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The Making of the European Energy Market: The Interplay of Governance and Government

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ABSTRACT

This case study asks whether delegated, sectoral governance by private actors and arm's-length agencies enhances policy efficacy or does sectoral governance require a shadow of hierarchy cast by government actors to deliver desired policy results? EU energy market liberalisation shows that sectoral governance successfully mobilises regulatory expertise, capacity and legitimacy and delivers workable norms and rules for market transactions in a complex policy environment. However, it also finds that the efficacy of sectoral governance mechanisms is constrained by distributive conflicts between different national jurisdictions and sector interests. If deadlock occurs, the European Commission as governmental principal casts a double shadow of hierarchy over sectoral governance agents: the threat of further legislation and of EU competition law. While both instruments enhance policy efficacy, they cannot substitute for the intrinsic rule-making qualities of sectoral governance: governance and government play complementary roles in the policy process.

Introduction

The creation of a single European energy market in electricity and gas provides an excellent example of how policymaking in technically complex and novel policy areas confronts political decisionmakers with a daunting set of challenges: a lack of expertise, a high degree of uncertainty and the political risk of being held responsible for unanticipated failures.[1] These information problems typically lead legislatures and executives to *delegate* considerable policy development and implementation responsibilities to private actors and to specialised state agencies.[2] These actors are credited with superior expertise and capacity to develop, manage and adjust public policies in a complex and volatile environment, in contrast to the more rigid legislative process of decision-making.[3] Furthermore, it is argued that delegation to arm's-length agencies or private actors can enhance the credibility of government policies, shielding policy commitments from the volatility of political preferences and changes in government.[4] However, the benefits of delegation must be weighed against potential costs; the monitoring of agent behaviour, in order to reduce 'shirking' or 'agency losses', is costly. In a principal-agent framework, the question then becomes one of the extent and type of control, by the principal, that is required to realise the benefits of delegation, and at which point monitoring costs are prohibitive. In this context, the looming 'shadow of hierarchy' can be construed as an expedient instrument of control with limited control costs.

In accordance with the general approach of this special issue, this article conceptualises the delegation relationship in policymaking based on an analytical distinction between political *government* and sectoral or functional *governance*. Sectoral governance denotes policymaking by private and/or public actors in a sectorally delineated area outside the legislative arena of democratic politics. Territorial government, by contrast, is about hierarchical decisionmaking of a legislative, executive or judicial kind pertaining to and directly legitimated by the entire democratic polity (see Héritier and Lehmkuhl, in this issue).

This article applies this framework to the supranational level and conceptualises the European Commission as a governmental actor and principal that delegates policymaking responsibilities to agents of sectoral governance – that is, private sector stakeholders and domestic regulatory agencies – in order to pursue two goals in a technically complex policy area: (a) the liberalisation of national electricity and gas markets and (b) their integration into a single European energy market. The key question is whether this delegation to sectoral governance agents enhances policy efficacy or whether it requires a shadow of governmental hierarchy to deliver the desired policy results. Policy efficacy is defined as the successful production and enactment of rules and standards necessary to achieve the given policy goal; it does not include performance in the sense of policy outcomes.

To conceptualise the Commission as a governmental actor and principal may seem counterintuitive for EU scholars who are mostly interested in vertical delegation from the national to the supranational level. In principal-agent accounts of EU decisionmaking, member states are usually considered to be political principals which delegate powers to the European Commission or the European Court of Justice as their international agents (Pollack 2003). But viewing the Commission as a principal can be very productive if the broader institutional environment is given sufficient consideration. This concerns in particular the constraints and opportunities that arise for the Commission from the delegated and shared nature of its governmental authority, as the agent of member state governments. Adequately set in this broader context, this new perspective yields an interesting insight: not only the need for expertise but also the lack of *vertical, governmental* delegation to the EU level spurs *horizontal delegation to sectoral governance actors*.

The first section of this article provides a survey of the trajectory and institutional constellation of the making of EU energy policy in the context of recent market reforms. The second section analyses the emergence and operation of sectoral governance mechanisms in response to incomplete vertical delegation and policy complexity. The third section evaluates the efficacy of sectoral governance, while the fourth discusses to what extent the shadow of hierarchy enhances policy efficacy. The fifth and concluding section examines the dynamic interplay of governance and government, highlighting their complementary relationship.

European energy policy and EU market reform: the long road to liberalisation

Until recently, the European electricity and gas supply industries were typically organised as regional or national monopolies in a closed national context (McGowan 1996; Midttun 1997). Vertical delegation of policymaking powers from the member states to the supranational level has traditionally been very limited, and several attempts to establish a supranational energy policy failed (Matlary 1997). The key reason is that member states have been keen to retain tight control over a sector that they consider to be of strategic geopolitical and economic importance, and an essential public service (Padgett 1992).

