

# **SINGLE VOICE OR CACOPHONY? COMPETING NATIONAL PREFERENCES IN EUROPEAN ENERGY POLICY**

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## **ABSTRACT**

The growing importance of energy needs and concerns is on the agenda of domestic and foreign policy makers alike in today's energy dependent world. The European Union, representing one of the largest economies and energy consumers in the world, has come to a crossroads in defining its energy policy, in light of the current and future energy dependence of its member states.

This thesis captures and conceptualizes the problematic of formulating a coherent energy policy on the EU institutions level, as viewed from the member states' perspectives. It will seek to explore the interplay between various factors on multiple levels, which either drive the integration in energy policy or bring it closer to a deadlock. This can be done by making use of EU integration theories that have successfully examined the integration process across time and space in various policy areas.

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# INTRODUCTION

The growing importance of energy needs and concerns is on the agenda of domestic and foreign policy makers alike in today's energy dependent world. The European Union, representing one of the largest economies and energy consumers in the world, has come to a crossroads in defining its energy policy, in light of the current and future energy dependence of its member states. Europe is becoming increasingly dependent on imported hydrocarbons. With no significant changes, the EU's energy import dependence will grow from 50% of total EU energy consumption today to 65% in 2030, while reliance on imports of gas is expected to skyrocket from 57% to 84% by 2030, of oil from 82% to 93%.<sup>1</sup> This has far-reaching implications both for the EU and its member states. Shaping and (re)defining energy policy, which is traditionally seen as a highly nationalized and politicized issue, will be a big test for Europe and might become the next great triumph or failure.

This thesis captures and conceptualizes the problematic of formulating a coherent energy policy on the EU institutions level, as viewed from the member states' perspectives. It will seek to explore the interplay between various factors on multiple levels, which either drive the integration in energy policy or bring it closer to a deadlock. This can be done by making use of EU integration theories that have successfully examined the integration process across time and space in various policy areas.

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<sup>1</sup> European Commission, *Communication from the Commission to the European Council and the European Parliament on An Energy Policy for Europe*, Com(2007)1 final, Brussels, January 10, 2007, [http://eur-lex.europa.eu/LexUriServ/site/en/com/2007/com2007\\_0001en01.pdf](http://eur-lex.europa.eu/LexUriServ/site/en/com/2007/com2007_0001en01.pdf)

## ***The Debate***

Traditionally, the EU's involvement in energy policy has been indirect through market integration and environmental policies.<sup>2</sup> However, as Gawdat Bahgat mentions, the situation has changed since the oil shocks of the 70s with the European Community taking steps to increase its energy efficiency.<sup>3</sup> Institutional arrangements, such as the White and Green Papers, the Gas and Electricity Directives and the Energy Charter Treaty, were launched by the European Commission in the past decade in attempt to create a common energy policy to face the growing demand and energy security concerns.<sup>4</sup> As Dominique Finon and Catherine Locatelli argue: "The need for a joint energy policy has become all the more pressing since ten new members joined in the Union in May 2004 (and Bulgaria and Romania in January 2007)."<sup>5</sup> Loyola de Palacio also states : "Energy policy will play a key role in ensuring that Europe's integration benefits its citizens and its neighbors."<sup>6</sup> This approach is outlined in the January 2007 Communication from the Commission on "An Energy Policy for Europe", adopted at the March 2007 European Council.<sup>7</sup> At the core of the European Energy Policy is an Action Plan, which addresses main concerns of the Union regarding energy security, sustainability and internal energy market. In May 2006, the Commission together with Secretary General and High

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<sup>2</sup> Dominique Finon and Catherine Locatelli, "Russian and European gas interdependence: Could contractual trade channel geopolitics?" *Energy Policy* 36 (2008): 426, [www.elsevier.com/locate/enpol](http://www.elsevier.com/locate/enpol).

<sup>3</sup> Gawdat Bahgat, "Europe's energy security: challenges and opportunities," *International Affairs* 82, no.5 (2006): 962-963, [www.ebscohost.com](http://www.ebscohost.com).

<sup>4</sup> Andrei Belyi, "New Dimensions of Energy Security of the Enlarging EU and their Impact on Relations with Russia," *Journal of European Integration* 25, no.4 (2003): 352, 359, 362, [www.informaworld.com](http://www.informaworld.com).

<sup>5</sup> Finon and Locatelli, "Russian and European gas interdependence," 427

<sup>6</sup> Loyola de Palacio, "Reforming the Gas Market," in *Energy and Security: Toward a New Foreign Policy Strategy*, ed. Jan Kalicki and David Goldwyn (Baltimore, MD: Johns Hopkins University Press, 2005), 175

<sup>7</sup> European Commission, *An Energy Policy for Europe*

Representative for CFSP, Javier Solana, published a paper on the external policy for energy security, which placed energy on the foreign policy agenda of the Union as well.<sup>8</sup>

However, despite the Commission's efforts to "speak with a single voice"<sup>9</sup>, a common energy policy approach faces a number of challenges, not least of them being the lack of extensive Community competencies in the energy sector: there is no Energy Chapter in the Treaties. In trying to carve its way with the above mentioned initiatives, the Commission's "creeping competencies" remain severely constrained by a number of issues that arise in this context. These issues have been recently addressed in the literature on European energy policy.

The literature debate surrounding the European Union's energy policy has mainly focused on its development alongside traditional dimensions of energy security: geopolitical, economic and environmental. Working within this framework, the literature has focused on the development of energy concerns and their implications for a common energy policy approach. Scholars have utilized various approaches in their attempt to conceptualize the relevance and development of energy policy. Andrei Belyi makes use of the Copenhagen school in discussing energy security<sup>10</sup>, while Debra Johnson examines multiple paradigms of energy policy.<sup>11</sup> Aad Correljé and Coby van der Linde develop two approaches in international energy relations: "Markets and Institutions" (M&I) and "Regions and Empires"(R&E). The former is a neo-liberal approach assuming the existence of a global interdependent energy market, while the latter is a neo-realist approach emphasizing the role of states in setting energy relations and policies.<sup>12</sup>

<sup>8</sup> European Commission and Secretary General/High Representative for CFSP, *An External Policy to Serve Europe's Energy Interests*, Brussels, May 30, 2006.

[http://ec.europa.eu/dgs/energy\\_transport/international/doc/paper\\_solana\\_sg\\_energy\\_en.pdf](http://ec.europa.eu/dgs/energy_transport/international/doc/paper_solana_sg_energy_en.pdf)

<sup>9</sup> European Commission, *An Energy Policy for Europe*

<sup>10</sup> Belyi, "New Dimensions of Energy Security"

<sup>11</sup> Debra Johnson, "EU-Russian Energy Policy- Single or Multiple Policy Paradigms?" *Energy and Environment* 15, no.3 (2004), [www.ebscohost.com](http://www.ebscohost.com)

<sup>12</sup> Aad Correljé and Coby van der Linde, "Energy supply security and geopolitics: a European perspective," *Energy Policy* 34 (2006), 535-536

Aurèlia Mañé-Estrada argues in favor of an EU energy policy based on the inregration of M&I and R&E approaches in order to create a “pan-European *geo-energy* space: a geographical area with a *governance structure* (emphasis original).”<sup>13</sup>

When talking about a European energy policy, scholars draw due attention to its shortcomings and complications. Finon and Locatelli point to the lack of a common foreign policy which hinders the creation of a strong, hard-power based energy policy, thus the Commission's efforts mainly fall within the soft power arena.<sup>14</sup> They further elaborate on the member states' diverging preferences in terms of delegating authority in the energy field to the Commission, and in their stances on the Commission's general rhetoric of liberalization and competition. Principal member states such as Germany, Italy, France and the Netherlands still prefer to negotiate bilateral deals with large energy exporters and lack confidence in the EU.<sup>15</sup> Similar problems are prevalent in other authors' work, including Belyi, Egenhofer and Johnson. According to Christian Egenhofer, any negotiations on a potential Energy Chapter in the Treaties have resulted in a deadlock, due to initially diverging member state preferences.<sup>16</sup> Johnson considers the lack of a specific foreign policy agenda as alleviating pressure on the EU to tailor its energy policy in a set pattern. At the same time, she recognizes that this gives member states considerable leeway in pursuing their own energy policy agendas.<sup>17</sup> Johnson also brings into the picture the mutual dependence of the EU and Russia on energy supply and demand, which puts pressure on both sides to work out a common ground.<sup>18</sup> Katinka Barysch adds on to the debate

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<sup>13</sup> Aurelia Mane-Estrada, “European energy security: Towards the creation of the *geo-energy* space,” *Energy Policy* 34 (2006), 3781

<sup>14</sup> Finon and Locatelli, “Russian and European gas interdependence,” 427

<sup>15</sup> Ibid., 438-439.

<sup>16</sup> Christian Egenhofer, “Understanding the Politics of European Energy Policy: The Driving and Stopping Forces, the Politics of European Energy, the Energy of European Politics and Maastricht II,” *CEPMLP*, University of Dundee (1997): par 8-9, [www.dundee.ac.uk/cepmlp/journal/html/vol2-9.html](http://www.dundee.ac.uk/cepmlp/journal/html/vol2-9.html)

<sup>17</sup> Johnson, “EU-Russian Energy Policy”, 454

<sup>18</sup> Ibid., 467

on potential problems for EU energy policy the blocking by some member states of accession negotiations with Turkey, a country with key strategic position for EU energy security.<sup>19</sup>

As shown above, scholars have quite extensively debated the relevance and viability of a common energy policy for the enlarging EU. However, most scholars touch somewhat superficially upon the divergence of member state preferences in energy policy as connected to specific national considerations and interests, and fail to provide a comprehensive analysis of such preferences. Mañé-Estrada defines a European energy community as a “*security community* to be built, starting from the voluntary integration of its members, and not excluding relationships with other spaces.”<sup>20</sup> This thesis argues that the voluntary integration of EU member states is the crucial component of any common EU policy. Thus, it is necessary to address the issue from such a theoretical perspective, which will encompass many, if not all, possible factors and variables of the EU integration process.

