will, as indicated in the previous section, monitor these contracts closely.

Long-term reservation contracts are far from illegal *per se*, but have the *potential* of infringing both Arts. 81 and 82 EC. Under Art. 81, the crucial questions will usually be whether the agreements have an appreciable anti-competitive effect (Art. 81(1)) and whether the exemption in Art. 81(3) is applicable,⁶⁰ whereas Art. 82 is concerned with the pipeline owner(s)' unilateral or collective *dominance*, and whether the reservation agreements imply a *misuse* of this position. In applying these criteria, an individual evaluation must be made, but several characteristics are of general importance, both as concerns Art. 81 and Art. 82. The *duration* of the agreement is only one of several factors; the *market shares* of the involved parties and the agreement's implication for the degree of *exclusivity* on the relevant market are also important, and so are factors such as the *maturity* of the market and the need for *investment incentives*.⁶¹

If necessary for the construction of new infrastructure, which normally increases competition, long-term reservation contracts are usually compatible with EC competition rules. On the basis of Art. 85(3) (now Art. 81(3)), the Commission accepted transportation agreements with a 20 year duration in the Gas Interconnector case concerning the high pressure submarine pipeline linking Bacton (UK) and Zeebrugge (Belgium).⁶²

In order to facilitate competition in markets where most pipeline capacity is reserved by long-term agreements, the Commission has encouraged the Member States to introduce so-called gas release programmes in the downstream markets. These are programmes under which the incumbents are forced to, or agree to, open up a percentage of existing long-term supply and capacity contracts to third parties, but without affecting upstream contracts that underpin investments and security of supply.⁶³

⁶⁰ The block exemption on vertical agreements and concerted practices (Regulation (EC) no 2790/1999, OJ 1999 L 336/21) applies to all vertical agreements, including gas transportation contracts, see Art. 2. However, the pipeline company will normally have a market share exceeding 30 %, precluding a block exemption according to Art. 3(1). An individual exemption according to Art. 81(3) EC is still possible; there is no general presumption for illegality for contracts not meeting the requirements for a block exemption, see the Commission *Guidelines on Vertical Restraints*, OJ 2000 C 291/1, para 62.

⁶¹ For further arguments and cases from the Commission concerning long-term contracts, see Devlin and Levasseur, *supra* note 33, at 709-718. An overview is given by Cameron, *supra* note 8, at 240-243 and 341-343; Palasthy, *supra* note 35, at 20; Albers, *supra* note 4, at 415-416; and A Tradacete, *The role of EC competition policy in the liberalisation of EU energy markets*, Brussels April 2000, at 12, available at http://europa.eu.int/comm/competition/speeches/index_theme_13.html.

⁶² European Commission, *XXVth Report on Competition Policy 1995*, Brussels - Luxembourg 1996, 125.

⁶³ COM(2001) 125 final, 31, and the *Discussion document on long-term contracts, gas release programmes and the availability of multiple gas suppliers*, available at http://europa.eu.int/comm/energy/en/gas_single_market/madrid.html, also giving examples of introduced release programmes.

5 The pipeline owner's supply interests – equality or priority?

5.1 Introduction

Third party access inevitably implies burdens on the pipeline owner, and this is justified by expected socio-economic advantages following increased competition. But what kinds of burdens are really put on the pipeline owner in the name of competition? Are the obligations in the Directive fulfilled if the owner offers access to the volumes that he himself does not need, i.e. volumes that would, without TPA, be unused? Alternatively, does the Directive require the pipeline owner to treat his own supply branch and other suppliers completely equally, implying that the owner must compete for scarce capacity with the risk of having to reduce his own supply activities if the capacity is insufficient to meet a growing capacity demand?

From the owner's perspective, the former option would certainly be preferable. He would argue that the alternative would imply a disproportionate restraint upon his property rights, and that it would reduce the *ex ante* profitability of necessary investments if he was not guaranteed pipeline capacity for his own supply needs. It must be remembered that huge investments in pipelines and ancillary facilities are necessary in the expanding gas market. Without sufficient incentives to take the commercial and financial risk of building new infrastructure, investments will be hampered, leading to capacity constraints, which, in turn, mean higher prices and reduced security of supply.

This negative scenario is more realistic upstream than downstream. Both costs and risks connected to construction of new infrastructure are higher offshore than onshore.⁶⁴

Ensuring the necessary economic incentives for investments in transportation infrastructure, both externally and internally within the EU, is seen by the Commission as a primary security of supply issue, but there has been limited research in the EU with respect to the question of how to meet this challenge.⁶⁵

From a third party perspective, letting the pipeline owner prioritise his own supply activities would reduce available volumes and diminish the advantages of introducing competition. The pipeline owners are traditionally vertically integrated with a monopoly or near monopoly position, *de facto* or *de jure*, in a regional or national market. How can the choice of supplier turn into a reality in parts of the market with limited surplus capacity if the pipeline owner can give priority to his own new capacity needs in addition to already concluded volumes (section 4)?

These conflicts of interest illustrate a general dilemma in competition law, finding the balance between maximum short-term competition on the one hand, implying as extensive TPA as possible, and increased competition and security of supply in the long run on the other hand, implying a limitation of TPA to give sufficient incentives for desirable investments.⁶⁶

⁶⁴ R Hannesson, *Petroleum Economics. Issues and Strategies of Oil and Natural Gas Production*, Westport, Connecticut - London 1998, 38, and, indirectly, Commission document on long-term contracts, *ibid*.

⁶⁵ COM(2001) 775 final, at 12, 15, and 21.

⁶⁶ In economic theory, this is a question of the extent to which a *dynamic* welfare analysis, taking into account market innovation, shall supplement a *static* (short or long-term) perspective on economic efficiency. For a useful introduction, see L Peeperkorn and K Mehta, *The Economics of Competition* in J Faull and A Nikpay, *supra* note

The Bronner case, presented above in section 3, must be read on the background of such conflicting interests. The rather reluctant attitude towards establishing a duty to contract is probably explained, at least in part, by the hampering of investment incentives following a more extensive TPA. In his Opinion in the case, Advocate General Jacobs argued that it “in the long run (...) is generally pro-competitive and in the interest of the consumers to allow a company to retain for its own use facilities which it has developed for the purpose of its business.” A more extensive right of access would leave “no incentive for a competitor to develop competing facilities. Moreover, the incentive for a dominant undertaking to invest in efficient facilities would be reduced if competitors were, upon request, able to share the benefits.”⁶⁷ The last mentioned point (the *owner's* incentives) is relevant also in markets where duplication rarely is realistic, as is often the case in the gas markets.

5.2 The owner's needs for transportation capacity in the system

5.2.1 Non-discriminatory allocation of capacity

The conflicting interests between the pipeline owner and third parties presented in the previous section, are not explicitly regulated in the Directive as regards access to the system. The fact that access may be denied due to “lack of capacity” (Art. 17) does not give any guidance in determining whether the pipeline owner can give priority to its own transport needs. The result will largely depend on the interpretation of the provisions of Arts. 7(2) and 10(2), directed at transmission and distribution undertakings respectively, obligating these companies “[i]n any event [not to] discriminate between system users or classes of system users, particularly in favour of [their] related undertakings”.

Reaching a conclusion that the pipeline owner must allocate capacities equally between *all shippers*, including his own supply arm, presupposes an affirmative answer to two separate questions. First, the duty not to discriminate must apply to the question of *what volumes* are accessible, not only to the question of the *conditions* for access. Second, this duty of equal treatment as regards capacity allocation must not apply between two third party shippers alone, but also between the pipeline owner *himself* and a third party shipper.

An affirmative answer to the first question does not necessarily presume an affirmative answer to the second, and vice versa. It is possible to conclude that transport capacities must be allocated in a non-discriminatory way, but that this duty is fulfilled when all *third parties* are treated equally, whereas the pipeline owner himself can be given priority. This may, for instance, be combined with a duty on the pipeline owner to treat third parties equally with his own supply branch, but only as regards the *conditions* for access.

Non-discrimination is stipulated as a *general* duty in Arts. 7(2) and 10(2), applicable in “any event”, i.e. to *all* of the activities of the pipeline company covered by the Gas Directive, including the duty to transport gas for others. There are no indications in the wording that the provisions do not imply both a duty to give access on non-discriminatory *terms and conditions* and a duty to treat all players equally as regards the *volumes* accessible. This is supported by the objective of the TPA regulation. In creating a functional and competitive internal gas market with fair and non-discriminatory access, it seems

33, at 3-60. An extensive analysis is presented by O Kolstad, *Fra konkurransepolitikk til konkurranserett* (in Norwegian), Oslo 1998.