This picture changed only in the early 1990s when two developments intersected. Firstly, global privatisation and liberalisation seized infrastructures and network industries, spilling over from technologically advanced sectors such as telecommunications into public utilities by the mid-1990s (e.g. Schneider, Fink and Tenbücken 2005). In Europe, Britain was the first country to adopt comprehensive electricity market reforms in 1990, followed by the Nordic countries. Secondly, the energy sector in Europe was incrementally incorporated into the single market agenda by an activist European Commission (Jabko 2006). However, the emergence of EU-level market reform policies was slow, protracted and uncertain (Hancher 1997; Schmidt 1998; Eising and Jabko 2001; Jabko 2006). Technological change and global competition were not significant drivers of market reform in electricity and gas (Bartle 2005: 96). Moreover, the advocates of liberalisation were opposed by a powerful alliance of incumbent utilities and national governments.

Given the pronounced political resistance of some member states, the Commission found that it could not press ahead based on its direct competition law powers, as it had done in telecommunications by attacking, under Article 86(3), 'special or exclusive rights' granted to member state energy monopolies. Rather, it opted for the negotiated decision route of Council legislation (Art. 251), under the internal market rationale as set out in Article 95 (Schmidt 1998).

After a first set of limited legislation on price transparency and energy transits in the early 1990s, significant progress was achieved only with the First Electricity Directive in 1996, followed by the First Gas Directive in 1998.[5] The deadlock in Council negotiations was lifted by a Franco-German agreement that accepted the principle of market opening and the need for common rules in a European market. This was an unlikely outcome: the pro-liberalisation coalition of industry consumers and potential competitors remained weaker than the incumbent utilities, and most governments remained sceptical.

The puzzle of electricity liberalisation has been resolved in different ways in the literature. One reading identifies an intergovernmental agreement in the shadow of community law: member states preferred negotiated (and contained) liberalisation to uncontrolled liberalisation under potential Court rulings that the Commission threatened to trigger (Schmidt 1998; also Levi-Faur 1999). A constructivist reading puts emphasis on preference changes of national actors under the procedural norms of extensive and consensus-oriented Council negotiations (Eising 2002). A third interpretation highlights the strategic use of the market norm by a skilful Commission that managed to pull the energy sector into the single market mould and to reframe energy as a market commodity (Jabko 2006).

Unfinished business: the EU regulatory dilemma and sectoral governance

The three accounts of liberalisation converge in viewing the two directives as breakthrough in energy policy, ushering in a new era of EU market governance. Yet this perception underestimates the degree to which the legislation marked only the beginning of an uncertain market-creation *process*, with the key goals of market opening and integration yet to be achieved. Firstly, the legislation prescribed only incremental and moderate market opening, by setting minimum thresholds that allowed different degrees of liberalisation to coexist. Furthermore, it left member states a large margin of discretion regarding crucial regulatory issues such as the degree of required unbundling of monopoly activities in vertically integrated undertakings. The result was a European patchwork of asymmetric national rules (Hancher 1998). Secondly, the directives failed to establish concrete rules for cross-border trade between individual markets, such as the transmission management of cross-border flows.

The Commission as governmental policymaker faced a regulatory dilemma not uncommon in the EU polity: 'On the one hand, increased uniformity is certainly needed; on the other hand, greater centralization is politically inconceivable' (Dehousse 1997: 259). In this context of 'incomplete vertical delegation', the Commission began experimenting with new modes of sectoral governance.

There are two distinct incentives for the Commission to delegate powers to sectoral governance actors. *Firstly*, this delegation is *politically expedient*, as a strategy to work around the lack of supranational governmental powers, by establishing network mechanisms that can co-ordinate member state policies (Eberlein and Grande 2005). The strategy involves building coalitions with private stakeholders and sub-state regulatory agencies. These transnational coalitions are designed to further domestic reforms *without having to resort to the level of political decisionmaking* by governments and legislators. Regulatory capacity and authority available in sub-state, domestic arenas are thus leveraged to compensate for incomplete vertical delegation (Eberlein and Newman 2008).

It is important to understand the strategic situation of the Commission in 1998, and its double role in a principal-agent perspective. As an agent of member state governments and the Parliament, it had only a very weak legislative mandate, the 1996 and 1998 directives. Furthermore, the Commission could not hope to draw much more on the shadow of 'judicial integration', i.e. the support of the European Court of Justice (ECJ) in infringement procedures against energy import and export monopolies of member states.

The ECJ had modified its pro-competition position to give much greater weight to public service obligations in energy supply (Hancher 1998).[6] Worse still, the Court had explicitly rebuked the Commission for its strategy of instrumentalising infringement procedures to press for far-reaching policy reforms that cut deep into the social fabric of member states. These reforms, the Court argued, required political deliberation and decision and should not be made by itself (Héritier and Moral Soriano 2002: 379; Hancher 1998: 51).

Hence, the Commission was keen to build coalitions with and delegate policymaking responsibilities to public and private actors that could provide capacity and legitimacy outside the difficult legislative and judicial arena.

The *second incentive* militating for delegation was that the Commission depended on the *expertise* of sectoral actors. Electricity (and to a lesser extent gas) liberalisation was a very new policy area with little experience to draw on. The technical and regulatory integration of national electricity systems in a common market was entirely virgin territory. It was thus practically inconceivable to advance market-making policies without the participation of industry actors. The Commission devised an experimental mechanism that reflected its high degree of dependence on expertise. It involved not simply consultation but delegation to a new body that was supposed to develop new policy.