Such an approach falls within the explanatory power of the liberal intergovernmentalist theory of EU integration, as developed by Andrew Moravcsik. Moravcsik's analysis is a variation of a two-level game, which takes into account national preference formations as the main driving force behind intergovernmental bargaining.<sup>21</sup> National preference formation thus represents the demand side in the EU integration, while the integration outcomes represent the supply side. Moravcsik identifies two main types of national preference, namely geopolitical and economic interests, and various implications of each of these for state behavior and decision-making. By accounting for the relative weight of both factors in preference formation, though being more

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<sup>19</sup> Katinka Barysch, “Turkey’s role in European energy security,” *Essays*, Centre for European Reform (2007): 6-7, [www.cer.org.uk](http://www.cer.org.uk)

<sup>20</sup> Mañé-Estrada, “European-Energy Security,” 3781

<sup>21</sup> Andrew Moravcsik, “Preferences and Power in the European Community: A Liberal Intergovernmentalist Approach,” in *Economic and Political Integration in Europe*, ed. Simon Bulmer and Andrew Scott (Oxford and Cambridge: Blackwell Publishers, 1994), 29-75.

inclined towards the liberal theory of economic preferences, Moravcsik has developed common dynamics and predictions about the level of integration sought and achieved, varying across issues and countries.<sup>22</sup> Using his theory, Moravcsik has explained the support for and success of the Single European Act, the Economic and Monetary Union, the Common Agricultural Policy and eastern enlargement among others.<sup>23</sup>

### **Research Question**

Despite agreement on some institutional policy, such as the Commission's "Energy Policy for Europe", there is still little action seen in substantive policy on the EU level. This thesis therefore aims to identify the reasons behind the lack of a jointly coordinated EU energy policy. Drawing on Andrew Moravcsik's theory of liberal intergovernmentalism, the thesis argues that this is due to divergent member state preferences and positions on various aspects of energy policy. Thus when speaking of integration and transfer of sovereignty, national preferences and alternative unilateral or bilateral solutions are at stake. Finon and Locatelli point to the existence of the "national fact" and the "European Fact" in energy policy, where the views of national governments might vary greatly from the views of the EU.<sup>24</sup> Thus this thesis claims that the "European Fact" is the outcome of the divergence and convergence of the "national facts". Where there is significant disagreement on a specific aspect of energy policy, the relevant EU policy will present an outcome acceptable to all member states, the so-called lowest common denominator. Even when a certain piece of legislation is passed, whether due to socialization or

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<sup>22</sup> Andrew Moravcsik, *The Choice for Europe: Social Purpose and State Power from Messina to Maastricht* (Ithaca, NY: Cornell University Press, 1998), 18-86

<sup>23</sup> C.f. Moravcsik, *The Choice for Europe* and Andrew Moravcsik and Milada Vachudova, "Bargaining Among Unequals: Enlargement and the Future of European Integration," *EUSA Review* 15, no.4 (2002), 1, 3-5.

<sup>24</sup> Finon and Locatelli, "Russian and European gas interdependence," 427

the Commission's efforts, the actual implementation of policies requires a certain degree of commitment from all the actors involved and affected.

## ***Methodology***

In order to answer the research question and prove the hypothesis, the thesis conducts case studies of two member states with strong and clearly defined energy policy preferences, namely Germany and the UK, which will then be used to explain the intergration outcomes. It examines policy documents and secondary sources, spanning the period from the Single European Act to the Energy Policy of Europe, in order to identify main issues and concerns of member states, as well as the Commission, as regards to energy policy. Resulting from this examination, a matrix of issues of concern, domestic preferences and integration outcomes is developed.

The structure of the thesis is as follows. The first chapter introduces the theoretical framework of liberal intergovernmentalism, put in a broader context of IR and EU integration theory, and its applicability to the study and understanding of EU energy policy. Chapter 2 provides the historical background of EU initiatives in the energy field, and introduces the three-dimensional position of the Commission in regards to energy policy. Chapters 3 and 4 examine the case studies in detail, and chapter 5 compares and contrasts the case study findings across the dimensions and, applying the theory, discusses the outcomes on the EU level.

# 1. THEORETICAL FRAMEWORK: LIBERAL INTERGOVERNMENTALISM

This thesis employs the framework of liberal intergovernmentalism, as proposed and developed by Andrew Moravcsik. This chapter elaborates on Moravcsik's model, locates it in the broader IR theory context and provides reasons for choosing this particular framework for the purposes of this thesis.

## 1.1. *Theoretical perspectives of EU integration*

When speaking about theories of EU integration, one can make use of several competing frameworks. The first substantial attempt to explain EU integration was developed between the 1950s and 1970s by so-called neo-functionalists, such as Ernst Haas, Philippe Schmitter, Leon Lindberg, Stuart Scheingold, Donald Puchala, Joseph Nye and others.<sup>25</sup> Neo-functionalism views the EU (or, earlier, EC integration) as a process towards a *sui generis* supranational polity, driven by "spillovers" from existing policy integration. As a result, the power of supranational institutions is emphasized as a crucial factor in integration.<sup>26</sup>

A viable critique of neo-functionalism came first from neo-functionalists themselves, such as Haas, Puchala, Cornett and Caporaso, later reviewing their work. By the 1970s, they had outlined three main features of a regional integration theory, which neo-functionalism seemed to lack. First, it needed to be grounded in existing general theories of international interdependence. Second, it needed to account not only for institutional, but also for substantive policy changes, i.e. not only for institutional integration, but for distributional conflicts. And third, it needed to

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<sup>25</sup> C.f. Ernst Haas, *The Uniting of Europe* (Stanford, CA: Stanford University Press, 1958) and Philippe Schmitter, "A Revised Theory of Regional Integration," in *Regional Integration: Theory and Research*, eds. Leon N. Lindberg and Stuart A. Scheingold (Cambridge, MA: Harvard University Press, 1970), 232-264

<sup>26</sup> Ben Rosamond, *Theories of European Integration* (Hampshire, UK: Palgrave, 2000), 50-73.

have a multicausal explanation.<sup>27</sup> Andrew Moravcsik, drawing on these criticisms, developed the competing framework of liberal intergovernmentalism (LI) in the early 1990s. Moravcsik's further critique of neo-functionalism is not only empirical, i.e. that it did not sufficiently explain the EU integration process, but mainly theoretical. Moravcsik argues that neo-functionalism is a pre-theory, as it is not fully predictive and testable due to the fact that it is not grounded in existing theories and treats the EU as a sui-generis case. According to Moravcsik, for an EU integration theory to be parsimonious and convincing, it needs to be based on existing IR explanatory frameworks and, furthermore, combine such frameworks. Thus Moravcsik combines two distinct approaches: the liberal theory of national preference formation and interstate bargaining or regime theory.<sup>28</sup> Indeed, such an approach makes the theory not only potentially applicable to other regional integration cases, but also takes into account the two-level structure of EU integration: member state level and EU institutional level.

According to Moravcsik, liberal theories of international relations are based on the state-society relations in the context of interdependence. The liberal tradition dates back to John Stuart Mill, Giuseppe Mazzini, Woodrow Wilson, and Adam Smith among others. Liberalism, as a general theory, rests on three core assumptions: primacy of societal actors, representation of state preferences and interdependence of those preferences. Moravcsik identifies three variants of liberalism that all share these assumptions: ideational, commercial and republican.<sup>29</sup> According to liberal theory, domestic politics are reflections of societal pressure, as formed by the existing international constraints. Such preferences are not fixed or exogenous, as in realism, but vary greatly and ultimately explain policy outcomes. Moravcsik argues: "The most fundamental

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<sup>27</sup> Moravcsik, "Preferences and Power", 34-35

<sup>28</sup> Ibid, 35-38.

<sup>29</sup> Andrew Moravcsik, "Taking Preferences Seriously: A Liberal Theory of International Politics," *International Organization* 51, no.4 (1997), 516-533.

influences on foreign policy are, therefore, the identity of important societal groups, the nature of their interests, and their relative influence on domestic policy." <sup>30</sup> In the EU integration context, Moravcsik identifies two broad categories of national interests: geopolitical and economic. While the first category, drawing on neo-realist, institutionalist and constructivist theories, underlines "high politics" and geopolitical goals as ultimate determinants of domestic interests, the second category is derived from international political economy. According to this account, economic interdependence creates negative policy externalities, i.e. negative effects of national policies of one state on other states. Thus national preferences are formed to eliminate such externalities by any means possible, including international cooperation. Accordingly, Moravcsik develops predictions about national preference formation across five dimensions: cross-issue and cross-country variation, timing of shifts in preferences, policy consistency, domestic cleavages and domestic policy discourse. <sup>31</sup>

The second component of LI is interstate bargaining, based on the regime theory of international relations, in its turn developed from the complex interdependence theory of the 1970s. Generally speaking, the definition of a regime comprises "implicit or explicit principles, norms, rules and decision-making procedures around which actors' expectations converge in a given area of international relations." <sup>32</sup> Moravcsik makes use of the functional regime theory of international institutions, as developed by Robert Keohane. According to Keohane, states acting as rational actors cooperate and delegate authority to institutions for the purposes of reducing transaction costs, monitoring compliance and identifying transgressors. <sup>33</sup> However, Moravcsik

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<sup>30</sup> Ibid, 39

<sup>31</sup> Moravcsik, *The Choice for Europe*, 24-50.

<sup>32</sup> Stephen Krasner, ed., *International Regimes* (Ithaca, NY: Cornell University Press, 1983), quoted in Chris Brown, *Understanding International Relations* (New York, NY: Palgrave, 2001), 177

<sup>33</sup> Robert Keohane, *After Hegemony: Cooperation and Discord in the World Political Economy* (Princeton, NJ: Princeton University Press, 1984), chap. 6.

develops the regime theory further with regard to EC institutions. At the EC level, he argues, two processes happen that distinguish it from a mere transaction cost reducing institution: pooling of national sovereignty (QMV) and delegating sovereign powers to institutions.<sup>34</sup> These processes happen through interstate bargaining, initiated by member states. Such bargaining has three important conditions: it is a non-coercive consensus system, the transaction costs of information sharing are low, and, most importantly, the distribution of benefits reflects the relative bargaining power of member states. Thus each member state brings its national preferences and bargaining power to the negotiating table. The outcome of negotiations ultimately depends on three factors: the existence of unilateral alternatives and alternative coalitions, and issue-linkages.<sup>35</sup>

Moravcsik's LI theory is also regarded as a variant of a "two-level game", a concept developed by Robert Putnam. Drawing on behavioral theory of social negotiations, Putnam developed a model for explaining the interaction between domestic and international politics. He argued that political leaders are continuously required to play across two boards: domestic and international. Such a game is increasingly complex in that the two boards are interconnected, so that a move made on one board will necessarily depend on or influence possible moves on the other. Ultimately, the outcome of any international negotiation will depend on the decision makers' ability to reconcile domestic and international pressure.<sup>36</sup>

The relationship between domestic politics and international cooperation has been studied by various scholars of international political economy, such as Peter Gourevitch and Peter

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<sup>34</sup> Moravcsik, "Preferences and Power", 65

<sup>35</sup> Moravcsik, *Choice for Europe*, 50-67

<sup>36</sup> Robert D. Putnam, "Diplomacy and Domestic Politics: The Logic of Two-Level Games," in *Double-Edged Diplomacy: International Bargaining and Domestic Politics*, eds. Peter B. Evans et al. (Berkeley, CA: University of California Press, 1993)

Katzenstein.<sup>37</sup> Moravcsik not only adapts these studies to EU integration, but develops his own elaborate scheme of national preference formation and interstate bargaining in the EU. Staying true to the rational framework of international cooperation, he generally rejects the assumption of states as unitary actors and emphasizes the importance of domestic cleavages. However, as Frank Schimmelfennig has pointed out, Moravcsik does not acknowledge any significant international role of domestic actors beyond influencing the state. Thus the state is still the main actor in international negotiations as the “filter” for domestic preferences.<sup>38</sup> However, recent developments in the EU have shown that powerful domestic actors have considerable ties with European institutions, through lobby offices in Brussels and expert committees. As discussed in the following chapters, there has been direct investigation and communication between the Commission and big European energy companies.

Nevertheless, LI gains its explanatory power with clear predictions and hypotheses derived from the theory. In addition, it leaves room within the framework for development of additional explanations for national preference formation, in its attempt to move from a pre-theory to theory of EU integration.