⁶⁷ Opinion in case C-7/97, [1998] ECR I-7791, para 57. Discussing investment incentives, Bergman, *supra* note 4, at 63, argues that a “well-chosen criterion” for the essential facilities doctrine should “result in both short-run and long-run efficiency improvements”.

necessary that at least all *third* parties are treated equally as regards the fundamental question of *what volumes* can be accessed.

Third party access is a competition law concept, and the duty not to discriminate between pipeline users according to Arts. 7 and 10 can be seen as the Directive parallel to Arts. 81(1)(d) and 82(2)(c) EC, prohibiting the applications of “dissimilar conditions to equivalent transactions with other trading partners”.⁶⁸ These provisions are apparently limited to discriminating *conditions*, not to the question of *when* access can be required. This can, however, for two reasons not be a convincing counter-argument against interpreting the *Directive* provisions as *general* prohibitions against discrimination, even though the Directive in many respects only clarifies existing Treaty principles. First, it must be respected that the Directive wording *does* differ from Art. 82, and this has to be intentional. *Conditions* are not explicitly mentioned in Arts. 7 and 10. Second, discrimination is prohibited by Art. 82 to a larger scale than indicated by its subparagraph (c). For instance, if the right of access is given to one third party, it is the Commission’s view that it will constitute illegal discrimination to refuse access for another third party without proper, objective justification.⁶⁹

Both difficult and controversial is the second question relating to non-discrimination: Does the duty not to discriminate include a duty to treat *all* users of the pipeline equally, i.e. that the supply arm of the pipeline owner must compete on equal terms with other shippers for scarce capacity? Supply and transportation activities can either be run by separate legal entities within the same group of undertakings or be fully integrated in one legal entity.

The former situation seems directly addressed in Arts. 7(2) and 10(2) of the Directive, prohibiting discrimination “particularly in favour of its related undertakings”. Having concluded that the provisions prohibit non-discrimination in *general*, the wording indicates that at least a supply company legally separated from the transportation activities should not be given priority to scarce capacity. It must be remembered that this will shortly be the standard form of organisation. In the Commission’s proposal for an amended Gas Directive, the duty not to discriminate is imposed directly on the transmission and distribution operator, obliged to be independent from gas supply activities “at least in terms of its legal form, organisation and decision making”, cf. new Arts. 7a(2) and 10(4). Consequently, *all* users of the infrastructure will be third parties or related undertakings, explicitly mentioned in the equal treatment provisions in new Arts. 7(2)b and 10(2).⁷⁰

“Related undertakings” are typically a parent company and its subsidiary. Art. 2(18) gives a definition of the term with reference to the Seventh Directive on consolidated accounts.⁷¹ Somewhat simplified, an undertaking is related when it is controlled by a majority of votes, either by direct ownership or by agreement with other shareholders. In addition, undertakings which belong to the same shareholders are related.

⁶⁸ More precisely, such conditions are seen as having a particular anti-competitive effect (Art. 81) and as constituting an abuse if applied by a dominant company (Art. 82).

⁶⁹ Telecom Access Notice, *supra* note 35, para 85; Palasthy, *supra* note 35, at 19; and J Temple Lang, *The Principle of Essential Facilities in European Community Competition Law – the Position since Bronner*. Lecture notes, Copenhagen September 2000, at 21 (unpublished, on file by author).

⁷⁰ COM(2002) 304 final.

⁷¹ Seventh Council Directive 83/349/EEC of 13 June 1983 on consolidated accounts, OJ 1983 L 193/I. See Arts. 33(1) and 41.

Having presented these starting points, two main questions remain to be analysed. First, in subsection 5.2.2, it will be examined whether the Directive opens up for a different treatment of the pipeline owner if supply and transportation activities are organised within the same legal entity. Thereafter, I shall turn to some general arguments against full equal treatment between the pipeline owner and its competitors as regards capacity allocation. Despite the arguments derived from the wording and objective of the Directive presented so far, it must be considered whether important counter-arguments lead to an interpretation of the equal treatment provisions *accepting* priority for the owner. These arguments seem to be relevant both when gas supply is organised through a branch and through a subsidiary.

5.2.2 *The internal organisation of gas supply activities: branch or subsidiary*

Organising gas supply and transportation activities as branches within the same legal entity is common in the gas industry. Even according to the Commission's proposal for an amended Directive, this form of internal organisation can continue for small distribution companies and for companies performing supply and transportation through upstream networks.⁷²

As opposed to *related* supply undertakings, the internal supply arm within the vertically integrated gas company is not mentioned in the equal treatment provisions of Arts. 7 and 10. Discrimination is prohibited "between system users or classes of system users, particularly in favour of (...) related undertakings". The wording *can* be read as an indication that the Directive opens up for a preferential position for the pipeline company's own supply activities organised within the same legal entity performing gas transportation as well.⁷³ The non-exhaustive form of the provisions ("particularly") will, with such an interpretation *a contrario*, underline that related undertakings are more likely to be favoured than "true" third parties. To draw a conclusion on this basis alone would, however, be too hasty. Several arguments must supplement the wording, and the wording itself is ambiguous. All "system users" are mentioned, and the pipeline owner can, as all other suppliers, be seen as a user of the pipeline system. Further, the emphasis on the related undertakings in Arts. 7 and 10 ("particularly in favour of its related undertakings") does not rule out that the provisions apply to the internal supply arm of the pipeline company as well.⁷⁴

The main argument supporting a duty to treat the supply arm of the pipeline company and all other shippers equally, is that it promotes the objective of the Directive, namely, the creation of a competitive natural gas market. By controlling the desirable infrastructure, the pipeline owner has incentives to protect his own gas supply activities from competition. This danger of overt or covert discrimination is mainly due to the interests as *owner* and exists therefore more or less irrespective of whether the supply

⁷² Proposal for new Arts. 10(4)(d) and 23, COM(2002) 304 final.

⁷³ This is Burchard's main argument, *supra* note 48, at 206.

⁷⁴ The German Bundeskartellamt even sees the wording as indicating that the supply arm of the pipeline company and its related undertakings should be treated equally, see decision of 30.8.1999 in case B8-40100-T-99/99, *Berliner Kraft- und Licht (Bewag) Aktiengesellschaft v. RWE Energie Aktiengesellschaft*, available at <http://www.bundeskartellamt.de/BEWAG.pdf>.

function is handled by a separate legal entity. It thus seems too formalistic to emphasize *form* rather than *function* in deciding what capacities should be available. Focusing on form would be unusual in a competition law context and could constitute a trap for potential customers, making their rights of access dependent on the internal organisation within the pipeline company. As stated by Temple Lang as regards the essential facilities doctrine, a “dominant company cannot avoid its duty to contract, or justify discrimination in favor of its own operation, by having a branch rather than a subsidiary.”⁷⁵

Support of focusing on the *functions* as gas supplier is to be found in the rules on unbundling of accounts in Chapter V of the Directive. Integrated gas companies, typically transmission and distribution companies performing both gas supply and transportation, are to keep “separate accounts for their natural gas transmission, distribution and storage activities” as if the activities were “carried out by separate undertakings”, cf. Art. 13(3). The key feature is the separation of the natural monopoly functions (transmission and distribution) from the supply function that is open to competition. The underlying reason for this requirement is to make sure that the service component (gas transportation) is “correctly” priced to avoid “discrimination, cross-subsidisation and distortion of competition”. Discrimination is here undoubtedly a reference to the favouring of the pipeline company’s internal supply arm compared to third party shippers. Even though the accounting requirements do not relate directly to capacity allocation, they illustrate that the different interests of the pipeline company as gas supplier and gas transporter must be seen separately in creating truly competitive gas markets, quite irrespective of internal organisation within the pipeline company.

The unbundling requirements relate directly to the *pricing* of gas transportation and indicate that the tariffs for third party access must be cost-reflective.⁷⁶ This is in line with competition law as well. As far as prices and other conditions are concerned, Art. 82(2)(c) EC prohibits a dominant firm from treating customers in the traditional meaning of the word (e.g. third parties seeking access) differently from its own internal activities (e.g. its own gas supply arm).⁷⁷ Additionally, prices lacking cost-reflectiveness may be seen as “unfair (...) selling prices” contrary to Art. 82(2)(a).⁷⁸

Separation of interests is further underlined by the obligation on the transmission and distribution companies to preserve the confidentiality of commercially sensitive information. It is explicitly stated that they must refrain from abusing information obtained in their respect as gas transporters (“obtained from third parties in the context of providing or negotiating access to the system”) in their functions as gas suppliers (“in the context of sales or purchases of natural gas by the transmission [or distribution]

⁷⁵ Temple Lang, *supra* note 36, at 483.