The principal avenues for sectoral governance are the Florence Forum for Electricity and the Madrid Forum for Gas. They were set up by the Commission in 1998 and 1999 respectively.[7] These informal Fora are chaired by the Commission and the member state holding the EU presidency. They meet biannually and bring together national regulators and ministries with important market actors and stakeholders, in particular network operators as well as industry consumers and traders. In between plenary meetings, smaller working groups tackle the specifics of technical and regulatory detail. The debates at Forum meetings are typically organised around regulatory propositions put forward by the energy regulators (and at times the Commission) to which the regulatory addressees, the network operators, respond. Other market players and stakeholders then participate in an open debate.

The key idea was to provide a platform for informal discussion and co-operation, in order to identify appropriate solutions to the regulatory challenges. The Forum would develop, in a deliberative fashion, legally non-binding, 'best-practice' rules and procedures for sector regulation, based on professional expertise, and outside the political arena.[8]

The practical challenge for the Forum in both electricity and gas was (a) to ensure that member states would put into place an effective regulatory framework for the introduction of competition and (b) to develop a system of cross-border trade, the linchpin of an integrated energy market. Two specific issues needed to be addressed: the tariffication of cross-border electricity, or gas flows; and the allocation and management of scarce interconnection capacity between national transmission systems.[9] In the following section, I will limit myself empirically to the Florence Electricity Forum and draw heavily on Eberlein (2005).

Policy efficacy of sectoral governance: production versus distribution

How effective is the Forum mechanism, which relies on voluntary collaboration as a tool of sectoral governance? And to what extent does its success depend on the shadow of hierarchy?

On the one hand, the Forum succeeded in *producing* workable regulatory rules, and in *building* EU-level sector institutions necessary for the organisation of an integrated energy market. On the other hand, the Forum was stalled several times by distributive conflicts when it came to *enacting* consensual agreements on 'best-practice' solutions. Hence, the benefits of delegation were high in terms of the sectoral expertise provided by the Forum. However, it performed less well as a politically expedient strategy designed to compensate for the Commission's lack of hierarchical powers vis-à-vis diverging national and stakeholder interests. While delegation to the Forum did go some way towards depoliticising policy debate and shielding expert-driven problem-solving from political preferences, it failed to resolve the conflicts prevalent in the sector. Here, the shadow of hierarchy seemed necessary to break deadlock.

In assessing the Forum's performance, it is useful to distinguish between three different functions set by the Commission. Firstly, the Forum's mission was to generate and assess relevant information and then to elaborate regulatory proposals based on a range of technically feasible options. As already pointed out, there was little experience available, and the Forum's first step was to canvass international expertise from non-EU countries (Norway, New Zealand, the USA).

More importantly, the Forum then moved to *narrow down a set of technical options to specific regulatory principles and guidelines* that both reflected the pro-competition agenda-setting by the Commission and put transmission system operators, and by extension vertically integrated utilities, under pressure to adapt.

The key progress in the field of cross-border transmission pricing and congestion management was to establish a non-transaction based approach to network costs as 'best practice', as opposed to determining network costs on the basis of individual transactions, a position initially defended by the transmission system operators. On this basis, the Forum developed a postage-stamp tariff, granting network users access to the entire European grid at a flat rate.

The second achievement is the *establishment of EU-level institutions that helped to structure the new EU energy policy field*. The Forum organised the regulatory dialogue between regulators and regulatees as well as other market players in a sector that lacked EU-wide bodies. The Commission encouraged the creation of transnational associations on both sides of the regulatory table that were then to operate as single voices on the EU level. The European Association of Transmission System Operators (ETSO) was put into place in July 1999. It was designed not only to facilitate communication between national entities but also to enhance their independence in the national context, in the spirit of unbundling, i.e. of the separation of commercial from (regulated) natural monopoly activities. As such, it contributed to domestic regulatory reform.

The Forum also played a crucial role in federating national energy regulators. In March 2000, the Council of European Energy Regulators (CEER) was constituted based on a memorandum of understanding. It currently brings together the energy regulators from all EU member countries (except Luxembourg) plus Norway and Iceland. The main purpose is to facilitate the creation of an internal energy market by fostering co-operation both between national regulators and with EU institutions. Operating out of a small office in Brussels and organised around issue-specific working groups, its mission is to help develop an EU energy regulatory framework. The Commission encouraged this regulatory institution-building by mandating CEER, a body without formal regulatory powers, to develop a system for cross-border trade within the Forum context.

The third and crucial task of the Forum is to *build consensus on regulatory solutions and deliver agreements that command sufficient support* in formal bodies that need to adopt the non-binding Forum deliberations. Here, the Forum process had to confront *two types of distributive conflict*. The first and major conflict is *between networks operators (TSOs) and network users*, including industry and household consumers who pay for network charges as an important component of wholesale and retail prices. In good part, this is the conflict between vertically integrated market incumbents who own the major transmission networks and new entrants that depend on network access.