## ***1.2. Liberal Intergovernmentalism and EU Integration***

When applied to EU integration, LI seeks to provide explanations and make predictions for the level of integration in various EU policy areas. Moravcsik broadly divides these policy areas into three categories: commercial liberalization (internal market), provision of socio-economic collective goods (monetary and regulatory policies), and political or institutional

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<sup>37</sup> C.f. Peter Gourevitch, “The Second Image Reversed: the International Sources of Domestic Politics,” *International Organization* 32, no.4 (1978):881-912, and Peter Katzenstein, *Small States in World Markets: Industrial Policy in Europe* (Ithaca, NY: Cornell University Press, 1985).

<sup>38</sup> Frank Schimmelfennig, “Liberal Intergovernmentalism,” in *European Integration Theory*, eds. Antje Wiener and Thomas Diez (Oxford, UK: Oxford University Press, 2005), 77.

policies (EP affairs, structural funding). Within each area there exist sources of societal interests and determinants of state action. In the commercial liberalization area the main pressure comes from domestic producers, who undertake a net cost-benefit analysis of policy coordination. The stronger the producer interests, the more pressure on the government to conform to these interests and less room for maneuver in the interstate bargaining. In the socio-economic public goods provision area, the pressure is two-dimensional: from producers and from the public. In the political and institutional area, however, the existing pressure comes from narrowly defined groups and thus is relatively diluted compared to the other two policy areas. This is the area where the governments have the most autonomy.<sup>39</sup>

In his works, Moravcsik has used the LI framework to explain the process of EU integration spanning all three policy areas. In his book, *The Choice for Europe*, he offers a detailed account of the consolidation of the common market, notably the establishment of the Common Agricultural Policy, and the move towards economic monetary union, culminating in the Single European Act and the Treaty of Maastricht. Moravcsik examines the national preference formation of the "big three" (France, Germany and the UK) in various issues at stake, such as the internal market, CAP and budget, industrial policy, monetary policy, foreign policy, institutional arrangements and others. Each preference reflected the domestic interests of the respective member state, and the outcome depended on the bargaining power, available information and the ability to create issue-linkages. For example, French support for the CAP in the 1960s and 1970s is explained by its position as a net exporter of agricultural goods, whereas German and British opposition to the CAP is explained by their net importer position. The ultimate outcome reflects the leverage of Germany, which was able to maintain high prices and

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<sup>39</sup> Moravcsik, "Preferences and Power," 44-52

receive national subsidies for its farmers, and French ability to bargain for external closure.<sup>40</sup> During the Single European Act negotiations, the partisan support of centrist parties that came to power in the mid-1980s, opened up the possibility for reform and convergence on the liberalization of the European market.<sup>41</sup> Recently, Schimmelfennig has attempted to apply the LI framework to Eastern enlargement by arguing that geographical proximity and different levels of losses and gains from potential enlargement, as reflected in the socio-economic structure among the EU member states, serves to explain divergent preferences for the enlargement. However, Schimmelfennig argues that while LI can successfully explain the initial association agreements with CEE countries, it can not fully account for the 1993 Copenhagen summit decision to admit those countries as members.<sup>42</sup>

Even though LI is often termed a "theoretical school with no disciples and a single teacher"<sup>43</sup>, it can be linked to other theories, such as rational-choice institutionalism, social constructivism and even supranationalism.<sup>44</sup> Moravcsik himself has pointed out that LI does not sufficiently cover every aspect of EU integration, and other factors such as ideology or EU institutions also play a role. Particularly the so-called "new institutionalists", such as Mark Pollack, Geoffrey Garrett and George Tsebelis, have studied the role of the institutional setup in creating constraints and opportunities for member states to bring out their preferences.<sup>45</sup>

As EU integration is an ongoing process, though not completely smooth and continuous, LI theory can be further tested against integration attempts in other policy areas, one of them being energy policy.

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<sup>40</sup> Moravcsik, *The Choice for Europe*, 162-163

<sup>41</sup> Andrew Moravcsik, "Negotiating the Single European Act: National Interests and Conventional Statecraft in the European Community," *International Organization* 45, no.1 (1991)

<sup>42</sup> Schimmelfennig, "Liberal Intergovernmentalism," 87-90.

<sup>43</sup> Ibid, 75

<sup>44</sup> Ibid, 92

<sup>45</sup> Rosamond, *Theories of European Integration*, 141-145.

### ***1.3. Liberal Intergovernmentalism and energy policy***

For the purposes of this thesis, EU energy policy is a plausible and interesting case for testing the LI theory for two reasons. Firstly, energy policy is a complex case study, as it aims to create new competences for the EU in a policy area which is not mentioned in the treaties. Therefore, taking into consideration Moravcsik's argument about EU bargaining taking place in a non-coercive and voluntary environment, it becomes crucial to find out the reasons behind any move towards pooling sovereignty and delegating authority in such an area. With the EU having adopted a very wide “three-legged stool” definition of energy policy to include sustainability (carbon reduction), security and competition/liberalization, it is inevitable that member states have their own national priorities within this very agenda.

Secondly, energy policy fits in two of the three EU policy areas identified by Moravcsik: commercial liberalization and provision of socio-economic public goods. Energy is a good within the EU common market, thus liberalization of the energy market in order to conform to the general internal market rules is a crucial part of a common energy policy. This involves dominant domestic players, such as energy producers, exporters and distributors, all of which are highly interdependent. To some extent, with increasing globalization, foreign energy producers (e.g. Russia) now also have an increasing stake in European markets. On the other hand, in many member states energy companies are still under full or majority state ownership, making energy a public good and the market itself vulnerable to disruptions. In this view, increased pressure towards policy co-ordination between member states has surfaced in order to offset negative policy externalities and address the issue of security of supply.

Moravcsik's accounts of EU integration have so far focused on bargaining between the three big member states: France, Germany and the UK. In the following chapters, this thesis

examines the German and British positions on energy policy, particularly liberalization/competition and security of supply, in an attempt to show the divergence and convergence across issue-areas. It examines the member states' official policies, underlined by national preferences of dominant societal actors. It then looks at how those preferences have shaped the interstate bargaining and institutional as well as substantive outcomes at the EU level. It also accounts for those aspects that can not be fully explained by LI, namely the UK's pioneering of liberalization and privatization despite certain deep-rooted national interests.

The next chapter briefly presents the history of community initiatives in energy policy and introduces the three dimensions of energy policy: competition/liberalization, security of supply and sustainability, which will then be used to assess the case studies.

## 2. EU ENERGY POLICY: HISTORICAL BACKGROUND

### *2.1. Traditional energy policy*

It can be argued that energy has been at the heart of the EU from the beginning, with European Coal and Steel Community (ECSC) and Euratom treaties. As the founders of Europe intended to create a regime for common management of vital energy resources necessary for post-war reconstruction, the ECSC and Euratom both failed to create a common policy of any sort. Though considered by many a catalyst for further EC integration, these treaties did not have a significant implication for a common approach to energy. The Treaty of Rome, establishing the EC, also did not specifically mention energy policy, thus leaving it out of the EC competences area as a national prerogative. Thus national markets remained protected, with large energy utility companies supplying the market and national governments developing their energy strategies accordingly.

While security of energy supplies has always been a vital concern, more acute after the 1973 oil price crisis, member states had mainly relied on bilateral agreements with OPEC countries and membership in the multi-lateral International Energy Agency (IEA).<sup>46</sup> However, the Single European Act (SEA) provided a different spin on energy debate at the EU level. Some discussion on the energy sector had already started during the 1980s, reinforced by 1989 Washington Consensus' liberalization agenda and the UK's pioneering of sector reforms and privatization.<sup>47</sup> As the single market was becoming a reality, an internal market for energy became a necessary component. With the signing of the Single European Act, the Commission in 1988 published a working document on the Internal Energy Market (IEM), as part and parcel of

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<sup>46</sup> Janne Haaland Matlary, "Energy Policy," in *Policy Making in the European Union*, eds. Helen and William Wallace (Oxford, UK: Oxford University Press, 1996), 260-261.

<sup>47</sup> Ibid., 258

the completion of the single market project.<sup>48</sup> Moreover, the SEA also extended QMV to the proposals on IEM and created incentives for DG Competition to become more active in energy.

## **2.2. EU energy policy initiatives**

Under the aegis of IEM, the Commission launched a number of initiatives during the next decade such as 1990 Transit Directive, 1990 Energy Price Transparency Directive, 1994 Green Paper, 1995 White Paper, 1996 Electricity Directive and 1998 Gas Directive.

The main purpose of the directives was establishing of common rules for the liberalization of the energy sector. The common rules were: abolition of exclusive rights, unbundling of production/supply from transmission and distribution activities, and third party access (TPA).<sup>49</sup> As connected to energy networks, another IEM initiative aimed to develop energy infrastructure under the new trans-European network system, which was included in the Treaty on European Union (TEU) and funded by the Cohesion Fund.<sup>50</sup> Yet another element of IEM was the effort to create a Community tax on CO<sub>2</sub>, which however met with resistance from a number of member states, including the UK.<sup>51</sup> This initiative was also part of increasing Community concern with sustainable development.

Apart from using its competences within the single market, the Commission has also attempted to concentrate more power at the European level with more radical proposals that would actually create an integrated energy policy, rather than just a free market for energy. Janne

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<sup>48</sup> Jonathan Stern, *Third Party Access in European Gas Markets: Regulation-driven or market-led?* (London, UK: Royal Institute of International Affairs, 1992), 55

<sup>49</sup> Third Party Access: a regime providing for an obligation, to the extent that there is capacity available, on companies operating transmission and distribution networks... to offer terms for the use of their grid, in particular to individual consumers or to distribution companies, in return for payment. Source: European Commission, *Proposal for a Council Directive concerning common rules for the internal market in natural gas*, Com(91) 548 Final, Brussels, 21 February 1992.

<sup>50</sup> Matlary, "Energy Policy", 265

<sup>51</sup> Ibid., 269

Haaland Matlary argues that the Commission has used so-called “windows of opportunity”, such as political conflicts and major market crises, to advance the need for a common energy policy.

<sup>52</sup> Shortly after the 1990 Gulf War, the Commission proposed to create a legal basis for energy policy. In a communication submitted to the Intergovernmental Conference (IGC), the Commission argued that: "as far as energy is concerned, the Treaties could be consolidated into a single chapter making it possible to implement a common energy policy."<sup>53</sup> This sparked discussion in the run-up to the 1992 Maastricht IGC on whether energy policy deserved its place in the new EU Treaty. However, the only progress made was the mention in Article 3(t) that energy measures were legitimate Community activities.<sup>54</sup> This of course was too vague of a statement to create any kind of tangible common energy policy. It is interesting to note that the UK, although strongly in favor of most IEM proposals, opposed all attempts at creating a common energy policy.<sup>55</sup> This shows that energy policy is perceived by member states as a multi-dimensional issue, with some of its dimensions more acceptable than the others. Thus the Commission's attempt to bring the whole package to the table and include it in the Treaties has met considerable caution and resistance.