⁷⁶ The methodologies for the calculation of the tariffs may nevertheless vary a lot, see for instance the Brattle Group, *supra* note 48, at 51-74. In the amended Gas Directive, it is explicitly stated that the tariffs should be “non-discriminatory and cost-reflective”, see recital (14) of the preamble, COM(2002) 304 final.

⁷⁷ For a comprehensive analysis, see Larouche, *supra* note 36, at 218-231. He describes this as “the new pattern of discrimination”, since discrimination is not, as traditionally, between two of the customers of the dominant firm.

⁷⁸ Defined as a price that has “no reasonable relation to the economic value of the product supplied”, implying a test whether “the difference between the costs actually incurred and the price actually charged is excessive”, see case 27/76, *United Brands Company and United Brands Continentaal B.V. v Commission*, [1978] ECR 207, paras 250 and 252.

undertakings or related undertakings”), cf. Arts. 8(2) and 11(2). Gas sale activities by the transmission and distribution companies themselves and by their related undertakings are treated equally.⁷⁹

Against this line of argument can be submitted the fact that the functional separation of gas sales and gas transportation activities in the Directive is limited. There is no duty of management unbundling as in the Electricity Directive,⁸⁰ and certainly no duty to organise separate legal entities.⁸¹ This *may* be seen as acknowledging that truly vertically integrated companies are in a special position. However, it can hardly be a convincing argument for giving these companies, quite generally, a preferential status, always having priority to scarce pipeline capacity. The coming amendments requiring legal and functional unbundling cannot be seen as accepting that the pipeline owner under *today’s* regulation is not bound by the equal treatment provisions. An important objective of the amendments seems to be to prevent discrimination that is made *possible*, though not *legal*, by the existing rules.⁸²

Despite the indicated counter-arguments, the conclusion so far must be that the internal organisation of the supply activities of the pipeline company is irrelevant, and that the pipeline owner must treat his own supply activities equally with the interests of third parties as regards allocation of pipeline capacity.

5.2.3 Modifications: capacity priority for the owner?

For several reasons, total non-discrimination between the owner and third parties can be difficult, and the pipeline owner may have a legitimate need for some kind of preferential access to scarce capacity. These concerns seem relevant both where the supply activities are run by a branch and by a subsidiary, even though their importance may be greater in the former situation. Some of the arguments indicate that the owner should have a *general* right to give preference to his own needs, whereas others more specifically concern capacities in *new* pipelines.

A first argument that has been put forward, is that an interpretation of the Directive implying a risk that the pipeline owner must reduce his own supply activity, would constitute an unlawful restriction of the owner’s right to enjoy his property, prohibited by EC law.⁸³ The fundamental principle of right of property is based on the constitutional principles common to the Member States and on the first Protocol

⁷⁹ This duty of confidentiality, known as “Chinese Walls” within the vertically integrated company, is described by Cameron, *supra* note 8, at 182-183.

⁸⁰ According to Art. 7(6) of the Electricity Directive (Directive 96/92/EC, OJ 1997 L 27/20), the system operator must be “independent (...) in management terms from other activities not relating to the transmission system”. Burchard, *supra* note 48, at 207, sees this as an important difference between the two Directives as regards the interpretation of non-discrimination.

⁸¹ This is clarified by Statement 86/98 regarding Arts. 8(2) and 11(2) by the Council and the Commission given in the minutes of the Council, released in May 1998, available at http://europa.eu.int/comm/energy/en/gas_single_market/index_en.html.

⁸² The Commission *may* be read in line with this when arguing that legal unbundling will “permit more market entry, as potential entrants will be *confident* of non-discriminatory access” (my italics), see COM(2001) 125, 37.

⁸³ See J Schwarze, *Der Netzzugang für Dritte im Wirtschaftsrecht* in Schwarze, *supra* note 35, 11-27, at 19-20 with further references.

to the European Convention for the Protection of Human Rights.⁸⁴ Restrictions of property have to serve objectives of general interests pursued by the Community and cannot constitute a disproportionate interference with the rights of the owner. If the legislation *deprives* the owner of the right to enjoy his property (expropriation), and not only *restricts* the exercise of this right, compensation is required to make the restraint lawful.

Third party access as such implies a heavy impairment of property rights. Third parties have a transportation right, more specifically a right to make use of the pipelines and a right to require the owner or operator to perform the transportation service. Being obliged to work actively for his competitors, and not only refrain from some kind of utilization of his own property, TPA can be seen as a kind of expropriation of the rights of the owner. However, fair compensation seems secured through transport tariffs,⁸⁵ and the categorisation of third party access as a restriction or expropriation must therefore be of limited importance.⁸⁶ It remains that TPA impairs property rights heavily, and that a careful justification according to the above mentioned principles is required. The risk for the owner of having to reduce his own business is one important element in analysing the proportionality of the restriction.

It should be evident from the previous sections that third party access serves to promote the desired objective of creating a competitive internal market in natural gas, a core objective pursued by the Community. Further, it seems difficult to find alternative and less restrictive means, taking into account the traditional structure in the European gas markets. In any case, the ECJ has given the Community legislator wide discretion in determining the necessity and proportionality of the measures chosen,⁸⁷ and this makes it unlikely that TPA as such would be seen as contravening the right of property.⁸⁸ Interpreting the Directive so that the pipeline owner must compete for capacity on equal terms with third parties can make the proportionality test more questionable. However, this interpretation of the Directive promotes competition, and must probably be regarded as proportionate as long as exceptions may be implemented in the situations in which capacity reservation for the owner is of vital importance, see below.

A second concern is connected to non-discrimination according to *competition law*. Does the indicated interpretation of the Directive go longer than the duties according to Art. 82 EC, and, if so, does this constitute a valid counter argument against requiring the pipeline owner and third parties to be

⁸⁴ Cf. Treaty on European Union Art. 6 and extensive case-law from the ECJ, *inter alia*, case 44/79, *Liselotte Hauer v Land Rheinland-Pfalz*, [1979] ECR 3727, paras 17 *et seq.*

⁸⁵ It can, however, be questioned whether cost-reflected tariffs imply a *full* compensation.

⁸⁶ Jarass, *supra* note 27, at 108, regards TPA as a *restriction*, and the same does the Bundeskartellamt in the *Bewag*-decision, *supra* note 74. For further comments, see Wälde and Gunst, *supra* note 4, at 208.

⁸⁷ See, as an example, case 113/88, *Karl Leukhardt v Hauptzollamt Reutlingen*, [1989] ECR 1991, para 20.

⁸⁸ See a thorough analysis by Jarass, *supra* note 27, at 98-117, especially 101-103 and 106-111. Also positive, C C von Weizsäcker, *Wettbewerb in Netzen*, *Wirtschaft und Wettbewerb* 7-8/1997, 572-579. For the opposite view, see F von Burchard, *Third-Party Access: Proposal for a Council Directive concerning common rules for the internal market in natural gas* in F von Burchard and L Eckert (eds), *Natural Gas and EU Energy Law*, Baden-Baden 1995, 85-119, at 99-100, arguing that TPA will not lead to any advantages and that the right to establish alternative pipelines is a less restrictive means to achieve the same objective. Also negative, R Scholz and S Langer, *Europäischer Binnenmarkt und Energiepolitik*, Berlin 1992, 253 *et seq.*

treated equally as regards capacity allocation?⁸⁹ Even though a dominant firm has a special duty to secure competition, the duty to contract under the essential facilities doctrine is normally not extended so far as requiring the owner to provide access to volumes needed for his own activities.

However, the test of abuse in Art. 82 is applied on a case-by-case basis, and the Commission has held that a dominant firm may be under an obligation to reduce its own business to make capacity available to a competitor in a market with limited competition.⁹⁰ The characteristics of the gas markets, with dominating vertically integrated gas companies, make such a requirement for a reduction a realistic possibility; a real market opening would be rendered difficult if the owner is given a general capacity priority.⁹¹ The seemingly opposite starting point in competition law cannot therefore be an argument for a different interpretation of the Directive.⁹²

The third, and in my opinion most important, argument for capacity priority for the pipeline owner is the need for incentives for pipeline investments. As outlined in subsection 5.1, such incentives are crucial in developing an efficient and stable gas market, but the incentives are reduced if the owner risks being forced to cut down on his supply activities. A general capacity priority seems to favour the owner more than necessary to secure sufficient incentives, and it is difficult to interpret the Directive in this vein without further regulation. As a contrast, Art. 23(2)(c) quite generally opens up for a priority for the transport needs of the pipeline owner on the expense of other suppliers as regards access to *upstream pipelines*.⁹³

Different regulation of access to the system and the upstream network can be an argument for an interpretation *a contrario*, substantiating that a general capacity priority is illegal as regards *system access*. One should, however, exercise some caution in emphasizing such a deduction.