The second, related conflict is more clearly *between different member states*. Transit countries with a high volume of import and export – such as Germany, centrally located in the European grid system – can expect to host the majority of electricity flows on their networks. Hence, they are concerned about cost recovery and about the viability of their domestic generators if cross-border flows are facilitated and make cheaper generation from abroad more easily available. Trading countries, by contrast, are in the opposite position. They wish to import or export electricity as inexpensively as possible across grid borders. Finally, agreement may be hampered by the general tension between national regulatory discretion and the Forum agenda of supranational rule-making.

These conflicts proved to be stumbling blocks in the laborious road to a cross-border tariffication system compatible with the internal market concept. After a considerable period of impasse, in 2002 the eighth meeting marked a breakthrough, with the introduction of a provisional cross-border tariffication system and a basic agreement on a long-term system. In 2003, finally, at the tenth meeting of the Florence Forum, an agreement was reached to abolish all import or export charges, as part of a tariffication scheme that compensated network operators for hosted flows without penalising cross-border trade. By that time, however, the Commission had already secured approval for fresh Council legislation, including a Regulation on Cross-Border Trade in Electricity that addressed exactly the same issues discussed at the Forum: had sectoral governance proven ineffectual and been replaced by governmental procedures?

The shadow of governmental hierarchy I: legislative initiative

While fostering novel sectoral governance mechanisms and building transnational institutions and coalitions, the Commission never abandoned the legislative and executive route to advancing market reform. And both avenues were employed to induce Forum actors to engage in effective self-regulation when deliberations were deadlocked.

Incidentally, at the height of the crisis and impasse in the Forum process, in March 2001, the Commission put forward new legislative proposals including the Regulation on Cross-Border Trade in Electricity.[10] At the next meeting the Commission urged Forum participants to reach a rapid agreement on a transitory solution for cross-border tariffication – the Forum, it was argued, needed to refute accusations that 'it was just a talking shop that never respected deadlines'. But how *credible* was the threat of legislation?

To be sure, the Commission can only initiate, not pass, legislation. The success of initiatives depends on support coalitions as well as the macro-political climate. The Commission could make the case that progress towards an internal energy market was insufficient and hence warranted more stringent legislation.[11] Strategically, its position in the legislative arena had improved: while national implementation was very uneven and cross-border market integration largely absent, some member states had actually opted to open their markets more quickly than required. This encouraged the Commission to bring forward these so-called acceleration directives. It could count on member states that had liberalised more fully to express concerns that laggards would use the asymmetric playing field to their advantage – which was clearly the case for French electricity monopolist EDF, which went on an acquisition spree abroad while its domestic market remained protected. Secondly, the 2000 Lisbon Council had elevated energy market liberalisation to one of the key projects in the drive to make the EU more competitive. This political context gave a certain momentum to the Commission initiative that successfully resulted in new legislation – and successfully incentivised Forum actors to arrive at an agreement.

The 2003 Directives for Electricity and Gas[12] made important progress towards establishing a more robust EU framework of rules designed to open and integrate national markets. They set a firm date for full market opening (July 2004 for non-household consumers, July 2007 for all consumers); put into place stricter rules for national network access regimes and the unbundling of vertically integrated utilities; and made it mandatory for member states to have regulatory authorities with minimum set of powers and responsibilities to regulate national markets (Cameron 2005). Yet, the common rules still allow considerable scope for diversity in implementation by member states. Politically, it was not an option to require full harmonisation, or to delegate formal regulatory powers to the Commission, let alone to establish an independent EU energy regulator.

Instead, the EU framework relies very much on national regulatory authorities to enforce existing EU-level rules, to develop new ones and to co-ordinate national implementation. The legislation requires regulators to co-operate with each other and with the Commission in order to develop a level playing field.[13] In November 2003, the Commission created the European Regulators Group for Electricity and Gas, to give informal co-operation between national regulators a more formal status. The purpose of this advisory group is 'to advise and assist the Commission in consolidating the internal energy market'. In particular, the group's objective is to facilitate 'consultation, co-ordination, and co-operation of national regulatory authorities, contributing to a consistent application' of Community legislation.[14]

The shadow of governmental hierarchy II: executive competition policy

The executive competition law powers of the Commission under the treaty are a potentially powerful tool to induce regulatees to collaborate with regulators and comply with pro-competition policies. The Directorate General for Competition was a regular participant in the two Forum processes and had the opportunity to present its positions. It made clear that, while the negotiated Council legislation-*cum*-Forum process route had become the main avenue for EU liberalisation, this orientation did not exclude the 'adoption of directives and decisions on the basis of Art. 86(3) ECT by the Commission with the aim to push the transformation of the industries forward or to resolve quickly specific issues which come up in the process' (Albers 2001: 2–3).

Forum actors were thus reminded that anti-competitive obstruction or intransigence could be addressed under competition law – the application of which may make the party concerned worse off than compromise reached in the Forum process. By changing the 'default position' of regulatees (from non-agreement or status quo to measures or remedies defined by the Commission and/or the Court), the shadow of competition law (Schmidt 1998) provided an incentive to pursue 'voluntary' collaboration.