### ***2.3. “Three-legged stool”: sustainability, competition, security of supply***

Recognizing the complexity of energy policy, the Commission developed a three-dimensional approach in its 1994 Green Paper: security of supply, competition/liberalization (IEM), and sustainability.<sup>56</sup> These not only encompassed various aspects of energy policy, but

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<sup>52</sup> Matlary, “Energy Policy”, 273

<sup>53</sup> Quoted in Matlary, “Energy Policy”, 267

<sup>54</sup> Egenhofer, “Understanding the Politics of European Energy Policy”, par. 7

<sup>55</sup> Matlary, “Energy Policy”, 270

<sup>56</sup> Ibid., 268

would allow for a concentration of Community competences in all three areas, intricately connected to each other. Each of these dimensions has been advanced by different Directorate Generals over the years. DG TREN and DG Environment have been in charge of the sustainability agenda; DG TREN, DG Competition and to a certain extent DG Relex - security of supply; and the liberalization agenda started by DG TREN was eventually picked up by DG Competition's monopoly inquiries in the early 90s and 2000s.<sup>57</sup>

This agenda correctly reflected the main energy concerns of member states. As the demand for energy was rising, security of supply and diversification of sources away from the Middle East after the 1973 oil price crisis and the Gulf War led to increasing importance of natural gas production and imports. At the beginning of 1980s, Soviet gas exports began to flow into Western Europe through the newly built Urengoy pipeline, causing sharp criticism from Reagan administration in the US.<sup>58</sup> By 1987, total natural gas requirement of the EC was at 201.7 mtoe, with West Germany and the UK being the main consumers.<sup>59</sup> An agreement was reached within the IEA to keep the import dependence on Soviet gas at 30-35% of total gas supplies of any west European country.<sup>60</sup> In view of this, the competition and liberalization argument, as advanced by the Commission and the UK, comes into play not only as a means to achieve lower prices for consumers, but also as a means for diversification of sources. However, as discussed below, this view has recently been contested.

The last, but not least, dimension of the new Community energy policy is environment and sustainable use of energy. Concerns with climate change and the environmental impact of

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<sup>57</sup> Jonathan Stern, interview with author, May 8, 2008.

<sup>58</sup> Jonathan Stern, *Competition and Liberalization in European Gas Markets: A Diversity of Models* (London: Royal Institute of International Affairs, 1998), 25

<sup>59</sup> Jonathan Stern, *European Gas Markets: Challenge and Opportunity in the 1990s* (Hants, UK: Dartmouth Publishing Company, 1990), 11

<sup>60</sup> Stern, *Competition and Liberalization*, 25

fossil fuel emissions, as well as environmental degradation in Central and Eastern Europe and the nuclear disaster in Chernobyl, reinforced the Commission view on the need for a common policy to tackle these problems. Moreover, the TEU gave a considerable legal basis to environmental policy, extending QMV to issues not connected with the single market.<sup>61</sup> The Commission developed the first comprehensive European Union Strategy for Sustainable Development and proposed it to the the Gothenburg European Council in 2001. The strategy included a commitment to meeting the Kyoto targets by 2010 and further reducing emissions by 1% below 1990 level per year.<sup>62</sup> According to Jonathan Stern, commitment to emission reduction is the most tolerable aspect of energy policy that might push the other dimensions further down the agenda.<sup>63</sup>

According to Matlary, a good example of a Commission initiative that brings together all three dimensions of energy policy is the Energy Charter Treaty (ECT). The Energy Charter Treaty (ECT), signed in December 1994 and in force since 1998, is a formal agreement establishing the rules for investment and transit of energy resources between Western and Central Europe and former Soviet Union. On the one hand, it is an extension of EU's free market rules to the former Soviet Union, presently CIS countries. Moreover, Article 7 of the ECT prohibits parties to restrict transit through their territories based on the origin, destination or pricing of the energy, and to resort to the treaty's dispute resolution provisions if an agreement can not be reached on commercial terms.<sup>64</sup> This provision is geared towards concerns with

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<sup>61</sup> Alberta Sbragia, "Environmental Policy," in *Policy Making in the European Union*, eds. Helen and William Wallace (Oxford, UK: Oxford University Press, 1996), 242

<sup>62</sup> European Commission, *A Sustainable Europe for a Better World: A European Union Strategy for Sustainable Development*, COM (2001) 264 final, Brussels, May 15, 2001, [http://europa.eu/eur-lex/en/com/cnc/2001/com2001\\_0264en01.pdf](http://europa.eu/eur-lex/en/com/cnc/2001/com2001_0264en01.pdf)

<sup>63</sup> Jonathan Stern, interview, May 8, 2008.

<sup>64</sup> Energy Charter Secretariat, *The Energy Charter Treaty and Related Documents*, Energy Charter, [http://www.encharter.org/fileadmin/user\\_upload/document/EN.pdf](http://www.encharter.org/fileadmin/user_upload/document/EN.pdf)

security of supply from the region. And finally, due attention is also paid to the environment in the objectives section of the treaty.

The role of the Commission as an agenda-setter, regulator and "voice" of the Union has greatly depended on the member states' acceptance of its proposals, which has proved a difficult task in regards to energy policy. In the following chapters, this thesis examines the German and British positions on all three dimensions of energy policy, focusing on liberalization and security of supply dimensions in greater detail, in an attempt to show the variation of divergence and convergence across issue-areas. The case studies focus on the natural gas market in both countries, comparing the structures and identifying the main players. It is argued that while the UK has been the champion of energy sector reforms, German market structure is much more complicated and the government coalition is not in agreement on energy policy, thus forcing the Commission to present compromise proposals. At the same time, the new millenium has shifted preferences in terms of the two remaining dimensions, security of supply and sustainability, and the Commission has used these windows of opportunity to give energy policy some flesh.

### 3. CASE STUDY: GERMANY

Germany is the biggest single energy market in Europe and accounts for approximately 19% of total EU-27 energy consumption.<sup>65</sup> Therefore, when critically evaluating the development of the EU common energy policy, it is essential to analyze Germany's position at stake vis-à-vis the Commission initiatives, most notably regarding the liberalization of the natural gas market.

Drawing on the LI framework, this chapter argues that Germany's national preferences have undermined main EU energy initiatives, and made the transposition of existing EU rules and regulations cumbersome. It is argued that this is due to three factors: the peculiar structure of the German energy market (specifically for natural gas), disagreements within the domestic structure on energy related issues, and special considerations regarding security of supply and energy exports. However, the chapter will also take into account the impact of the institutional environment of the EU, which is acknowledged by Moravcsik in his later works and further developed by scholars such as Mark Pollack and Wayne Sandholtz.<sup>66</sup>

#### **3.1. German natural gas industry structure**

The German natural gas market is extremely complicated and unlike other European gas markets in a number of ways. First and foremost, the market consists of over 750 companies with various functions and mixed public/private ownership. The International Energy Agency has grouped these companies according to their market functions, as following: natural gas producers, supra-regional companies, regional distributional companies, local distributional

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<sup>65</sup> OECD, *Statistical Profile of Germany 2008*,  
[http://www.oecd.org/country/0,3377,en\\_33873108\\_33873402\\_1\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/country/0,3377,en_33873108_33873402_1_1_1_1_1,00.html)

<sup>66</sup> Rosamond, *Theories of European Integration*, 141-145.

companies and gas dealers.<sup>67</sup> Within this structure, the most important and influential players are the supra-regional companies, also called long-distance suppliers or transmission companies. These companies purchase natural gas from local or foreign producers and store and transmit them to either the distributional companies or large industrial end-consumers. In 1990, there were only six supra-regional companies operating in the German market, while in 2002 their number went up to fourteen.<sup>68</sup> Privately owned, some of these companies are involved in a number of other activities as well, such as production, import and local distribution. Thus, there is a considerable degree of vertical integration in the supra-regional companies. The regional distributional companies, in their turn, buy gas from the transmission companies and distribute it to end consumers.<sup>69</sup>

The Commission has always seen such a structure as impediment to competition, therefore insisting on unbundling. Unbundling is defined as: “the effective separation between the operation of electricity and gas transmission networks from supply and generation activities.”<sup>70</sup> In effect, this means that supra-regional gas companies would have to sell their transmission and distribution networks. However, for German companies such as Ruhrgas, which owns over 10,000 km of transmission pipelines, this would mean a tremendous market share and revenue loss.

Germany has also opted for negotiated TPA, which essentially means that access rules and prices are negotiated between market players and are defined in so-called Association

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<sup>67</sup> International Energy Agency, *Energy Policies of IEA Countries-Germany 2002 Review*, [http://www.iea.org/Textbase/publications/free\\_new\\_Desc.asp?PUBS\\_ID=1097](http://www.iea.org/Textbase/publications/free_new_Desc.asp?PUBS_ID=1097)

<sup>68</sup> International Energy Agency, *Natural Gas Distribution- Focus on Western Europe 1998*, [http://www.iea.org/Textbase/publications/free\\_new\\_Desc.asp?PUBS\\_ID=1192](http://www.iea.org/Textbase/publications/free_new_Desc.asp?PUBS_ID=1192)

<sup>69</sup> Ibid.

<sup>70</sup> European Commission, *Energizing Europe: A real market with secure supply*, Memo/07/361, Brussels, Sep 19, 2007, <http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/07/361&format=HTML&aged=0&language=EN&guiLanguage=en>

Agreements between industrial user associations and gas user associations. Both the Federation of German Industries (BDI) and supra-regional companies have been in favor of negotiated rather than regulatory system. However, the negotiated TPA system is not flawless as the process is time consuming and burdensome for small market players.<sup>71</sup>

. Even though Germany had legally fully liberalized its energy market by 1998, competition did not quite develop afterwards. According to the IEA, by 2002 less than 5% of consumers had switched their suppliers, with many simply renegotiating with their old suppliers, and new entrants to the German gas market still considered the access tariffs too high and discriminatory.<sup>72</sup>

### ***3.2. To merge or not to merge? Debates in the German coalition***

The slow progress of the German gas market liberalization could be attributed not only to the leverage of big supra-regional companies, but also to lack of consensus within the German political circles on the status of the energy market. Such disagreements can play to the hands of big companies as well as slow down the transposition of EU regulation.

Take for instance, the domestic debate over the merger of two energy giants, E.ON and Ruhrgas. Ruhrgas is the largest supra-regional gas company in Germany, supplying about 60% of the German gas market, while E.ON, formed in June 2000 by the merger of VEBA and VIAG, was looking to integrate electricity and gas in one company. When E.ON first applied to the Federal Cartel Office in 2001 for permission to acquire 60% of Ruhrgas, it was denied on the grounds that: “the merger would strengthen E.ON's dominant position on the gas and electricity markets to a serious extent and that the resulting negative effects on competition could not be

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<sup>71</sup> IEA, *Energy Policies of Germany 2002*

<sup>72</sup> Ibid.

remedied by commitments by the companies." <sup>73</sup> However, E.ON applied to the Ministry of Economics to overrule the decision. The Ministry authorized the merger based on the German Act against Restraint of Competition, despite the negative opinion from the Monopolies Commission, a group of experts on competition law and economics. <sup>74</sup> It is interesting to note that, Werner Müller, the Minister of Economics and Technology at the time, had previously worked for one of the companies that formed E.ON, and later became CEO of the German power company RAG. <sup>75</sup> Immediately following that E.ON's main competitors took the case to the Düsseldorf High Court, which ruled against the merger. However, a second authorization was issued by the Ministry, followed by an application to the Court to lift its preliminary injunction to suspend the merger. <sup>76</sup> This tug-of-war was finally resolved in January 2003, surprisingly enough with an out of court settlement, with all the opponents of the ministerial approval dropping their legal case and E.ON acquiring 60% of Ruhrgas. <sup>77</sup> Interestingly enough, though invoked by plaintiffs and the Monopolies Commission, the European Commission did not intervene in the process. Though Commissioner for Competition Neelie Kroes is critical of the state of European energy markets, breaking up E.ON/Ruhrgas ex post will not be an easy, if not impossible task for the Commission.