When it comes to capacity in *new* infrastructure, the need for incentives is at the highest, and priority for the owner seems to be a suitable means. Still, capacity priority in these situations is not directly regulated in the present Directive text or in the Commission's proposals for an amended Directive.⁹⁴ However, the different proposals discussed by the Council of the European Union this summer all seem to include a very interesting suggestions on capacity priority for the owner of major new infrastructure, explicitly opening up for exemptions from non-discrimination if that is necessary to finance the pipelines.⁹⁵ These

⁸⁹ Jarass, *supra* note 27, at 47, argues that the owner's capacity priority should be evaluated on the basis of Art. 82 EC rather than on the provisions of the Directive.

⁹⁰ See the Commission decision 94/119/EC, *Port of Rødby*, OJ 1994 L 55/52, para 16, and Temple Lang, *supra* note 69, at 16.

⁹¹ For a similar view, see the Bewag-decision, *supra* note 74.

⁹² The fact that the contested interpretation of the Directive to some extent corresponds with the primary competition law, makes it even more difficult to conclude that the Directive implies a disproportionate restriction upon the owner's property rights, see immediately above.

⁹³ This provision is discussed in subsection 5.3.

⁹⁴ However, the second Commission proposal states that "[f]avourable investment conditions should exist", recital (7) of the preamble, COM(2002) 304 final.

⁹⁵ The competence to exempt parts of the pipeline capacity from non-discrimination, and thereby give the owner priority, is given to the *Member States* and the *Commission*. The proposals are therefore presented as exemptions from Art. 14(1), obligating the *Member States* to ensure non-discrimination, and not from Arts. 7 and 10, directed at the pipeline companies.

proposals imply that the starting point, without an explicit exemption, is total equality between *all* shippers, including the pipeline owner himself. Additionally, they illustrate that the owner may have a need for priority even when the supply activities, as in these same proposals, are legally separated from transmission and distribution.

Among the proposals is one presented by the General Secretariat of the Council on 30 July 2002, stating that

“A Member State or, where the Member State considers it appropriate, the independent regulatory authority referred to in Article 22 may, on a case by case basis, decide that major new gas infrastructure, such as interconnectors between Member States, transmission pipelines, LNG and storage facilities, shall be subject to an exemption from the provisions of Article 14(1) and Article 22(2) and (3). Such an exemption may also be granted in case of significant increase of capacity of existing infrastructure.”⁹⁶

Even according to the *present* Directive, the pipeline owner may be given priority to new infrastructure. Two different approaches are possible.

First, the Directive opens up for a postponement of the implementation of the third party access provisions in immature gas markets according to Art. 26. Of special relevance is the right of the Member State to derogate in general from the TPA rules if they qualify as “emergent markets”, defined as States with less than ten years experience with commercial long-term gas supply contracts, cf. Arts. 26(2) and 2(24). Further, a Member State may apply to the Commission for a temporary derogation from TPA in a geographically limited area of the State if market opening would cause substantial problems, “in particular concerning the development of transmission infrastructure, and with a view to encourage investments”, cf. Art. 26(3-5).

The second possible modification from a complete non-discriminatory allocation of capacity applies irrespective of derogations according to Art. 26. The Directive prohibits discrimination between “system users or classes of system users”, but this hardly means that all players must be treated equally, irrespective of relevant differences in their legal or factual situation. Non-discrimination is a general concept of EC law, and the Directive must be read in accordance with the case law of the ECJ, repeatedly holding that non-discrimination is a principle

“... which requires that comparable situations are not to be treated differently and different situations are not to be treated alike *unless such treatment is objectively justified*” (my italics).⁹⁷

If there is an objective justification, different treatment of comparable situations is permitted. The pipeline owner can thus give capacity preference to his own supply needs if that is objectively justified.⁹⁸ The justification here relates to enhancing incentives for pipeline investments, an objective differentiating the owner from other pipeline users. Increased pipeline capacity is important in ensuring

⁹⁶ Transmission note, *Amended proposal for a Directive of the European Parliament and of the Council amending directive 96/92/EC (electricity) and directive 98/30/EC (gas) concerning common rules for the internal market in electricity and natural gas - Gas*, doc 11271/02, Art. 14(3). Similar proposals are presented by the Working Party on Energy, see doc 8419/02, 30 April 2002, and doc 10932/02, 12 July 2002.

⁹⁷ Case C-15/95, *EARL de Kerlast v Union Régionale de Coopératives Agricoles (Unicopa) and Coopérative du Trieux*, [1997] ECR I-1961, para 35.

⁹⁸ Much the same will follow from Art. 82(2)(c) EC, requiring that the transactions must be “equivalent” before unlike treatment is prohibited.

the Community objectives of security of supply and the transformation of the national gas markets into one single, interconnected market.⁹⁹ Proportionate measures suitable to support these goals must be accepted as objective justifications, and capacity priority for the owner to major new pipelines will probably often fulfil these criteria.

A concrete evaluation of each case is necessary, and the test may imply difficult analyses. Priority cannot be given in a larger scale than justified by the needs of the pipeline owner. His concluded and planned supply contracts must therefore constitute the maximum priority; it is difficult to allow the owner to prevent access for third parties to unused capacity.¹⁰⁰ Further, the duration of an exemption from non-discrimination and the share of the total pipeline capacity exempted must depend, *inter alia*, on the size of the investments and the commercial risks connected to the project. Additionally, an exemption from non-discrimination can hardly be *justified* if the exemption would harm competition and an efficient internal market in a long-term perspective.¹⁰¹

It should also be remembered that the transport tariffs may include a component covering investment costs. There are therefore *some* incentives for investments even without giving the owner priority to scarce capacity. These incentives may, however, be too limited for the desired investments to take place.

5.2.4 Conclusions

The preceding analysis has revealed that the Directive prohibits the pipeline owner from giving his own gas supply entity a general priority to scarce transmission and distribution capacity. The owner's supply arm is, as all other shippers, a "system user" according to Arts. 7(2) and 10(2), subjected to the equal treatment provisions. This probably applies irrespective of internal organisation within the gas company, i.e. both when the supply activities are run by a subsidiary and by a branch. Put differently, the "non-contracted" volumes available to third parties are *not* reduced by the volumes desired by the pipeline owner himself. At the same time, of course, the owner is entitled to compete for these volumes on equal terms with other pipeline users.

There are important legal arguments against this wide interpretation of the equal treatment provisions, but they cannot lead to a different solution generally. They must nevertheless be decisive in some situations, and this is notably the case for capacity in major new pipelines.

The expected amendments to the Directive, introducing, as a minimum rule, a legally and functionally independent system operator (new Arts. 7a and 10(4)), do not change these conclusions, but they make it even more difficult to conclude that the owner, except in special situations, has a preferential position as regards capacity allocation.

The German Bundeskartellamt reached the same main conclusion as regards the parallel provisions on non-discrimination in the Electricity Directive (Arts. 7(5) and 11(2)) in its Bewag-decision, concluding that the Directive

⁹⁹ See *Security of EU Gas Supply*, COM(1999) 571 final; *Green Paper: Towards a European strategy for the security of energy supply*, COM(2000) 769 final, at 70; and COM(2001) 775 final, at 12, 15, and 21.

¹⁰⁰ Priority due to future supply contracts is discussed in subsection 5.4.

¹⁰¹ A detailed regulation of the priority for the owner is suggested by the Council, see *supra* note 96, Art. 14(3)-(5), taking into account, *inter alia*, the arguments presented here.

prohibited Bewag from giving capacity preference to its own supply needs in West Berlin.¹⁰² The line of argument follows much of the above. However, it must be remembered that the supply and transport functions are more clearly separated in the Electricity Directive than in the Gas Directive, requiring so-called management unbundling.

5.3 The owner's needs for transportation capacity in the upstream network

Contrary to the regulation in respect of access to the *system*, the Directive addresses the interests of the different users of the *upstream network*. According to Art. 23(2)(c), the Member States may, when implementing rules on TPA, take into account

“the need to respect the duly substantiated reasonable needs of the owner or operator of the upstream pipeline network for the transport and processing of gas and the interests of all other users of the upstream pipeline network or relevant processing or handling facilities who may be affected”.¹⁰³

The “reasonable needs of the owner” for the transport and processing of gas is explicitly mentioned. These needs will typically be full security for capacity in pipelines and processing facilities. Priority to scarce capacity, at the expense of volumes for third parties, is an appropriate means to achieve this objective. As discussed above, capacity priority may be necessary in encouraging investments onshore, and this is even more so offshore, where both costs and risks connected to investments are higher.