The question again is, however, how *credible* the threat actually is. In contrast to EU legislation, the Commission can act independently of Council and Parliament. However, it cannot ignore the general political context, and it relies on the support of the ECJ when competition cases need to be adjudicated. As discussed earlier, the Court could not be counted on to do the political bidding of the Commission in pushing electricity liberalisation by judicial fiat. Yet, one could argue that, to the extent that legislated, democratically legitimated liberalisation progressed (with the passage of the 2003 directives), the enforcement of competition law would enjoy a stronger footing as well, which might be reflected in future ECJ rulings.

The Commission has at its disposal three main competition instruments that can be fully applied to the energy sector: antitrust (anti-competitive agreements (Art. 81), abuse of dominant position (Art. 82), monopoly rights (Art. 86)); merger control (Regulation no. 139/2004); and state aid control (Arts. 87 and 88). Antitrust and merger cases are of particular relevance for the development of the internal energy market.

One of the Commission's priorities has been to control the conduct of network operators who typically enjoy a 'dominant position' as they control access to the natural-monopoly grid in their geographic area. Concerns include excessive (not cost-reflective) or discriminatory transmission pricing, or long-term reservation contracts, especially on interconnectors between national networks.

A good example of how competition policy attempts to contribute to the improvement of network access conditions is the Marathon case. Marathon is a US oil and gas producer whose European subsidiaries were allegedly refused network access by five major gas importers and network operators: Thyssengas, Gasunie, BEB, GDF and Ruhrgas. The Commission agreed to close the cases after the companies offered substantial concessions with regard to the access regime, congestion management and the balancing system (Albers 2005: 48).[15] An important case regarding the anti-competitive effects of exclusive long-term reservation contracts was Spanish Gas Natural/Endesa. The Commission raised concerns about an agreement that required leading electricity generator Endesa to purchase its entire future gas demand from former monopolist Gas Natural for more than twenty years, in effect blocking potential new entrants to the Spanish gas market. The companies agreed to modify their contract in terms of volume and duration after receiving a warning letter from the Commission (Albers 2001: 6).[16] In a similar vein, the Commission achieved substantial revisions of exclusionary capacity agreements on key electricity interconnectors, for example on the Skagerrak cable between Norway, West Denmark and Germany or on the UK–French submarine interconnector.[17]

These and other cases can be interpreted as signal to all network operators that abuses would not be tolerated. This should in turn induce the network operators' association ETSO to negotiate voluntary agreements either in the Forum setting or directly with European regulators. However, it is difficult to see how these individual cases, mostly settled out of court (hence no case law), amount to a coherent and *credible* 'governmental framework' of rules that is *systematically* being taken into account by regulatory addressees. Energy market reviews continue to stress that network access and vertical foreclosure, due to insufficient unbundling of vertically integrated companies, remain major obstacles to new entrants and competition in general.[18]

Furthermore, the Commission has used merger control as a regulatory lever to promote market reforms and regulatory changes, by tying merger approvals to specific regulatory remedies or requirements, often extracting concessions from regulatees in areas well beyond the case under investigation. A good example is the merger in 2000 between the leading German energy companies VEBA and VIAG,[19] to form the new e.on Group. As part of an agreement between the Commission and the companies that included divestiture elements, 'the enterprises committed themselves also to less conventional remedies and undertook, for instance, to drop the t-component surcharge for certain power transmissions within Germany which adversely affected competition from traders and smaller generators' (Albers 2001: 9). In essence, the Commission instrumentalised the merger case to attack the German (domestic and cross-border) network tariffication system as developed by industry associations under the negotiated third party access system (since replaced by regulated access). Interestingly, the companies, as a concession to enable them to go forward with the merger, 'accepted the agreement on cross-border tariffication that had been worked out in the Florence Regulatory Forum' (Cameron 2002: 326) but that was at odds with the association agreement that governed network access in Germany.

In a similar case, the EDF/EnBW merger,[20] French electricity giant EDF had to release virtual domestic generation capacity, by way of auctions, as well as its cross-holdings in the French producer CNR in exchange for the approval of the takeover of German utility EnBW.

However, EU merger control has failed to slow the massive and rapid restructuring and consolidation of European energy markets, in anticipation of full market opening by July 2007. Following a wave of domestic and cross-border mergers and acquisitions, the degree of market concentration has reached new, disconcerting levels (Codognet et al. 2003; Jamasb and Pollitt 2005; Green 2006). This significantly increases the potential for market abuse and may put the entire concept of market competition in jeopardy. Besides, national governments have intervened frequently to bolster their national champions in the European market place. Prominent examples are the merger between German electricity and gas giants e.on and Ruhrgas in 2002, cleared by the German government against the express opinion of the German competition authority and to the dismay of many European regulators;[21] or the very recently approved merger between French GDF and Suez, engineered by the French government to thwart a feared hostile bid for Suez by Italian competitor Enel.[22]

Against this background of disappointing market developments, the Commission has moved more aggressively to police and attack anti-competitive conduct. In June 2005, it launched a formal energy sector competition inquiry (under Art. 17 of Regulation 1/2003). A sector inquiry entails the systematic collection of a wide range of precise company data, an empirical base that is supposed to help the Commission in future to investigate and intervene before a merger occurs or a complaint is filed (Lévêque 2006: 32). The inquiry report, released in January 2007, revealed serious malfunctions in EU energy markets, in particular high levels of market concentration and the lack of cross-border integration and competition (European Commission 2007b).[23] Based on preliminary findings in 2006, individual investigations had, for example, resulted in dawn raids at utility companies in six member states.[24] The Commission is currently pursuing follow-up actions in individual cases under the competition rules. It will be interesting to see if this pro-active approach will prevail over political opposition by member states and their national energy champions.