The current ruling coalition of Christian Democrats and Social Democrats, headed by Chancellor Angela Merkel, does not always speak in a single voice on energy issues. In a discussion paper published by a group of German Social Democrats in 2005, they call for a more integrative European approach and compliance with EU rules:

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<sup>73</sup> Ines Zenke and Becker Buttner-Held, "The merger of E.ON and Ruhrgas: a never ending story?" *Oil, Gas and Energy Law Intelligence* 1, no. 1(2003): par. 2, [http://www.gasandoil.com/ogel/samples/freearticles/roundup\\_07.htm](http://www.gasandoil.com/ogel/samples/freearticles/roundup_07.htm)

<sup>74</sup> Ibid

<sup>75</sup> Julianne von-Reppert Bismarck, "Rhetoric vs. Reality: Angela Merkel is committed to the environment, but can she stand up to German industry?" *Newsweek*, March 31, 2008, <http://www.newsweek.com/id/128416/page/1>

<sup>76</sup> Zenke and Held, "The merger of E.ON and Ruhrgas"

<sup>77</sup> E.ON, *E.ON History 2003*, <http://www.eon.com/en/unternehmen/2067.jsp>

National policies must come to be seen as components of European energy policy. 'Brussels' is not the problem, but rather the answer. Accordingly, European directives must not simply be implemented at national level, but also require active national involvement and input from the start.<sup>78</sup>

It can be argued that the Social Democrats who signed this declaration have been "Brusselized" during their time spent as Members of the European Parliament. Indeed one of the undersigned, Rolf Linkohr, who had been an MEP for 25 years, repeatedly speaks in favor of using nuclear energy, which his own party is opposed to.<sup>79</sup> The usage of nuclear energy has created a chasm in the coalition, with the Christian Democrats, headed by Minister of Economics and Technology Michael Glos, raising the possibility of reversing the nuclear phase-out agreement, reached in 2001 by the previous coalition of the SDP and the Green Party (the Red-Green coalition).<sup>80</sup> Chancellor Merkel has decided to postpone the decision for the next government to be elected in 2009.<sup>81</sup> But nuclear phase-out is not the only divisive issue for the government. Economics minister Michael Glos has also voiced concerns regarding Merkel's ambitious greenhouse gas emission reduction targets (40% below 1990 level by 2020), backed by the environment minister and a Social Democrat, Sigmar Gabriel.<sup>82</sup> In such a difficult domestic situation the EU policies can either be promoted or pushed aside, depending on which side of the debate tips the balance at a certain time.

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<sup>78</sup>Rolf Linkhor et. al.

"Accept Energy Policy Realities", Brussels, November 30, 2005, [http://www.linkohr.de/3english/seite\\_21.htm](http://www.linkohr.de/3english/seite_21.htm)

<sup>79</sup> Mr. Linkhor was recently involved in a conflict of interest scandal. He had been providing consulting services to energy companies, while at the same time serving as special advisor to Energy Commissioner Piebalgs.

<sup>80</sup> Ulrike Guerot, 'Germany and Europe: A New Tone or Politics as Usual?' - A Projection of the German EU Presidency," *Romanian Journal of European Affairs*. 7, no. 1(2007), 3, <http://ssrn.com>

<sup>81</sup> Judy Dempsey, "Merkel confronts German energy industry with radical policy overhaul," *International Herald Tribune*, July 4, 2007

<sup>82</sup> Katinka Barysch, "Why the UK needs to back Commission energy plans," *Centre for European Reform*, Jan 12, 2007, [www.cer.org.uk](http://www.cer.org.uk)

### 3.3. Security of supply

Germany has also been criticized for sabotaging the EU energy policy by not showing solidarity with other EU member states by making bi-lateral deals with gas exporters, mainly Russia. The biggest object of criticism has become the pet deal of former Chancellor Gerhard Schröder and Russian president Vladimir Putin: the North European Pipeline or Nord Stream. Signed in September 2005, the project is a joint venture of Russian gas giant Gazprom and German Wintershall and E.ON (later Dutch Gasunie joined the project), and involves the construction of a direct gas pipeline from Russia to Germany across the Baltic Sea bed. By the time of its completion in 2010, the pipeline should be able to carry around 40% of total German gas imports from Russia.<sup>83</sup> Even though it was labeled as "Trans-European Network" by the European Commission at its initial stages in 2000, the project has since come to be seen as a privileged deal between Germany and Russia. Since the pipeline will bypass the traditional transit countries such as Belarus, Ukraine, Poland and the Baltic States, it raises considerable concerns in those countries, despite continuous assurance by both the German and Russian side that the project will ensure more security of supply for entire Europe. In addition to Russia, Wintershall also imports gas from the UK via the Netherlands, thus adding one additional source of supply.<sup>84</sup> However, Gazprom's acquisition of 49% shares in the joint venture with Wintershall, Wingas, does not seem directly related to European energy security but rather a clever move from the Russian side to gain foothold in the European downstream sector.<sup>85</sup> According to some analysts, the Nord Stream will also increase Germany's influence in the

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<sup>83</sup> Roland Gotz, "The North European Pipeline: Increasing Energy Security or Political Pressure?" *German Institute for International and Security Affairs*, SWP Comments 42, September 2005, [www.swp-berlin.org](http://www.swp-berlin.org)

<sup>84</sup> International Energy Agency, *Natural Gas Security Study 1995*,  
[http://www.iea.org/Textbase/publications/free\\_new\\_Desc.asp?PUBS\\_ID=1259](http://www.iea.org/Textbase/publications/free_new_Desc.asp?PUBS_ID=1259)

<sup>85</sup> Wintershall AG, "Asset swap between BASF and Gazprom largely completed," Oct 25, 2007,  
<http://www.wintershall.com/pi-gazprom-basf-071025.html?&L=0>

region, as it will become the main re-distributor of gas to Eastern Europe.<sup>86</sup> However, such a scenario could only be possible if Russia interrupted all its deliveries through existing pipelines and filled the Nord Stream to its maximum capacity of 27.5 billion cubic meters per year.

### **3.4. The EU influence**

So is Germany the black sheep in the EU family? Certainly with its unique market structure and powerful energy lobby, Germany has been able to resist many ambitious plans of the Commission. However, it should not be disregarded that Germany's EU membership has created a degree of socialization, which has prompted both the government and energy companies to make some concessions.

Some recent developments can be observed, which suggest that Germany is finally willing to consider the Commission's proposals. In 2005, a new Energy Industry Act was passed with the intention to fully transpose the Gas and Electricity Directives to German national law. The act creates a regulatory agency, Federal Grid Agency (Bundesnetzagentur), in charge of monitoring the access to electricity and gas grids, as well as grid fees. This represents a step away from negotiated association agreements for access to networks towards a regulatory approach. The Energy Act means to establish a system of incentive regulation by 2007, which would provide more incentives for cost reductions and higher efficiency of grid operators.<sup>87</sup>

Meanwhile, the European Commission has continued its work of promoting energy market liberalization. Competition Commissioner Kroes initiated an EU-wide energy sector inquiry in 2005, the findings of which were published in early 2007, on the very same day with

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<sup>86</sup> Simon Araloff, "Schroeder-Putin Pact: Germany and Russia divide Europe again," Global Challenges Research, May 12, 2005, <http://www.axisglobe.com/>

<sup>87</sup> V.Heck, "German Energy Policy-Current Status," RWA, April 10, 2006, <http://www.rwe.com/generator.aspx/investor-relations/presentationen/2006-april/property=Data/id=334074/german-energy-policy-pdf.pdf>

the Commission's draft proposal "An Energy Policy for Europe". In February 2006, Commissioner Kroes announced that the Commission will hold individual antitrust investigations across the EU member states.<sup>88</sup> Indeed, proceedings were initiated against RWE AG and E.ON in 2007, followed by very recent investigations in February of this year into the German electricity wholesale market.<sup>89</sup> RWE AG, one of the two largest electricity companies in Germany, has already initiated voluntary legal, functional and accounting unbundling in 2005. Recently, E.ON has also approached DG Competition with a proposal to sell its electricity transmission system network to an independent operator and to divest 4800MW of generation capacity to competitors. The Commission, in return would drop the antitrust case.<sup>90</sup>

In addition to individual company actions, groups such as the European Federation of Energy Traders bring together energy companies across the EU and wider Europe. EFET continuously submits discussion and reaction papers to the Commission, the Council and the Parliament, thus adding to the dialogue between EU institutions and energy companies. EFET's official mission is "to improve conditions for energy trading in Europe and provide an exchange for non-commercially sensitive information between organizations and members of the developing pan-European energy industry."<sup>91</sup> The dialogue between the Commission and energy companies, bypassing the national government, shows that the dominant societal actors do not only rely on the government to represent their interests at the EU level, but are directly communicating their interests to the relevant European institutions. In addition, this could also be

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<sup>88</sup> Neelie Kroes, "Towards an Efficient and Integrated European Energy Market – First Findings and Next Steps," speech given at the European Commission Conference, Energy Sector Inquiry, Brussels, Feb 16, 2006, <http://ec.europa.eu/comm/competition/sectors/energy/inquiry/index.html>

<sup>89</sup> European Commission, *Antitrust Cases (1999 to date)*, <http://ec.europa.eu/comm/competition/antitrust/cases/index.html>

<sup>90</sup> European Commission, *Antitrust: Commission welcomes E.ON proposals for structural remedies to increase competition in German electricity market*, MEMO/08/132, Brussels, Feb 28, 2008, <http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/08/132&format=HTML&aged=0&language=EN&guiLanguage=en>

<sup>91</sup> European Federation of Energy Traders, *Mission*, <http://www.efet.org/Default.asp?Menu=63>

regarded as a sign of big energy companies wishing to create a good pan-European image for themselves, in view of possible mergers and acquisitions. Such interaction is largely overlooked by LI theory, which focuses mainly on the governments' efforts to represent their main constituencies.

Perhaps the biggest commitment on Germany's behalf to a European energy policy came during the German EU Presidency in the first half of 2007. At the March 2007 European Council, energy policy was on top of the agenda, in view of the Commission's January proposal. It is no coincidence that the issue was brought up during German presidency, for a number of reasons, such as the ever-growing concerns with energy security following the 2006 Russian-Ukrainian gas crisis, and Chancellor Merkel's repeated commitment to energy efficiency and emission reductions. The German Energy Summit of October 2006 strongly emphasized the climate protection goals as well as the lack of competition on the German market and high dependence on energy imports.<sup>92</sup> When Merkel took the seat of EU president in January, expectations were high among her European colleagues. After a year of two small country presidencies (Austria and Finland) and dampened spirits over the failed EU constitution, Merkel was regarded as a potent leader, capable to move the EU forward on salient issues.<sup>93</sup> She has largely managed to live up to the expectations of her European colleagues, often times having to maneuver between her home base and Brussels.