Even though it is clear that the owner can be given preference to scarce capacity, the detailed implementation of this right raises some questions. For instance: How should the interests of the pipeline owners be weighted against the users' interests, including the supply activities of the owners themselves? Two aspects should be mentioned here.

First, priority to *new* infrastructure must be within the core of the provisions, but what about priority to *existing* pipelines? Access to these pipelines is not a prerequisite for new investments. In assessing this issue, the general wording of Art. 23(2)(c) must be taken into account, as must the fact that the utilization of already depreciated pipelines is a natural part of advantages normally connected to ownership. Given this background, it is fair to say that the owner, at least in most cases, has “reasonable needs” for pipeline capacity in existing pipelines as well. Consequently, the owner can be given pipeline priority at the expense of other players' interests as long as his needs are “duly substantiated”.

A second aspect is interesting where the pipelines are owned by several players, for instance where, as on the Norwegian continental shelf, the pipelines are organised as joint ventures. The owners have varying shares in different pipelines, not necessarily corresponding to their committed and expected gas supply interests. Should the decisive factor for capacity priority be the pipeline owners' shares in the pipeline joint venture or rather their supply needs, i.e. their respective shares in relevant production licenses?¹⁰⁴ The quoted wording is ambiguous. Respect should be given to the needs of the “owner *or* operator” (my italics), implying that focus is on the needs of the company co-ordinating the operations of

¹⁰² For references, see *supra* note 74. See also Palasthy, *supra* note 35, at 10 and 12.

¹⁰³ Art. 23(2)(c) is discussed in Moen and Dyrland, *supra* note 8, at 161-164.

¹⁰⁴ The Norwegian petroleum legislation, including acts, royal decrees, and regulations, is available in English at http://www.npd.no/regelverk/r2002/frame_e.htm.

the pipeline, be it the owner himself or another company.¹⁰⁵ It is, however, the “reasonable needs (...) for *the transport (...) of gas*” (my italics) that could be taken into account, which includes the transport needs to perform the underlying *supply* agreement.

The rationale for giving priority to the owner must, at least mainly, be to enhance incentives for investments. This could indicate that focus should be on the risks connected to the *infrastructure*. Basing capacity priority on the respective owners’ shares in the pipeline joint ventures would also imply a *functional* approach in line with the general tendencies of the Directive.¹⁰⁶ On the other hand, the *real* incentives for establishing expensive pipelines may lie in reaching the customers with gas, making an argument for emphasizing the owners’ *supply needs*. Full vertical integration between gas sales and transportation activities will, as mentioned above, still be possible in the upstream sector. The Commission’s proposal for an amended Directive only introduces an independent operator in the *system*, not in the *upstream network*.¹⁰⁷

As to functional aspects upstream, it is worth noting that requirements for separation of accounts are more limited than is the case downstream. According to Art. 13(3), the integrated companies must keep “*consolidated* accounts for non-gas activities” (my italics), separated from their *supply* activities and from other *gas-related* activities (“transmission, distribution and storage”). These consolidated accounts may include “integrated accounts for hydrocarbon production and related activities” (recital (22) of the preamble), presumably including upstream transportation activities. There does *not* seem to be a requirement for separation of accounts as concerns upstream *transportation* alone. However, the dispute settlement authority can according to Art. 23(3) require “all relevant information” to settle disputes, and this may include “*accounting information* about upstream pipelines” (recital (22), last sentence, my italics). The pipeline company must therefore, on request, present the necessary information concerning gas transportation to assess disputes on terms and conditions for access, etc.¹⁰⁸ The rationale for such an information duty is much the same as for the separation of accounts within the system, see subsection 5.2.2 above.

The Directive does not give any definite answer to the issue of which interest is to be the primary “owner’s interest” according to subparagraph (c) of Art. 23(2), and it is probably within the discretion of each State to determine the decisive factors. However, it must be emphasized that the owner’s needs cannot be evaluated alone. Subparagraph (c) mentions the interests of *all* users of the infrastructure, and the general objective of access to upstream pipelines is the creation of a “competitive market in natural gas” with “fair and open access” to the upstream networks, cf. Art. 23(2). This must, *inter alia*, imply that all available capacities, if the special considerations in Art. 23(2) do not apply, must be allocated in a non-discriminatory way, and that access is granted on equal terms and conditions.

Contrary to access to the system, non-discrimination is not explicitly stated in Art. 23. However, the arguments for such a requirement are very similar, see subsections 5.2.1 and 5.2.2, and the principle of non-discrimination must be regarded as an integral part of the TPA system upstream as well. A general duty to treat shippers non-

¹⁰⁵ About the operator, see section 6.

¹⁰⁶ See above in subsection 5.2.2.

¹⁰⁷ The only amendment to Art. 23 proposed by the Commission is a minor change in no. 1 concerning eligible customers with the right of access to upstream pipeline networks, see COM(2002) 304 final.

¹⁰⁸ These accounting provisions appear as a peculiar construction, but they can perhaps be explained as an attempt to adapt the regulation of upstream pipelines, introduced at a late stage in 1997, to the Directive text that was more or less agreed upon at that time. Without having to re-negotiate the general accounting provisions in Arts. 12 and 13, some requirements of separation were conferred upon upstream companies as well. However, this legislative technique is not recommendable, leading to uncertainty and to legislation through the preamble.

discriminatorily seems necessary to ensure the objectives of competition and fair and open access, cf. Art. 23(2).¹⁰⁹ Further, different treatment of two shippers may be contrary to competition law, notably Art. 82(2)(c) EC on abuse of a dominant position.

5.4 Reservation for the owner's *future* capacity needs

Section 5 has so far concentrated on the conflict between the owner and a third party competing for scarce capacity where both parties need the capacity at the time of the request for access. These premises are now slightly changed. The question is whether the pipeline owner can reserve capacity due to his expected *future* capacity needs, and not because he needs it *at present*. Such a right for the owner would reduce the available transportation capacity for third parties in a future perspective, but also at the time for the request of access. If the pipeline owner is allowed to give priority to his own supply commitments expected to be realized in a year's time, and if the pipeline with these volumes is used to its capacity, it is impossible for a third party to conclude a firm transportation agreement lasting more than one year.

Accepting a denial of access in such cases can be seen as accepting a right to deny access despite the fact that non-contracted volumes are available. The issue could therefore have been examined in Part III of this article. However, the conflict between the owner's future needs and third party needs for pipeline capacity is only a variety of the general issue of pipeline priority for the owner, and it is thus reasonable to conclude the analysis at this point. Part III, therefore, is limited to another type of denial of access despite spare capacity; denial due to *public* interests.

We have seen that the pipeline owner, as regards access to the *system*, has only limited opportunity to give priority to his own supply needs when allocating scarce capacity (subsection 5.2). The owner can certainly not have a better position when it comes to *future* reservations. In a market with TPA, i.e. where there is no general derogation according to Art. 26, the relevant question is that of objective justification for giving preference to the pipeline owner's needs on the expense of other suppliers. It is, generally speaking, more difficult to substantiate a denial of access for a third party when there actually *is* spare pipeline capacity, compared to the situation analysed in subsection 5.2.3. However, the owner should in some situations be able to benefit from an exception from non-discrimination. For instance, capacity reservation for future supply needs seems reasonable if the owner has financed a new pipeline and started transporting gas without already having concluded sufficient supply volumes to defend his investments.

Reservation to *upstream pipelines* is differently regulated. Art. 23(2)(c) generally recognizes the need to respect the "reasonable needs of the owner" in transporting and processing gas. The general wording seems to include the right to take into account the owner's reasonable and substantiated needs for reservation of *future* capacity. The need for such a reservation will normally be greater upstream than downstream, *inter alia*, because investments in fields, pipelines, and ancillary facilities may be so extensive and risky that security for both present and future capacity is necessary in order to give the owner sufficient incentives to carry out the investments.¹¹⁰

All reservations must according to Art. 23(2)(c) be "duly substantiated and reasonable". A thorough assessment of these criteria is crucial in order to avoid future reservations preventing TPA and

¹⁰⁹ On non-discrimination as regards access to upstream pipelines, see Moen and Dyrland, *supra* note 8, at 159 and 174-175.

¹¹⁰ On investment incentives, see subsections 5.1, 5.2.3, and 5.3.

competition unnecessarily. A possible compromise would be to accept the owner's reservation, but at the same time to offer short-term contracts to the volumes available until the needs of the owner are materialized, alternatively to offer interruptible transportation rights to these volumes, see section 9.