Interface and interplay of governance and government: bringing hierarchy in?

There is considerable evidence in the energy sector to support the argument that the efficacy of sectoral governance depends on the shadow of hierarchy whenever policymaking is confronted with distributive conflicts.

Sectoral governance has important merits: it successfully mobilised regulatory expertise and capacity, organised a European dialogue between regulators and regulatees, and produced workable regulatory guidelines and rules that are essential to govern transactions in an evolving single energy market. Sectoral governance is, however, less successful in enacting those regulatory solutions in the face of distributive conflict in a politicised environment. This finding conforms to the argument made in the regulatory literature that political principals are more likely to delegate to regulatory agents under conditions of high technical complexity and low issue salience (Eisner, Worsham and Rinquist 2000: 29).

Under these conditions, the shadow of hierarchy has an important role to play, but it is more complex and subtle than a simple logic of substitution would suggest. In the case of cross-border tariffication, for example, the Regulation on Cross-Border Trade in Electricity that the

Commission introduced as part of the 2003 legislative package did not invalidate but rather *codified* the work accomplished in the Forum process. To be sure, the regulation was introduced in the first place because the Forum process was considered to be too slow and prone to deadlock. But in substantive terms the regulation practically adopted the results achieved in the Forum process. In a similar fashion, the establishment of the European Regulators Group for Electricity and GAS (ERGEG) *formalises* the informal role played by the CEER in the Forum process. Certainly, the formalisation of regulatory networking and input was to address the drawbacks of the informal and more inclusive Forum process that appeared cumbersome and seemed to lack regulatory teeth. At the same time, CEER continues to coexist and largely overlap with ERGEG. Essentially, the two bodies represent two faces of one network: CEER prepares material for ERGEG and continues to facilitate informal co-operation, while ERGEG provides formal advice to the Commission. In reality, therefore, much of CEER's work on regulatory harmonisation continues under a different label.[25]

Thus, governmental mechanisms play an important role in *lending authority to policy solutions developed under sectoral governance*.

From governance to government?

In a process perspective, there is also some evidence for a pattern described by the editors of this issue as 'sectoral governance prepares the way for government'. The recent trajectory of EU energy liberalisation and policymaking might be interpreted as increasing 'governmentalisation'.

As the policy sector begins to mature, issues and preferences are better understood. With policy complexity reduced, regulatory decisions can be more easily translated into distributive consequences. Hence, the benefits of delegation to sectoral governance in terms of expertise might decrease over time. The Forum mechanism has done most its job of producing regulatory best-practice solutions in the emerging EU energy policy field. A reading from the process perspective would conclude that, now that a more solid EU policy framework has been established, it is time to codify and enforce 'best practice' through legislation and executive competition policy.

Is this reading corroborated by empirical evidence? One might adduce the more aggressive use of competition law under the energy sector inquiry, as discussed above, as an indicator. However, this response to disappointing results of market opening and integration reflects dissatisfaction with the shortcomings of sectoral, voluntary governance, rather than simply the codification of sectoral governance results.

More importantly with regard to 'governmentalisation', there is considerable momentum for a stronger EU energy policy and a more robust supranational legislative and regulatory framework. The confluence of several factors has pushed energy policy to the top of the EU policy agenda:[26] oil price hikes; fresh concerns about import dependence and the security of European energy supply after the Russian–Ukrainian gas dispute; a series of blackouts and interconnection failures in 2005 and 2006; and, perhaps most important of all, the enormous political salience of climate change. These elements have converged to provide political support for an integrated climate and energy policy under the label of an 'Energy Policy for Europe', as first outlined and presented by the Commission in January 2007 (European Commission 2007a).

This new energy policy approach clearly goes beyond – and, in important ways, counterbalances – the earlier and narrow liberalisation agenda, by putting much more emphasis on environmental concerns and security of supply. However, somewhat ironically, this new stimulus also provides political support for a stronger supranational, 'governmental' role in the liberalisation process. The March 2007 European Council endorsed key elements of the Commission proposal, and adopted a comprehensive energy Action Plan for the period 2007–9 (Council of the European Union 2007). This includes regulatory measures to further the internal market for electricity and gas: the Council, for example, agreed on the need for more vigorous unbundling of supply and production activities from network operations (but did not endorse full ownership unbundling); for further harmonisation of the powers of national regulators; and for new Community mechanisms to develop and manage cross-border trade and network operations. There is agreement that the current structure of regulatory co-operation and enforcement through ERGEG needs to be strengthened in the context of the next legislative package on the internal market, expected from the Commission in autumn 2007. While member states are unlikely to agree to the creation of an EU regulatory body,[27] the shadow of more robust 'governmental' structures and powers looms over the current arrangements of sectoral governance actors in the sector.