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<sup>92</sup> BMWi, BUI, "Report of the Working Group 2: National Aspects," in preparation of the German Energy Summit, October 9, 2006, original text in German.

<sup>93</sup> Katinka Barysch, "What to expect from the German presidency," *Centre for European Reform*, Jan 3, 2007, [www.cer.org.uk](http://www.cer.org.uk)

## 4. CASE STUDY: UNITED KINGDOM

The United Kingdom presents an interesting case for study of energy policy in the European integration context, as it has been the frontrunner of crucial changes in energy utilities sector since the 1980s. What since became known as the “British model” is characterized by privatization of state-owned utility companies, creation of competitive wholesale and retail markets, and effective separation of network operation activities from market-driven retail supply activities.<sup>94</sup> Whether this model has proven to be successful and efficient in achieving its main goal (price reduction through introduction of competition) is an on-going debate among scholars.<sup>95</sup> However, it is beyond the scope of this thesis, which assesses not the success of the British model but rather the main players involved in the process and its connection with the EU energy policy debate.

The British case is all the more interesting as it presents somewhat of a challenge for the LI theory, the main theoretical framework used in this thesis. The British government played a decisive role in promoting the liberalization of the energy market despite the powerful position of the coal industry union, and its own commitment to nuclear power. Managing to establish ground-breaking rules and regulations governing competition in the energy market, the British model is largely reflected in the Commission directives for setting up common rules in the European energy market. However, having established a competitive market, the UK is now faced with additional energy challenges, which undoubtedly influence its national preferences and commitments.

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<sup>94</sup> Steve Thomas, “The British Model in Britain: Failing Slowly,” *Energy Policy* 34 (2006), 584.

<sup>95</sup> C.f. Steve Thomas, “The Grin of the Cheshire Cat,” *Energy Policy* 34 (2006): 1974-1983 and R. Green, “Failing electricity markets: should we shoot the pools?” *Utilities Policy* 11 (2003): 155-167.

#### **4.1. The UK natural gas market liberalization**

The UK downstream natural gas market has gone through a metamorphosis beginning with the Gas Act of 1986 and privatization of the state-owned monopoly supplier, British Gas (BG). Jonathan Stern divides the liberalization process into four phases. During the first phase, British Gas was privatized and the Gas Act created a regulator, the Office of Gas Supply (Ofgas) in charge of protecting the consumers and managing competition in the market.<sup>96</sup> During the second phase Ofgas attracted new entrants to supply the industrial market by requiring BG to publish price schedules, decrease its share of the non-captive industrial market to 55%, and purchase no more than 90% of North Sea gas production in order to make it available for new entrants. By 1994, the beginning of the third phase, the competition had picked up and become self-sustaining, experiencing sharp price falls and surplus capacity. In 1997, BG separated its supply and trading business into an independent company, Centrica, while its exploration, production, transportation and international trade activities were concentrated under the aegis of BG plc. The last phase, initiated in 1998, opened up the residential market to competition, during which about 20% of customers switched their suppliers and experienced price reductions of 24-27%.<sup>97</sup> By 2002, there were eight major gas suppliers in the UK, some with 20 to 30% of the market in many regions.<sup>98</sup>

All through the four phases of liberalization the Conservative government, which stayed in power from 1979 until 1997, was a firm believer in and main initiator of the reforms. It had persistently gone along with its plan, fast tracking legislation through the parliament and

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<sup>96</sup> UK Government, *Gas Act 1986*, The UK Statute Law Database, Ministry of Justice, <http://www.statutelaw.gov.uk/Home.aspx>

<sup>97</sup> Stern, *Competition and Liberalization*, 119-121.

<sup>98</sup> International Energy Agency, *Energy Policies of IEA Countries- The UK 2002 Review*, [http://www.iea.org/Textbase/publications/free\\_new\\_Desc.asp?PUBS\\_ID=1092](http://www.iea.org/Textbase/publications/free_new_Desc.asp?PUBS_ID=1092)

transferring considerable powers to the director of Ofgas.<sup>99</sup> Ofgas became the first European energy industry regulator, charged with specific powers, responsibilities and access to information.<sup>100</sup> It used its powers, when necessary referring to the Monopolies and Mergers Committee (MMC), to break up BG's monopoly status on the market and regulate the creation of competition. Relations between BG and first two Director Generals of Ofgas remained continuously strained.<sup>101</sup> However, it is interesting to note that breaking up a dominant energy monopoly such as BG did not turn out to be an overwhelmingly difficult task. BG unilaterally implemented MMC's "gas release" target of purchasing not more than 90% of any new gas field.<sup>102</sup> Already in 1991, the first independent gas supplier, Quadrant (joint venture of Shell/Esso) entered the industrial market, using BG's transportation system.<sup>103</sup> The initiative to demerge in 1997, also following an MMC report, was apparently taken voluntarily by BG.<sup>104</sup> It appears to be quite a puzzle how a company with a 100% share of the industrial contact market let that share fall to 35% in only five years. The answer seems to lie in BG's ability to diversify its business into exploration, production and global trading outside the UK.<sup>105</sup> Indeed, today BG Group has activities in exploration/production, LNG, transmission/distribution and power generation, operating in 27 countries across continents, including the UK Continental Shelf (UKCS) upstream production.<sup>106</sup> While BG Group has been exploring its possibilities abroad, the UK energy market has opened to the US, Dutch, German and French energy suppliers.

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<sup>99</sup> Stern, *Competition and Liberalization*, 122-123

<sup>100</sup> Stern, *European Gas Markets*, 81.

<sup>101</sup> Catherine Waddams Price, "The UK Gas Industry," in *Competition in Regulated Industries*, eds. Dieter Helm and Tim Jenkinson (Oxford, UK: Oxford University Press, 1998), 111

<sup>102</sup> Stern, *European Gas Markets*, 82

<sup>103</sup> Alexander J. Black, "Competition Law and British Natural Gas Regulation," *Energy Law Journal* 13, no.2 (1992), 369

<sup>104</sup> Philip Wright, "Liberalization and the security of gas supply in the UK," *Energy Policy* 33 (2005), 2282

<sup>105</sup> Black, "Competition Law", 371

<sup>106</sup> BG Group, *Annual Report and Accounts 2007*, <http://www.bg-group.com/InvestorRelations/Reports/Pages/AnnualReport.aspx>

## **4.2. Liberalization in the context of domestic producers**

In addition to the Ofgas efforts and BG's "cooperation", making the gas market competitive and attractive for investment had to be coordinated in the domestic context of traditional fuel suppliers, the coal and nuclear industries.

The coal industry employed around 300, 000 people by 1970 and had managed to keep that number stable through the decade with two successful national strikes and international oil crisis of 1973. When Conservatives announced plans for pit closures and job cuts in early 80s, the coal miners union, National Union of Mineworkers (NUM), initially averted those plans through negotiation in 1981; however, a major strike broke out in 1984.<sup>107</sup> Though the strike was unsuccessful and largely curbed NUM's power, the coal industry remained protected for a while by being granted special contracts with power generators until 1998. During that period, British Coal was privatized, and both the prices of coal and its share in electricity generation had declined and by the end of the contracts the British mining industry "was effectively destroyed".

<sup>108</sup> According to the Department for Business Enterprise and Regulatory Reform (BERR), as of 2006, the British Coal industry employed merely 5,600 people, with only 34% of electricity generation fired by coal in 2005. However, the demand for coal in power generation has recently increased, in view of its more attractive price in comparison to gas, due to declining North Sea gas production.<sup>109</sup>

The 1987 Conservative Party election manifesto stated that: "to reject, as our opponents do, the contribution of nuclear energy to supplying reliable, low-cost electricity, and to depend

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<sup>107</sup> Dave Lyddon, "1984-85 Miners' Strike," *The Union Makes Us Strong: TUC History Online*, Trades Union Congress, [http://www.unionhistory.info/timeline/1960\\_2000\\_Narr\\_Display\\_2.php?Where=NarTitle+contains+%27The+1984-85+Miners+Strike%27+](http://www.unionhistory.info/timeline/1960_2000_Narr_Display_2.php?Where=NarTitle+contains+%27The+1984-85+Miners+Strike%27+)

<sup>108</sup> Thomas, "British Model in Britain", 590

<sup>109</sup> Department for Business Enterprise and Regulatory Reform, *Coal Industry in the UK*, <http://www.berr.gov.uk/energy/sources/coal/industry/page13125.html>

on coal alone, would be short-sighted and irresponsible.”<sup>110</sup> Thus unlike with the coal industry, the government committed itself to continuing the nuclear program, which dated back to 1956. According to Steve Thomas, governments usually support nuclear power for strategic purposes, as an indigenous and stable source of power compared to carbon fuels with volatile prices and supplies.<sup>111</sup> However, it is also a costly and financially risky source of energy, thus it could not be privatized at the same time with the gas and electricity market. To keep its promise and protect nuclear energy from market competition, the government introduced a consumer subsidy, which raised about £1 billion per year for the publicly owned nuclear generator, Nuclear Electric. Meanwhile, the government also went along with the construction of a new reactor unit, Sizewell B, despite projections that it would not be able to recover its costs.<sup>112</sup> The European Commission eventually declared the subsidy an unfair state aid, and it was removed in 1996 with the privatization of nuclear reactors in a new company, British Energy.<sup>113</sup>

By the time of the expiration of the coal contracts, removal of the nuclear subsidy, and the opening of the residential market, the UKCS gas production had boomed, creating a surplus of gas and driving prices down.<sup>114</sup> Natural gas became an attractive fuel for power generation, and electricity generators began the so-called "dash for gas", building cheap combined cycle gas turbines (CCGT) which could effectively recover their full costs from Power Pool (wholesale electricity market) receipts. By 1999, a total of 18,500 MW of power had been generated at these

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<sup>110</sup> UK Conservative Party, *1987 Conservative Party General Election Manifesto*, Archive of Conservative Party Manifestos, <http://www.conservative-party.net/manifestos/1987/1987-conservative-manifesto.shtml>

<sup>111</sup> Steve Thomas, “Can nuclear power plants be built in Britain without public subsidies and guarantees?” presented at conference, *Commercial Nuclear Energy in an Unstable, Carbon Constrained World*, Prague, Czech Republic, March 17-18, 2008

<sup>112</sup> Ibid., 13

<sup>113</sup> Thomas, "British Model in Britain," 590-591.

<sup>114</sup> Department for Business Enterprise and Regulatory Reform, *Energy Statistics: Gas*, <http://www.berr.gov.uk/energy/statistics/source/gas/page18525.html>

plants.<sup>115</sup> Thus the connection between gas and electricity markets created a new interest group in the society, generators, who were in favor of liberalization in order to decrease their costs and offer cheaper prices to both contract and tariff consumers.

#### **4.3. New Labor, New Order? Shifting preferences in security of supply**

By the time the Labor Party, headed by Tony Blair came into office in 1997, liberalization in the energy market had largely been completed and continued at full speed with the opening of the residential market in 1998, though halted for a brief while with the so-called “stricter consents” on the gas-powered plants to help boost the coal industry again.<sup>116</sup> However, the new government added more issues to its agenda to keep up with the contemporary energy challenge. The 2003 Energy White Paper established a pillar system quite similar to that of the Commission's:

This white paper is a milestone in energy policy. It is based on the four pillars of the environment, energy reliability [security of supply], affordable energy for the poorest, and competitive markets for our businesses, industries and households.<sup>117</sup>

Though competition and liberalization is still the corner stone of the government strategy, the addition of other issues, such as the environmental and security of supply concerns have important implications both for the national and the EU agenda of the UK.