Reservation of capacity for the owner as examined in this section, implies a right to reserve capacity before having concluded a supply agreement. In order for the needs to be "duly substantiated and reasonable", however, the coming supply needs must be well documented. This differentiates the situation from booking of "pure" capacity with no underlying supply contract as discussed in section 2 above. Such contracts *may* be an instrument in securing capacity for future supply needs, but are not *dependent* on reasonable future capacity needs. Member States may prevent such capacity contracts, limiting the right of access to those suppliers intending to deliver to a specific eligible customer.

6 Priority for the pipeline operator?

Priority to scarce capacity can to some extent be required by the pipeline owner due to his supply interests, but does the same apply to the pipeline *operator*? The wording of Art. 23(2)(c) appears to place the operator on equal terms with the owner, opening up for the Member States to take into account the "duly substantiated reasonable needs of the owner or operator of the upstream pipeline network for the transport and processing of gas". This must, however, be read on the background of the different roles of the company acting as operator.

The key function of the operator is the day-to-day responsibility for the pipelines and ancillary facilities, including a co-ordination of the interests of different suppliers in access to the network. In today's legal regime, the operator is scarcely regulated, and the functions may be executed both by the owner and by another company. Additionally, there is nothing prohibiting the operator from being vertically integrated, performing gas *supply* activities within the same legal entity that is responsible for the functions as *operator*. The amended Gas Directive, however, obligates the transmission and distribution operators, but not the operators in the upstream networks, to be legally and functionally separated from the supply activities, see sections 1 and 5.2.1 above. There is no requirement for ownership separation.¹¹¹

Management unbundling will, according to the Commission, "lead to a more effective and equivalent competitive structure throughout the internal market and will permit more market entry, as potential entrants will be confident of non-discriminatory access. Moreover, within integrated companies it will provide clearer cost signals and incentives to the different business functions. The adoption of this measure will thus lead to a more rapid and equitable development of an effective internal market for gas."¹¹²

Concerning his gas sales interests, the operator is a third party as all other shippers, unless the pipeline owner is the operator. He therefore has to be treated equally with other third parties as regards capacity allocation, cf. Arts. 7(2) and 10(2) and section 5 above. The same interpretation must apply in respect of upstream operators, despite the unclear wording of Art. 23(2)(c). The "needs of the (...) operator" cannot be a reference to the needs as gas *supplier*, but must be limited to the special needs in the role as *operator*, being responsible for the functioning of the pipeline network.

¹¹¹ On the different levels of unbundling, see Wälde and Gunst, *supra* note 4, at 198.

¹¹² COM(2001) 125 final, 37.

In *this* respect, the operator must be given priority to pipeline capacity whenever necessary to perform his functions, and this must equally apply to transmission and distribution operators even without any explicit regulation. Capacity for balancing the system and a margin of capacity available for emergency operations and unexpected disturbances are some examples. Additionally, the operator must be able to close down the pipeline or reduce the activity to perform necessary maintenance.

In order to contribute to a competitive market with a functional TPA system, the operator must perform his tasks without discriminating between the pipeline users. For instance, maintenance must be performed in periods where reduced capacity does not have unnecessary negative effect on third parties. If the operator himself has gas supply interests, this requires a close monitoring in order to avoid covert discrimination.

III Denial of access despite spare volumes – third party access and public interests

7 Public service obligations

Focus has so far been on the interests of the different parties directly involved in the gas markets and whether any party can be given capacity priority. Here, I shall turn to the interests of the *Member States* in ensuring that the gas markets work to the benefit of society at a whole. Having found what constitutes *contracted* volumes in Part II means that the starting point for firm transportation right is established: Access can be required if there is sufficient non-contracted capacity. The extent to which exceptions from this right can be implemented to secure public interests as regards access to the system and access to upstream networks is the subject of Part III of this article.

Regarding access to the *system*, the possibility for the Member States to implement public service obligations is the means by which public interests can be given priority. According to Art. 17(1), a request for access may be refused where access “would prevent [the natural gas undertakings] from carrying out the public-service obligations (...) assigned to them”. Public service obligations are further regulated in Art. 3(2), largely echoing Art. 86(2) EC, and in Art. 9(2). The essence of this derogation is to secure certain public priorities, such as energy supply to vulnerable customers at reasonable prices, if necessary, at the expense of TPA and competition.¹¹³

¹¹³ For comments on the public service derogation in the Directive, see Moen and Dyrland, *supra* note 8, at 117-127. More generally on public service in the energy markets, see U Hammer, *EC Secondary Legislation of Network Markets and Public Service: An Economic and Functional Approach*, 3 *Journal of network industries* 1 (2002), 39-75; Hancher, *supra* note 26. A comprehensive analysis of Art.86 EC is given by J L Buendia Sierra, *Exclusive Rights and State Monopolies under EC Law. Article 86 (formerly Article 90) of the EC Treaty*, Oxford 1999.

A denial of access is legitimate if that is necessary to perform the tasks of general interests under economically acceptable conditions.¹¹⁴ This necessity requirement, which implies a proportionality test, indicates that the company entrusted with a public service duty has to limit the exception to the least restrictive means. Instead of a general denial of access, reduced transport tariffs would be an option, enabling the tasks to be performed economically,¹¹⁵ and reservation of capacity would in some situations be another alternative.

A key public service is security of supply, ensuring that the customers, both in a short and long-term perspective, will receive the necessary gas volumes. In order to enhance the security of supply, Member States often obligate the pipeline company to have a certain amount of gas stored for emergency situations, particularly for the winter periods. Access to the storage facilities must be denied if the capacities are bound up for such emergency situations. Additionally, refilling of the storage facilities, usually performed during summer, requires available *pipeline* access, and for that purpose, the pipeline company must be allowed to reserve capacity and thereby reduce the capacities for third party access.

A second example is related to *long-term* security of supply. The Directive opens up for long-term planning (cf. Art. 3(2)), defined as “the planning of supply and transportation capacity of natural gas undertakings on a long-term basis with a view to meeting the demand for natural gas of the system, diversification of sources and securing supplies to customers” (Art. 2(23)). In enhancing security of supply, diversification of sources is one relevant measure, which to some extent can be implemented by giving priority to pipeline capacity for gas from an alternative source. If, for instance, a country is too dependent on Russian gas, preference to spare capacity can be given to gas from other countries.

8 Resource management

Efficient and healthy “resource management” has been a key objective of the gas producing countries. By this is meant a management of the non-renewable gas resources in a long-term perspective for the benefit of society as a whole, for instance by maximising long-run production and securing the environment.¹¹⁶ Several measures can contribute to achieving this, and most of them lie outside the scope of the Gas Directive, for instance decisions in respect of which fields to explore, how much gas to produce, etc. To some extent, however, resource management has affected the regulation on access to upstream pipeline networks, notably in subparagraph (b) of Art. 23(2), opening for the States to take into account

¹¹⁴ This criterion is established by the case law of the ECJ as regards Art. 86(2) EC, see, *inter alia*, case C-157/94, *Commission v Netherlands*, [1997] ECR I-5699, para 53. The Directive must be interpreted similarly, see Moen and Dyrland, *supra* note 8, at 124-125.

¹¹⁵ In line with this as regards Art.86(2) EC, case C-340/99, *TNT Traco SpA v Poste Italiane SpA and Others*, [2001] ECR I-4109, accepting that operators of the *competitive* part of the postal services in Italy had to pay special postal dues to finance the universal service granted *exclusively* to Poste Italiane, enabling that task to be performed in conditions of economic stability.

¹¹⁶ See, for instance, the Norwegian Petroleum Act (Act 29 November 1996 No. 72 relating to petroleum activities) §§ 1-1 and 1-2.

“the need to avoid difficulties which cannot be reasonably overcome and could prejudice the efficient, current and planned future production of hydrocarbons, including that from fields of marginal economic viability”.

Measures necessary to ensure an efficient oil and gas production in the long run can be implemented, even though they will reduce the scope for third party access. Some examples will show that capacity priority or reservation for future, non-contracted volumes are possible measures by which to ensure this.

Production from fields of “marginal economic viability” is mentioned explicitly. These fields, being small or difficult to produce, can help maximising the total production, but there is a risk that the gas will remain where it is if the producers are not given some kind of preferred position. Several measures are feasible, for instance an obligation upon the producers of large and more profitable fields to include quantities from marginal fields, or a reduction of the transport tariffs for gas from the less profitable fields. Additionally, full security for pipeline capacity will contribute to make marginal fields worth producing.

A field that, evaluated separately, is of marginal viability, can radically increase in profitability by coordinating the production and transportation capacity with other fields.¹¹⁷ The need for transportation capacity for these small fields is still important in order to make the total production efficient, and the State may therefore reserve necessary capacity according to subparagraph (b) for fields that, considered separately, would have been marginal.