While current external conditions and the political macro-context are exceptionally favourable for the emergence of a supranational energy policy, further governmentalisation is, however, unlikely to take the form of centralisation of legislative and regulatory powers at the EU level. Rather, the Commission will have to work with more formalised *networks of national regulatory authorities* to advance the single market goals, a constellation that increasingly characterises EU regulation in a host of economic sectors (see Coen and Thatcher, in this issue; Eberlein and Newman 2008). Empirically, therefore, the major shift is not one from governance to government, as defined here, but rather a shift from private to public, sub-state actors *within* the realm of sectoral, functional governance. In the energy case, for example, the Forum processes – while they continue as platforms for industry and stakeholder input – have to cede regulatory ground to the Regulators Group. This indicates a trend towards more formal and more trans*governmental* co-operation, but not the decline of sectoral governance.

The interplay of governance and government

More generally, and in conclusion, it is important to stress that a perspective that sees sectoral governance as being pushed back or supplanted, over time, by government, runs a double risk: (a) of overrating the *capacity and credibility of 'substitute' government mechanisms*, and (b) of underestimating the *distinct and permanent contribution of sectoral governance* to policy efficacy. A brief review of the efficacy limits of competition law and legislation, the double shadow of hierarchy in the energy case, will help illustrate this point.

Competition law, based as it is on *ex post* and case-by-case procedures, is a negative control instrument, not a substitute for the positive development of fine-tuned regulatory rules as they emerge from the Forum process.[28] To be sure, it can work as a check on and as an incentive for regulatory groundwork. But it cannot take its place and produce ground-level regulatory solutions. Therefore, case-based enforcement of competition law rules is essentially limited to a complementary role in market-building; it cannot provide 'the momentum for change in the sense of a "deepening of the IEM" (Cameron 2002: 344).

What about legislation that can set general rules, beyond specific cases? Short of creating an omniscient and all-powerful EU energy regulator with executive powers, any further legislation, even if more stringent and detailed, will still need to be interpreted and implemented on the national level. Legislation, by its very nature, cannot address all current and future regulatory contingencies and needs in a technically complex policy area, and across twenty-seven heterogeneous national jurisdictions. It will leave regulatory gaps. Hence, the need for an iterative *process of rule development and co-ordination* – something only governance can provide – will persist.

The upshot of this is that *hierarchy or government is not a viable substitute for rule development by governance mechanisms*. If sectoral governance fails to produce or implement the specific rules required for policy development in a sector, a government actor (such as the Commission) is unable to simply take over the regulatory functions itself, even if it is vested with full legal powers.

Government actors typically lack the specific knowledge about local conditions and the capacity to process information to flexibly adjust rules in a volatile environment. Governance mechanisms provide opportunities for information sharing, mutual learning processes and performance-enhancing benchmarking processes that are crucial for developing sound policies. Moreover, the inclusion of sectoral governance actors is a source of legitimacy for policy results.

For example, industry commitment and collaboration in the building of the single energy market are crucial assets, if not indispensable requirements, for the success of a technically complex project that cannot rely exclusively on hierarchical fiat, even at a more mature stage of policy development.

In short, this case study of EU energy market liberalisation demonstrates that governance and government have complementary contributions to make to policy efficacy.

NOTES

1. I would like to thank the anonymous reviewers and the two guest editors as well as Rainer Eising and Susanne K. Schmidt for very helpful comments on earlier versions of this article.
2. On delegation, see Epstein and O'Halloran 1999; Bendor, Glazer and Hammond 2001; Huber and Shipan 2002.
3. For the EU, see Héritier 2003; Héritier and Eckert, in this issue.
4. For the EU, for example, see Majone 2001.
5. Directive 96/92/EC of the European Parliament and of the Council of 19 December 1996 concerning common rules for the internal market in electricity, Official Journal, L027, 30.01.1997; 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, Official Journal L204, 21.07.1998.
6. This was evidenced in five landmark rulings issued in 1994 (Almelo) and 1997 (Commission vs Netherlands, vs Italy, vs France, vs Spain) respectively (Almelo (Case C-393/92), Commission vs Netherlands (Case C-157/94), vs Italy (Case C-158/94), vs France (C-159/94), vs Spain (C-160/94)).
7. The official titles are 'European Electricity Regulation Forum' and 'European Gas Regulatory Forum', Florence and Madrid being the two cities where the two Fora began to meet. For details on the Forum processes, see Eberlein 2005. For a more detailed discussion of transnational regulatory networks in the energy case, see Eberlein 2003. The minutes and materials of Florence and Madrid meetings are available on the website of the European Commission, Directorate General for Energy and Transport (ec.europa.eu/energy/electricity/florence/index_en.htm; ec.europa.eu/energy/gas/madrid/index_en.htm)
8. See the minutes of the first meeting of the Florence Forum in February 1998 at: ec.europa.eu/energy/electricity/florence/doc/florence_1–7/fl_concl_1_en.pdf.
9. For an excellent discussion of the technical and regulatory issues at stake, see Hancher 2000.
10. On 13 March 2001, the Commission adopted a proposal for a directive amending Directives 96/92/EC and 98/30/EC concerning common rules for the internal markets in electricity and natural gas and a proposal for a regulation on conditions of access to the network for cross-border exchanges in electricity. After a first reading in the European Parliament and further discussion in the Council, the Commission presented amended proposals for the directive and the regulation on 7 June 2002 (all available at www.europa.eu.int/comm/energy/en/internal-market/int-market.html).
11. See in particular 'First Benchmarking Report on the Implementation of the Internal Electricity and Gas Market', Commission Staff Working Paper, SEC (2001) 1957, Brussels, 03.12.2001 (ec.europa.eu/energy/electricity/benchmarking/doc/1/report-amended_en.pdf).