First and foremost, security of supply has only recently started occupying the minds of the British government. In the 1986 Gas Act, security of supply was not mentioned explicitly and was in principal conditional to economic objectives of competition. The 1995 Gas Act established the "Network Code" and a new Public Gas Transporter's (PGT) License for Transco,

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<sup>115</sup> IEA, *Energy Policies of UK 2002*, 104

<sup>116</sup> Ibid.

<sup>117</sup> Department of Trade and Industries, “Energy White Paper- Our Energy Future- Creating a Low Carbon Economy,” CM 5761 (HMSO, 2003): p. 3, <http://www.berr.gov.uk/files/file10719.pdf>

the monopoly transportation and distribution system, which mentioned some measures on transportation and distribution relevant to security of supply. However, some major changes happened with the Utilities Act of 2000, which merged the electricity and gas regulators into a single body, the Gas and Electricity Markets Authority, to govern the single Office for Gas and Electricity Markets (Ofgem).<sup>118</sup> The Utilities Act explicitly states that the authority has the duty "to secure a diverse and viable long-term energy supply."<sup>119</sup> In 2002, a Joint Energy Security of Supply working group was established with the responsibility of meeting on a regular basis and reviewing the situation. The first JESS report in 2002 stated:

Britain's energy markets have recently adjusted to both the collapse of the world's largest energy trader, Enron, in late 2001, and increasing gas demand (the highest gas demand to date was 427 mcm/d (million cubic metres a day), on 2 January 2002, and this demand was met from a range of sources, including beach gas, gas from storage and gas through the interconnector [pipeline between the UK and Belgium]).<sup>120</sup>

This situation and switch of attention to security of supply issues have multiple implications for the UK energy market. First and foremost, it puts more responsibility on the government and its regulator, Ofgem, to ensure that the liberalized and competitive market works and delivers properly, and to step in and correct its failures when it does not or can not do so. In so far that it implies diversifying the energy mix, the government in 2005 has declared attempts to re-launch the nuclear program, this time without a subsidy and totally implemented by the private sector.<sup>121</sup>

On the EU level, the UK has recently backed France, some Central European and Baltic states on the idea of a "single negotiator" with foreign exporters, which they presented at the European Council in March 2006.<sup>122</sup>

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<sup>118</sup> Wright, "Liberalization and security," 2277

<sup>119</sup> UK Government, *Utilities Act 2000*, The UK Statute Law Database, Ministry of Justice, <http://www.statutelaw.gov.uk/Home.aspx>

<sup>120</sup> Joint Energy Security of Supply Working Group, *First Report- June 2002*, <http://www.berr.gov.uk/files/file10728.pdf>

<sup>121</sup> Thomas, "Can nuclear power plants be built in Britain", 3

<sup>122</sup> Finon and Locatelli, "Russian and European gas interdependence," 424

#### 4.4. The EU energy policy context

The UK had largely implemented the energy market model that the Commission has been promoting even before most of the Commission proposals were put forward. Third party access, creation of a regulator, unbundling of transportation and supply activities, the right to choose your gas supplier all exist in the British market. From the beginning of the EU energy policy debate, Margaret Thatcher, though largely at odds with the European Community over procedural and budgetary issues, in principle supported the internal market liberalization. "Insofar as Thatcher was pro-European, it was largely because she saw the EC almost exclusively as an organization for promoting economic liberalism in the industrial and service sectors."<sup>123</sup> The state and future of European industries were on the agenda of the European Council during British presidency in 1981. In a communication to the Council on the strategy for European industries, the Commission stated:

The sealing off of national public-sector markets is a threat to the unity of the market that will get worse unless the growth of the public sector in the Member States is accompanied by the opening up of public contracts [...] However, the disadvantages of restricted public procurement, [...] are becoming more and more obvious: as a result, the time has come to take a firm step towards opening up these contracts.<sup>124</sup>

The Communication goes on to propose that the telecommunications industry presents a good example of an industry in need of liberalization and introduction of a European regulatory agency.<sup>125</sup> In 1984, telecommunications became the first utility sector to be privatized in the UK, starting a wave of privatization followed by gas and electricity markets.<sup>126</sup>

<sup>123</sup> Moravcsik, "Negotiating the Single European Act", 52.

<sup>124</sup> European Commission, *A Community Strategy to develop Europe's industry*, Com(81) 639, Brussels, October 23, 1981.

<sup>125</sup> Ibid.

<sup>126</sup> Mark Armstrong, "Telecommunications," in *Competition in Regulated Industries*, eds. Dieter Helm and Tim Jenkinson (Oxford, UK: Oxford University Press, 1998), 139.

The current government is also broadly in support of the Commission strategy, though finds some proposals even too ambiguous to reach the set goals. In a Memorandum on the Commission Green Paper, Ofgem expressed its views by agreeing with the main objectives of the Paper and listing additional concrete measures that, in Ofgem's view, should be included and implemented by the Commission. These measures are mostly related to the internal market (unbundling, competition, European regulators) but emphasis is also put on solidarity, external action, climate action and energy mix.

The strong role for EU wide action concerning most of the issues identified in the Paper is appropriate, particularly in relation to the need for solidarity between Member States, external relations, and climate change issues. The EU should also retain a role in order to oversee the coherent development of the EU gas and electricity markets – for example ensuring that national market developments complement EU wide market development, and that powers of regulators are consistent across the EU.<sup>127</sup>

Ofgem's call for more concrete measures from the Commission does not mean that it would necessarily favor ceding more power to it. Rather, it could be reflecting a sincere belief in the "British model" and its application in the rest of Europe, coupled with security of supply concerns that are rather new to the UK. However, exporting the "British model" to the continent is not as easy as pumping gas through the Interconnector. Britain's alignment with the Commission policies does not guarantee the agreement of other member states to follow suit, especially the ones with a more vulnerable or essentially different market structure and understanding of energy policy.

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<sup>127</sup> Ofgem, "Memorandum from the Office of Gas and Electricity Markets," House of Lords EU Committee – Internal Market (Sub-Committee B) Inquiry into the European Commission's Green Paper "A European Strategy for Sustainable, Competitive and Secure Energy", p. 1, [http://ofgem2.ulcc.ac.uk/temp/ofgem/cache/cmsattach/16113\\_Ofgem\\_Inquiryinto\\_the\\_Green\\_Paper.pdf?wtfrom=/ofgem/shared/template3.jsp&assortment=/parliament/selectcommitteeevidence](http://ofgem2.ulcc.ac.uk/temp/ofgem/cache/cmsattach/16113_Ofgem_Inquiryinto_the_Green_Paper.pdf?wtfrom=/ofgem/shared/template3.jsp&assortment=/parliament/selectcommitteeevidence)

## 5. DIVERGENCE AND CONVERGENCE: THE OUTCOME

As seen from the case studies, member states have quite distinct energy policies, which more often than not tend to diverge. The theoretical framework of LI used in this thesis suggests that institutional and substantive outcomes at the EU level reflect the preferences of member states, especially the "big three" and integration is likely to happen if there is enough convergence in preferences. In most cases, the Commission, through official statements and unofficial channels, is highly aware of the member states' stances and proposes legislation accordingly. The Commission intentionally keeps the tone of some of its proposals and directives down, in order to find a lowest common denominator for all the member states involved in the decision-making process. Thus it is possible to examine the energy policy proposals, culminating in the 2007 "An Energy Policy for Europe" communication, in light of the national preferences of member states studied in this thesis, Germany and the UK.

### 5.1. *Energy market liberalization*

The Commission's 1992 Draft Directive on common rules for the internal gas market contained three main principles: abolition of exclusive rights, unbundling and TPA.<sup>128</sup> Of the three, TPA seemed to be the most controversial one. TPA was first mentioned in the 1988 Commission working document and sparked many negative reactions mainly from big natural gas producers and transmission companies, as well as Member States' government representatives. The reason for that was the near-monopolistic control of gas and electricity networks under long-term contracts by big transmission companies.<sup>129</sup> A report issued in the mid-90s by a Member States' Committee (CCEMG) stated that: "...in terms of balance of

<sup>128</sup> European Commission, *Proposal for a Council Directive concerning common rules for the internal market in natural gas*, Com(91) 548 Final, Brussels, February 21, 1992.

<sup>129</sup> Matlary, "Energy Policy", 264

opinions, the skeptics of the possible advantages and modalities of implementing TPA outnumbered those who were favorable.”<sup>130</sup> Though the report was anonymous, it was clear that the UK, which already had such a system in place, was in favor of it, while other member states were against, Germany being one of them. German supra-regional companies are known for entering into long-term take-or-pay contracts for imports and internal supplies, and not being very keen on letting third parties enter their system.<sup>131</sup> For example, in 1986 Ruhrgas refused Bayerngas, a Bavarian transmission company, access to its system for transporting Algerian LNG cargoes. Though the case went to the European Commission, there was no effective remedy provided.<sup>132</sup> The German way of creating gas-to-gas competition is simply to allow new entrants to build their own pipelines, the most successful example of which is Wingas. Wingas, a joint venture of Gazprom and Wintershall AG, entered the German market in 1993 and by 2002 controlled 1,836 km of high-pressure pipelines.<sup>133</sup> However, in the UK, providing TPA to the networks of Transco, the monopoly transportation network, is an essential component of supply competition. TPA is guaranteed both by the 1995 Gas Act and the 1996 Network Code.<sup>134</sup> As a middle ground, the 1998 Gas Directive provided two options for third party access: negotiated and regulatory.<sup>135</sup>

The 1998 Gas Directive also settles for the lowest common denominator for unbundling provisions. As mentioned in the previous chapters, the German natural gas market structure and dominant players are very much against full ownership unbundling, while the UK together with

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<sup>130</sup> Cited in Stern, *Third Party Access*, 80

<sup>131</sup> IEA, *Energy Policies of Germany 2002*, 77

<sup>132</sup> Stern, *Third Party Access*, 88

<sup>133</sup> IEA, *Energy Policies of Germany 2002*, 74

<sup>134</sup> Wright, “Liberalization and security of gas supply”, 2280

<sup>135</sup> European Parliament and European Council, *Directive concerning common rules for the internal market in natural gas*, 98/30/EC, Luxembourg, June 22, 1998, [http://ec.europa.eu/energy/gas/legislation/historical\\_documents.htm](http://ec.europa.eu/energy/gas/legislation/historical_documents.htm)

the Netherlands, Denmark, Portugal, Romania, Spain and Sweden, has already implemented this provision.<sup>136</sup> The 1998 Gas Directive found a compromise, mentioning only unbundling of “the accounts of all integrated undertakings in the sector” (emphasis added by the author)<sup>137</sup> as opposed to full asset ownership unbundling. However, the Commission never completely abandoned the idea and pressed forward with unbundling recommendations, sparking more negative reaction from Germany. Recently, president of the German Gas Federation called asset unbundling an “expropriation”, while the German economics minister Michael Glos claimed that it is unconstitutional.<sup>138</sup>