A third example is due to the link between oil and gas production. Most fields contain both oil and gas components, and it is usually profitable to recover most of the oil to start with. High recovery factor¹¹⁸ requires a certain pressure in the well that can be achieved by leaving the gas *in* the field or by injecting gas from neighbouring fields. When oil production declines, and gas production can increase, it would prejudice an efficient total production if third parties had reserved all the gas transportation capacity. Consequently, Art. 23(2)(b) opens up for reservation of capacity for future (increased) gas flow.

IV Right of access despite a fully contracted pipeline

9 Interruptible transportation rights to unused volumes

Access to non-contracted volumes on equal terms can be seen as the basic rule of the Gas Directive. As examined in Part II of this article, *all* gas suppliers, including the pipeline owner, normally have to compete for scarce capacity without any discrimination. The analysis so far has shown, however, that the pipeline owner can be given priority in certain situations (section 5), and public interests may

¹¹⁷ Such *associated fields* are common on the Norwegian continental shelf, see, *inter alia*, St.meld. nr. 46 (1997-98), at 33.

¹¹⁸ Defined as “[t]he ratio between the recoverable volume of petroleum from a petroleum deposit and the volume of petroleum originally in place in the deposit”, Art. 2 of Regulations relating to resource management in the petroleum activities (FOR-2001-06-18-749), issued by the Norwegian Petroleum Directorate 18 June 2001.

occasionally lead to a denial of access despite the fact that there is spare, non-contracted capacity (Part III). The subject in this part is the “opposite” exception: Can access be required to a pipeline that is already fully contracted?

Two issues must be examined. First, can access be required to volumes that are de facto unused (section 9)? And, second, does the pipeline company have a duty to enhance the pipeline capacity so that TPA soon can be required despite the pipeline being fully contracted and even used to its present capacity (section 10)?

Gas supply and transportation contracts are traditionally long-term and have a flexible volume obligation, stipulating the gas volumes by maximum and minimum input and offtake levels. As a result, the total contracted volumes often, especially in periods with limited demand for gas, exceed the volumes actually transported. This opens up for the indicated question of whether third parties can require access to these volumes on the basis of the Gas Directive.¹¹⁹

This practically important question is related to, though not similar with, the situation examined in section 4.2.2 concerning capacity reservation without an underlying gas supply agreement. Both sections concern the utilization of de facto unused capacity, but here, as opposed to the situation in section 4.2.2, is the supply contract with an eligible customer concluded before the performance of the transportation agreement.

Firm capacity to the unused volumes is excluded. The Directive does not interfere with existing contracts (section 4.1 above), and all shippers, whether the pipeline owner himself or third party shippers, must be allowed to increase their transport volumes to the contractual maximum levels (section 4.2.1). *Interruptible* transportation rights are, however, possible. These rights are, contrary to the *firm* transportation rights described in section 4.1, without any capacity guarantee, meaning that the shipper must step aside if the holders of firm rights increase their actual gas flow.¹²⁰ This can be seen as a kind of “use-it-or-lose-it” system, since the original shipper loses the control over the unused part of the pipeline capacity until he chooses to increase his transported volumes under existing contracts.¹²¹

As is the case for the questions of tradability and “use-it-or-lose-it” as analysed in section 4.2.2, the Directive does not mention interruptible services. This does not necessarily mean, however, that such services cannot be required by third parties.

It is already established that the Directive requires all available capacity to be offered to third parties, see section 4.1. Access can only be refused due to “lack” of capacity, cf. Arts. 17(1). Unused capacity within contracted volumes is *de facto* available, and it could therefore be argued that these volumes should be accessible. This view is supported by the obligation on the Member States to implement a TPA system creating effective gas-to-gas competition, see section 4.2.2. Interruptible transportation rights are regarded as important in achieving this objective in that they contribute to a short-term gas market and

¹¹⁹ The same question arises for volumes reserved for future operations, discussed in sections 5.4, 7, and 8.

¹²⁰ This picture, with either firm or interruptible capacity, is somewhat simplified. There are further variations, including “non-firm capacity” where the contracts stipulate certain, though limited, situations legitimating interruptions. For a description, see Council of European Energy Regulators, *supra* note 5.

¹²¹ The term is probably used in this way in the Commission working paper, *First benchmarking report on the implementation of the internal electricity and gas market*, SEC(2001) 1957 (updated version, march 2002), at 8, stating that “there are no use-it-or-lose-it rules relating to long term capacity reservation”.

better utilization of the networks.¹²² Interruptible rights are especially important for customers who are able to switch their source of energy, for instance power plants, and access to such services will thus contribute to increased inter-fuel competition as well. If interruptible rights can legitimately be refused, there is scope for a simple and efficient method for contractual blocking of capacity.

It is nevertheless uncertain whether these arguments are sufficient to conclude that the Directive, without more explicit regulation, can obligate the Member States to require the pipeline companies to offer interruptible services. The Commission presupposes that the States are *not* required to do so. A suggested amendment by the European Parliament to the Commission's proposals for an amended Directive, stipulating that capacities "not used shall be made available to the system users", was rejected by the Commission because this issue was "dealt with (...) in the Madrid Forum".¹²³ Regarding *electricity* transmission, "use-it-or-lose-it" is introduced in the coming legislation,¹²⁴ but *not* in the *Electricity Directive*. This can indicate that the corresponding Gas and Electricity Directives do not give the legal basis for interruptible transportation rights. Additionally, information about de facto free capacity within the contracted volumes has until now usually not been available to third parties, and this efficiently obstructs a market for interruptible transportation rights.¹²⁵ Interruptible services presuppose continuously updated information of the nominated volumes.

There are at least good reasons for hesitating to require interruptible transportation rights to be made accessible to the *upstream networks*. There is limited experience with such rights upstream, presumably due to the special characteristics of these networks, and the wide discretion assigned to the Member States in implementing Art. 23 probably implies a freedom not to require to amend this practice.

Despite this uncertainty concerning a *general* rule on interruptible transportation rights, the prohibition against discrimination, contained in Arts. 7(2) and 10(2), seems to obligate pipeline companies to offer interruptible services in several practically important situations. This duty on the transmission and distribution companies to refrain from any "[discrimination] between system users or classes of system users" is analysed above in section 5.2. That examination showed that non-discrimination applies quite generally, and should therefore include the question of what *types* of services must be offered. Further, it applies both where the supply unit of the pipeline company is legally separated from the transportation unit and where the supply and transportation tasks are performed within the same legal entity. Finally, the pipeline companies are obliged to treat the shippers non-discriminatorily as regards upstream access as well, see section 5.3, though with important modifications.

This means that a pipeline company offering interruptible transportation rights to one player in the gas sales market, whether a "true" third party, a related undertaking, or the supply arm of the pipeline company, is required to offer the same services to *all* players if there is no objective justification

¹²² COM(2001) 775 final, at 16 and 21, and the Brattle Group, *supra* note 48, at 44.

¹²³ COM(2002) 304 final, 12. The guidelines presented by the Madrid Forum are discussed immediately below.

¹²⁴ Art. 6(4) of the amended proposal for a Regulation on conditions for cross-border exchanges in electricity, COM(2002) 304 final.

¹²⁵ SEC(2001) 1957, at 18.

legitimizing unequal treatment. This is of practical importance, since related undertakings, at least on the transmission level, usually have been offered interruptible services.¹²⁶

The competition rules may supplement the Directive as concerns capacity blocking, see section 4.2.2, but they do not generally require the offering of interruptible transportation rights. Interruptible rights are, however, pro-competitive and may thus be important in determining whether, as an example, an agreement between more pipeline owners on capacity services offered, is violating Art. 81 EC.

As noted previously, the gas company Thyssengas has committed itself to offer more efficient network access. This includes, *inter alia*, the right for third parties to require interruptible services.¹²⁷

Another important supplement to the binding Directive is, as mentioned, the Recommendations on Guidelines adopted by the European Gas Regulatory Forum (the Madrid Forum). The transmission operators should offer “interruptible services when firm capacity is not available and no liquid secondary market exists”, and they should “facilitate reutilisation of un-used capacity”.¹²⁸ Access to interruptible services presupposes a duty on the pipeline company to publish both total contracted capacity and the aggregate amount of nominations at each entry point, and these are among the minimum data to be published by the transmission system operators on their web-sites.¹²⁹

In order to have efficient access to interruptible services, it seems necessary to update the nominated volumes continuously. It is therefore surprising that the operators shall update the publications each time a contract for firm capacity expires, whereas the guidelines do not mention the update of *nominated* volumes.