12. Directive 2003/54/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in electricity and repealing Directive 96/92/EC, OJ L176/37, 15.7.2003; Directive 2003/55/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in natural gas and repealing Directive 98/30/EC, OJ L176/57, 15.7.2003; Regulation (EC) No 1228/2003 of the European Parliament and of the Council of 26 June 2003 on conditions for access to the network for cross-border exchanges in electricity, OJ L176/1, 15.7.2003.
13. Article 23, Directive 2003/54/EC (electricity) and Article 25, Directive 2003/55/EC (gas).
14. Commission Decision of 11 November 2003 on establishing the European Regulators Group for Electricity and Gas (2003/7 96/EC).
15. For details, see EC Competition Policy Newsletter 2/2004: 'Access to Gas Pipelines: Lessons Learnt from the Marathon Case' (ec.europa.eu/comm/competition/publications/cpn/).
16. For details, see EC Competition Policy Newsletter 2/2000: 'Long-Term Supply Agreements in the Context of Gas Market Liberalization: Commission Closes Investigation of Gas Natural' (ec.europa.eu/comm/competition/publications/cpn/).
17. For details, see Cameron 2002: 321–2.
18. The annual Commission reports on the electricity and gas markets actually underscore this point (for example, ec.europa.eu/energy/electricity/report_2005/index_en.htm).
19. Commission Decision, Case M 1673 (europa.eu.int/comm/competition/megers/cases).
20. Commission Decision, Case M 1853 (europa.eu.int/comm/competition/megers/cases).
21. See the complaint letter regarding this case written by the British energy regulator: Callum McCarthy, Open Letter to the European Commission on the e.on/Ruhrgas deal, 18 February 2003, Office of Gas and Electricity Markets, Press Release, R/14, 2003.
22. 'EU Approves Merger of Gaz de France and Suez, with Conditions', *International Herald Tribune Business*, 14 November 2006 (www.iht.com/articles/2006/11/14/business/web.1114suez.php).
23. For detailed information on the energy sector inquiry, see ec.europa.eu/comm/competition/sectors/energy/inquiry/index.html#final.
24. Philip Lowe (Director General, Directorate General for Competition), 'The Liberalisation of EU Energy Markets', The Beesley Lectures, Institute of Economic Affairs, The Royal Society, London, 9 November 2006 (ec.europa.eu/comm/competition/speeches/text/sp2006_017_en.pdf).
25. See ERGEG Work Programme 2006, p. 3, n. 1 (available at www.ergeg.org/portal/page/portal/ERGEG_HOME/ERGEG). Certainly, the CEER remains a distinct body with a slightly broader membership base (not restricted to EU member states). And it does play a larger role, for example, in international networking and in providing training courses for regulators through the Florence School of Regulation. Yet it is quite clear that, in terms of activities and leadership in the EU context, there is broad overlap between ERGEG and CEER. It is indicative that ERGEG is housed at the CEER Secretariat in Brussels.
26. These developments go back to the British presidency (2005): the Hampton Court European Summit (27 October 2005) gave support to the idea of closer collaboration in energy policy. In March 2006, the Commission issued a green paper on 'A European Strategy for Sustainable, Competitive, and Secure Energy' (ec.europa.eu/energy/green-paper-energy/index_en.htm). It contained, *inter alia*, proposals to further enhance the governmental role of EU energy policy, most notably by creating an EU energy regulator.
27. Member states have already rejected, at the 2006 spring summit, the idea of a single European energy regulator, advanced by the Commission in the 2006 green paper (cited in n. 26).
28. There are additional limits to the effectiveness of competition policy specific to the energy sector. Abuse of dominant position is very difficult to demonstrate, and adequate concepts to evaluate market power are not in place yet. Nor does the Commission have a market surveillance committee to assist in market assessments (unlike the US federal energy regulator, for example). EU merger reviews are hampered by the two-thirds rule: national mergers that generate more than two-thirds of their revenues in a single member state do not fall under the Commission's jurisdiction. But given the highly concentrated structure of the industry, national mergers are likely to create important anti-competitive effects with implications for cross-border trade (Lévêque 2006). A case in point is the German e.on/Ruhrgas merger (see n. 21).

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