It is worth mentioning that the much debated Gas Directive was adopted in 1998, with all the above-mentioned concessions, and obliged the Member States to implement it by 2000, eight years after the initial Commission proposal. The Directive was amended in 2003, and in September 2007 DG TREN put forward its “Third Legislative Package”, containing proposals for new gas and electricity directives. The package is clearly hoping to catch the wave created by the adoption of “An Energy Policy for Europe” few months earlier. The unbundling issue is back on the agenda, with clear indications that ownership unbundling is necessary.<sup>139</sup> However, an alternative option of an Independent System Operator (ISO)<sup>140</sup> is still available. This is clearly intended for member states such as Germany, Austria, Bulgaria, Greece, France, Latvia,

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<sup>136</sup> European Commission, *An Energy Policy for Europe*, 7

<sup>137</sup> European Parliament and European Council, *Directive concerning common rules for the internal market in natural gas*, 98/30/EC, Luxembourg, June 22, 1998, [http://ec.europa.eu/energy/gas/legislation/historical\\_documents.htm](http://ec.europa.eu/energy/gas/legislation/historical_documents.htm)

<sup>138</sup> Daniel Niles, “German energy utilities: resistance to asset unbundling,” *Energy Business Review*, Jan 30, 2007, [http://www.energy-business-review.com/article\\_feature.asp?guid=05986B55-6F23-4974-B1FF-5CE4E93FEFAF](http://www.energy-business-review.com/article_feature.asp?guid=05986B55-6F23-4974-B1FF-5CE4E93FEFAF)

<sup>139</sup> European Commission, *Proposal for a Directive of the European Parliament and of the Council amending Directive 2003/55/EC concerning common rules for the internal market in natural gas*, COM(2007) 529 final, Brussels, September 19, 2007

<sup>140</sup> This option enables companies to retain the ownership of their network assets, but requires that the transmission network itself is managed by an independent system operator - entirely separate from the company.

Luxembourg and Slovakia, who are opposed to full ownership unbundling. Thus, no uniform provision for unbundling is suggested.

## **5.2. A new agenda for Europe?**

It should be noted that the liberalization agenda that dominated the 1990s, has gradually yielded its key position to the other two dimensions of energy policy: security of supply and sustainability. While the rhetoric of liberalization is still invoked in connection to the other dimensions, a general realization now exists that creating an energy market with truly uniform rules and regulations for market access, competition and ownership might after all prove to be rather cumbersome. Thus, the Commission has in recent years seized the opportunity to emphasize the newly emerging concerns of the Union regarding security of supply and climate change.

"An Energy Policy for Europe" presents a good example of this change of heart and action. The 28-page document reiterates the three dimensions of energy policy, however it makes a heavy emphasis on emission reduction targets, renewable energy source and energy efficiency.

[...]in this Strategic Energy Review the Commission proposes that the European Energy Policy be underpinned by:

- an EU objective in international negotiations of 30% reduction in greenhouse gas emissions by developed countries by 2020 compared to 1990. In addition, 2050 global GHG emissions must be reduced by up to 50% compared to 1990, implying reductions in industrialised countries of 60-80% by 2050;
- an EU commitment now to achieve, in any event, at least a 20% reduction of greenhouse gases by 2020 compared to 1990.<sup>141</sup>

This attitude undoubtedly reflects the Commission's intentions to keep energy policy high on the agenda, by focusing on more salient points, or the ones that member states display more divergence or at least general agreement on. Emission reductions and use of renewable energy have been on the agenda since at least 1992, with the signing of the UN Framework Convention

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<sup>141</sup> European Commission, *Energy Policy for Europe*, 5.

on Climate Change (UNFCCC), to which the EU is party as a regional organization and which, therefore, binds the Union as a whole to implement its commitments.<sup>142</sup> However, introducing a common target for the EU initially proved problematic for at least two reasons: divergence on the means to reach the target and a more acute question of actual ability to reduce emissions. The so-called "cohesion countries", which now also include the twelve new member states, have always been considered the "laggards", while Germany, together with the Netherlands and Denmark, formed the "green troika".<sup>143</sup> Meanwhile, the UK, caught in the wave of liberalization and principally cautious of extensive community powers, had clashed with Germany and the Commission on issues such as introduction of a carbon tax and energy efficiency standards in appliances.<sup>144</sup>

However, the New Labor government published the first UK Climate Change Program in 2000, committing itself to 20% GHG emissions reduction target by 2010 from 1990 levels.<sup>145</sup> Since the Labor's coming into office in 1997, new departments and units have been established to oversee and implement the environmental strategy of the government: the Sustainable Development Unit, the Office of Climate Change, the Department for Environment, Food and Rural Affairs etc. Though analysts and scholars argue that despite its commitments, the UK is unable to meet its targets due to still pursuing a policy of competition and price reduction,<sup>146</sup> it

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<sup>142</sup> Wyn Grant et. al., *The Effectiveness of European Union Environmental Policy* (New York, NY: St. Martin's Press, 2000), 120

<sup>143</sup> Ibid., 122

<sup>144</sup> Ibid., 141

<sup>145</sup> Department of the Environment, Transport and the Regions, *Climate Change: The UK Programme 2000*, London, CM4913, <http://www.defra.gov.uk/environment/climatechange/uk/ukccp/2000/index.htm>

<sup>146</sup> C.f. John Barry and Mathew Paterson, "Ecology, Political Economy, New Labor," paper presented at the European Consortium on Political Research Joint Sessions Workshop, *The Global Ecological Crisis and the Nation-State*, Grenoble, France, April 6th-11th, 2001

has created the momentum to bring climate change on top of the EU agenda, including the March 2007 European Council chaired by Germany.

"An Energy Policy for Europe" also accentuates the issue of security of supply as connected to two issues: dependence on imports and market liberalization. As discussed above, security of supply is a complex concept that not only requires diversifying outside sources, but also effectively regulating the internal market and, when need be, correcting its failures. In this sense, the proposal mentions both the need for diversification and solidarity between member states in the event of an energy crisis, as well as strengthening the role of network regulators.<sup>147</sup> In the UK, the discussion on Ofgem's duties and responsibilities has been going on for a while<sup>148</sup>, whereas Germany has recently created a regulator with the 2005 Energy Industry Act.

### ***5.3. Applying LI to EU energy policy***

To conclude the above-mentioned discussion of national preferences and interstate bargaining outcomes, it is possible to develop a table to put into perspective all three dimensions of energy policy. This table identifies positions of member states (Germany and the UK) on main aspects of each dimension, and the relevant outcome on the EU level, as outlined in "An Energy Policy for Europe".

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<sup>147</sup> European Commission, *Energy Policy for Europe*

<sup>148</sup> Chairman of Ofgem, Sir John Mogg, is also President of the European Regulators' Group for Electricity and Gas

<b>Dimensions</b>	<b>Germany</b>	<b>The UK</b>	<b>EU outcome</b>
Liberalization/ Competition	Opposed to TPA and ownership unbundling	TPA, full ownership unbundling, consumer choice	Two options: negotiated or regulated TPA, full unbundling or ISO
Security of supply	Increased dependency on imports, big deals with energy exporters (Russia)	Decreasing indigenous production, potential risks of liberalization	Solidarity, diversification, better regulation
Sustainability	Strong commitment to renewable energy increase (20% by 2020), emission reductions (40% by 2020), in favor of an EU-wide carbon tax	Recent commitment to emission reduction (20% by 2010), opposed to carbon tax	Mention of taxation as a measure to achieve energy efficiency, emission reduction and energy efficiency target of 20% by 2020

As seen from this table, the substantive outcome on the EU level tends to find a middle ground on issues of divergence, while strongly supporting and proposing concrete measures on issues of convergence. This, as predicted by the LI theory, in turn depends on shifting national preferences and the government's ability to maneuver between the national and intergovernmental politics. It is essential to keep in mind that national preferences are not fixed, but change over time with the national or international context. Moreover, as we have seen in the British case, governments can pursue certain policies at the expense of a dominant social group, potentially undermining their political base. LI theory explains this behavior as the result of ambiguous policies, which can give governments considerable leeway. However, in the British case, the policy pursued by the government had very clear implications for the coal industry. In the case of Germany, the ambitious emissions reduction target also has clear implications for the auto industry. Nonetheless, it is important to keep in mind that governments often times have a double agenda, one pursued at home and another one in Brussels.

## CONCLUSION

This thesis has critically evaluated the making of EU energy policy in the context of competing national preferences of EU member states. Its main aim was to clearly identify salient issues alongside three dimensions of energy policy (competition/liberalization, security of supply and sustainability) and explain the institutional and substantive outcomes on the EU level.

To put the “national fact” and “European fact” in a theoretical perspective of EU integration, the thesis employed the theory of liberal intergovernmentalism, developed by Andrew Moravcsik. LI brings together liberal theory of national preference formation and rational theory of interstate bargaining. Its explanatory power allows it to be applied to various integration areas, albeit some shortcomings.

In the context of this thesis, LI can contribute to our understanding of national preference formation in energy policy and its transformation to the intergovernmental level. Energy policy constitutes an area with clearly identified domestic and international actors, with clearly defined stakes and interests. Taking that as a starting point, one can further investigate how deeply these interests are entrenched in the society and how they are represented on the domestic, as well as the interstate level. This thesis has aimed to do that with the example of two EU member states, namely Germany and the UK.

The main findings of the investigation of the UK and German energy market, with a focus on the natural gas sector, have revealed that national policies are indeed affected by interest groups, particularly big energy producers and suppliers. However, due to its unique structure and vital role in the economy and everyday life, energy policy has far reaching implications for consumers, industries, the environment, foreign policy makers and many groups and individuals. Thus ideally every government considers it a duty upon itself to develop and

pursue such an energy policy as to maximize benefits and minimize costs. However, in reality formulating an energy policy almost always requires a degree of sacrifice. In the case of Germany, the government has been protective of its energy sector, represented by vertically integrated supra-regional companies, keeping energy prices rather high for consumers, at the same time claiming that the existing structure and bilateral deals with big gas exporters is the best way to ensure security of supply. On the other hand, the UK has liberalized its energy market, lowering consumer prices, at the expense of traditional energy suppliers and recently having to deal with bankruptcies of energy companies and create rules to ensure stable supplies. As far as climate change is concerned, both countries have developed emissions reduction targets and strategies, however also subject to further commitment from main pollutants.

The European Commission meanwhile has developed its own energy policy, first connected to the single market project of the early 90s, and later developing a more elaborate three-dimensional approach to include security of supply and sustainability. However, the outcome of its efforts to make the EU speak with a “single voice” on energy has largely depended on the divergence and convergence of national preferences. Thus what we see today is an energy policy with somewhat diluted proposals that creates a lowest common denominator, and without efficient enforcement mechanisms or non-compliance penalties, except for DG Competition’s sector inquiry.

However, this does not mean that no progress at all has been made or that the Commission is completely powerless in the energy policy. It has been able to use windows of opportunity, and its official and unofficial connections with the energy industries and companies. Moreover, however deep the cleavages in member state preferences, it still pays off to be a good European, at least on paper. "An Energy Policy for Europe" was adopted by the European

Council in March 2007, marking a commitment from all member states to speak in “single voice” on energy. Whether this commitment will solidify is an issue that needs to be seen in the complex context of national politics, changing coalitions, interest groups and new moves from Brussels.

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