It is worth noticing that the transmission operators have been very hesitant in accepting publication of available capacities, mainly due the confidential and commercially sensitive character of contracted and nominated volumes.¹³⁰ These concerns are to some extent taken into account in the Recommendations on Guidelines as well, limiting the publication to the *aggregated* volumes.

10 Enhancement of pipeline capacity

A key feature of third party access according to the Directive is that access may be denied due to lack of capacity, cf. Arts. 17(1) and 23(2). No spare capacity means no right of access, with the exception of interruptible transportation rights to unused volumes. But is this so quite unconditionally, or can third parties in certain situations require the pipeline company to enhance the pipeline capacity?

Enhanced capacity can be the result of either increased gas pressure or of construction of a new pipeline.¹³¹ As far as the latter situation is concerned, the pipeline company is in much the same position

¹²⁶ The Brattle Group, *supra* note 48, at 45. According to SEC(2001) 1957, at 123 (annex F), interruptible contracts are available at least in Belgium, Denmark, France, Germany, and in the UK.

¹²⁷ Commission press release IP/01/1641, 23 November 2001.

¹²⁸ *Recommendations on Guidelines for Good Practice*, at note 58 above, points 3.6 and 6.2. See section 4.2.2 for comments upon the latter formulation.

¹²⁹ *Guidelines on calculation methodologies and transparency requirements with regard to available capacities of gas transmission, LNG and storage facilities*, point 1.7, 5th meeting of the Madrid Forum, available at http://europa.eu.int/comm/energy/en/gas_single_market/madrid.html.

¹³⁰ See, *inter alia*, COM(2001) 775 final, 20.

¹³¹ Additionally, existing capacities may be increased through a loyal arrangement of the pipeline activities, including some co-ordination between connected pipelines, see section 4.1 above.

as other players in the gas market. The key background for third party access is that gas transportation constitutes a natural monopoly, but only within the capacity range of existing pipelines. It is within these volumes that the pipeline owner, by definition, can facilitate gas transportation, through TPA, at lower costs than a competitor.

When it comes to enhancement through gas pressure, expansion of the capacity with a certain number of cubic metres may be cheaper for the pipeline company than for a competitor, who would have to construct a new pipeline. Even though the pipeline company will often be interested in maximising its capacity, it is a danger that the company will hesitate in doing so, exposing, if vertically integrated, its own supply activities directly to increased competition. The result may be capacity constraints and high barriers to entering the market.

Capacity enhancement in transmission and distribution pipelines is regulated in Art. 17(2):

“Member States may take the measures necessary to ensure that the natural gas undertaking refusing access to the system on the basis of lack of capacity or a lack of connection shall make the necessary enhancements as far as it is economical to do so or when a potential customer is willing to pay for them. In circumstances where Member States apply Article 4(4), Member States shall take such measures.”

This provision must be read together with the right to establish new infrastructure according to Art. 4. Exclusive rights to construct pipelines are abolished, meaning that the establishment of new pipelines can only be denied on objective and non-discriminatory criteria. This can be seen as the primary measure to ensure increased capacities. Enhancement by the existing pipeline company having denied access due to lack of capacity is only stipulated as something the States “may” ensure. They are *encouraged* to ensure enhancements, but neither they nor the companies are *required* to do so.

A refusal to enhance capacity may limit the supply of gas, and can, in principle, constitute an abuse of a dominant position according to Art. 82(2)(b) as a measure “limiting production, markets or technical developments to the prejudice of consumers”. However, it seems hard to prove any abuse according to these criteria as long as volumes in the existing infrastructure are allocated non-discriminatorily and as long as competitors are free to construct alternative pipelines. This differentiates the gas markets from markets in which the ECJ has ruled that Member States are in breach of Art. 86, cf. Art. 82(2)(b) EC, when maintaining exclusive rights for a company “manifestly not in a position to satisfy the demand prevailing on the market”.¹³²

An exception is stipulated in the second sentence of Art. 17(2) for Member States applying Art. 4(4). This provision opens up for a distribution monopoly in newly supplied areas, allowing the Member States to decline to grant further authorisations for distribution pipelines if the capacity of existing or planned pipelines “is not saturated”. This derogation is complemented by Art. 17, requiring that the Member States “*shall take such measures*” (my italics), i.e. ensuring that the pipeline company enhances the capacity if existing facilities nevertheless are insufficient to meet the demand. It seems to be a condition for such a requirement that the enhancement is economical for the distribution company or

¹³² Case C-41/90. *Klaus Höfner and Fritz Elser v Macrotron GmbH*, [1991] ECR I-1979, para 31. The case concerned the statutory monopoly for the recruitment of executive personnel in Germany entrusted to the Bundesanstalt für Arbeit, excluding private companies from the offering of competing services.

financed by a customer.¹³³ In these two situations, the Member States are obliged to ensure that there are sufficient TPA capacities in the pipelines.

When it comes to upstream pipelines, Art. 23(2) states that Member States shall be taking into account capacities which “can (...) be made available” when implementing the TPA rules. A natural way of reading this is that the States are obliged to take into account enhancements that are soon to be realized when allocating capacity for transportation rights. Additionally, it can be seen as an emphasis on the significance of sufficient upstream capacity in reaching the goal of reduced gas prices for the end users.

The Commission analyses the present and expected electricity and gas grids in the communication on *European energy infrastructure*,¹³⁴ referred to several times above. A number of actions are proposed to ensure efficient use of existing infrastructure and to provide for new infrastructure where necessary. In addition to encouraging the adoption of the amendments to the Gas Directive and the work of the Madrid Forum, the report focuses on the political and financial support to infrastructure projects of Community interests. According to Art. 154(1) EC, “the Community shall contribute to the establishment and development of trans-European (...) energy networks”. This may include measures ensuring technical operability and financial support to projects of common interests. The Commission proposes a revision of the guidelines for such support, giving special priority to projects having a significant impact on the competitive operations of the internal market and/or strengthening security of supply in the Community.¹³⁵

V Final remarks

11 Finding the volumes for third parties

What pipeline volumes are available to third parties seeking access? Answering this key question related to third party access according to the Gas Directive has been the objective of this article. The pipeline company can deny access if there is *lack of capacity* (cf. Arts. 17(1) and 23(2)), but this basic starting point does not reveal the complexity of the issue discussed and the number of questions that have been examined. Both the present Directive and the expected amendments are surprisingly silent about these important questions, questions that to a large extent determine the real borderline between the rights of access for third parties, and thereby increased competition, and the freedom for the pipeline companies to limit competition by refusing requests for access.

The results of the analysis are by and large the same under the present Gas Directive and under the amended Directive expected to be adopted in 2003. In both cases, third parties have two different strategic options when seeking access to a gas pipeline.

The first and most important option is to require access to spare, non-contracted capacity. The starting point in finding these volumes is the already concluded transport volumes. As examined in section 4, the

¹³³ The two situations are mentioned in the *first* sentence of Art. 17(2), but the same limitation must be relevant for the distribution monopolies regulated in the second sentence, cf. the expression “such measures”, referring to the first sentence as such.

¹³⁴ COM(2001) 775 final.

¹³⁵ Art. 6a) of proposal for a Decision of the European Parliament and of the Council amending Decision No 1254/96/EC laying down a series of guidelines for trans-European energy networks, COM(2001) 775 final, 22 *et seq.*

aggregated maximum transport volumes concluded, either by the pipeline owner himself or by others, are the volumes beyond the reach of third parties seeking access to firm transportation rights.

In addition, some quantities may be reserved for the pipeline operator in ensuring a functional and secure network, see section 6. Further volumes may be excluded from TPA due to public interests, see sections 7 and 8.

Volumes not ensured capacity due to the above mentioned reasons must normally be allocated between the interested parties in a non-discriminatory way, cf. Arts. 7(2) and 10(2) of the Directive. The analysis in section 5 shows that even the pipeline owner himself is subjected to the equal treatment provisions. Consequently, *all* users of the infrastructure, whether the internal supply branch of the pipeline owner, a related supply company, or a “true” third party shipper, must be able to compete for scarce pipeline capacity on equal terms. There are, however, important modifications, notably concerning access to new infrastructure and access to upstream pipeline networks, see subsections 5.2.3 and 5.3, respectively.

The second possible approach for third parties is to require access despite the fact that the pipeline is fully contracted. This requires that there, *de facto*, are unused pipeline volumes, and the rights offered can be interruptible transportation rights only. It does not seem possible to establish a general legal duty to offer interruptible transportation rights at the present stage of liberalization. However, the pipeline companies are probably obligated to offer interruptible services to all third parties as long as some users, e.g. related companies, are offered such contracts, see section 9 on the provisions on non-discrimination.