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Commitments as a tool for energy sector liberalisation

Killian Kehoe of Hill & Knowlton considers the commission's use of Article 9 of the Modernisation Regulation to secure commitments from actors in the energy market



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COMMITMENTS AS A TOOL FOR ENERGY SECTOR LIBERALISATION

Killian Kehoe considers the European Commission's use of Article 9 of the Modernisation Regulation to secure commitments from actors in the energy market and drive the liberalisation agenda¹

Introduction

The energy sector has been the target of wide-ranging European reforms in order to establish a fully functioning single energy market, and the European Commission's use of the Article 9 commitments provision has been very much a part of this effort.

As many will be aware, these steps towards reform in the energy sector have formed part of the wave of liberalisation introduced by the commission in an array of other sectors such as postal services, telecommunications and transport, all designed to open these sectors to international competition, and to benefit consumers and businesses by securing a more complete single market and more reasonable prices.

However, over the course of the last five years the path to energy liberalisation has been identified by the commission as an area in need of further attention, given the lack of political willpower on the part of certain Member States to advance this. Consequently, DG Competition in particular has adopted competition policy tools as a means of driving the liberalisation process, to achieve the objectives of energy sector reform and a competitive single energy market.

This article will seek to briefly outline the background to the energy sector reform process, before considering some examples in which the commission has used the antitrust investigation procedure to secure structural reform among some of Europe's largest energy market players. The article will then raise some concerns about this process and how these concerns might be remedied.

Background of the energy sector liberalisation process

With respect to the electricity and gas sectors, the liberalisation process has involved the introduction of a series of legislative packages initiated by the commission, starting with the first liberalisation directives adopted in 1996 (for electricity) and 1998 (for gas), and was followed by the second liberalisation directives in 2003. However, in the light of the limited and partial impact of these measures on the sector, the DG Competition launched an enquiry in 2007 into the energy sector to identify the barriers in place that prevent competition.

This identified a number of anticompetitive aspects to the workings of the energy sector in the EU, including: high market concentration encouraging collusion between incumbents to share markets; vertical integration of supply, generation and infrastructure; a lack of access to infrastructure; and under-investment by transmission companies. All of these factors, it was decided, justified further regulatory reform.

The third liberalisation package was adopted as a step towards this reform, and came into force on 3 March this year. This package seeks to introduce a number of new steps including: unbundling of production and supply interests; increased transparency of retail markets; more effective regulatory oversight; the establishment of the Agency for the Cooperation of Energy Regulators; and increased cross-border collaboration and investment through the establishment of the European Network for Transmission System Operators.

But despite the progressive steps taken through successive legislative packages, obstacles to reform remain, with many of

the features observed by the sector enquiry still in evidence. There is also a fragmentation of the European energy market into localised and highly concentrated Member State markets, which are unwelcoming to new entrants. These obstacles are compounded by the lack of political willpower on the part of Member States such as France, Germany and others to take steps to implement the provisions of the third liberalisation package. This has resulted in the commission applying significant political pressure by threatening to take infringement proceedings against those Member States that have failed to take such steps² in February 2011, as well as suggesting it will initiate further reforms if required. The Hungarian presidency has also made energy liberalisation a priority of its current presidency.³

These delays and the persistence of anticompetitive features have led the commission to drive through liberalisation in parallel to the legislative process, by using competition policy. In the first instance, this involved the use of merger control during the wave of concentrations in the energy sector, whereby the commission secured significant modifications from the merging parties under Article 6(2) of the EC Merger Regulation.⁴ But with the reduction in merger activity, antitrust investigations carried out under the auspices of Regulation 1/2003⁵ have provided an innovative route for liberalising segments of energy markets by negotiating significant commitments packages, according to the principles of Article 102.⁶

The commission flexes its muscles

This innovative route has involved the flexible application of the powers prescribed to the commission by Article 9 of Regulation 1/2003 on the implementation of the rules on competition.⁷ This provides that where the commission intends to adopt a decision requiring that an infringement be brought to an end, and the undertakings concerned offer commitments to meet the commission's concerns, the commission may by decision make those commitments binding on the undertakings.

Unlike the standard approach under Article 7,⁸ Article 9 does not require a conclusive finding of dominance or an abuse, but merely the taking of a preliminary view on the potential existence of dominance and an abuse. Where undertakings offer commitments and these are accepted under Article 9, any breach of those commitments may result in a fine of up to 10 percent of the target undertaking's annual turnover, without having to prove any violation of the competition rules. Alternatively, a breach may result in the commission re-opening the proceeding and carrying out a standard investigation under Article 7.

The use of this tool has been widespread, and has featured in some of the most high-profile decisions by the commission over the course of the last five years. This has involved its launching 14 individual antitrust investigations targeting energy incumbents based in Member States with diverse energy markets, such as Germany,⁹ France,¹⁰ Italy,¹¹ Belgium,¹² Sweden¹³ and the Czech Republic.¹⁴ At the time of publication, 11 of these investigations have been closed, and nine of those involved the employment of the Article 9 commitments procedure.

A short run-through of some recent examples of the application of this procedure on undertakings active in Germany, France and Italy reveals the profound impact this approach has had on those respective energy actors, and on the markets in which they operate. It ought to be noted that in most instances, the commitments proposed by the target undertaking were put to domestic regulators, as well as competitors, in order to secure their approval that the measures proposed would remove the abuses in question. This factor will be considered in the final section of this article.

The commission is willing to use Article 9 in different energy markets with their own particular features

i) Germany – E.On (2010)

The German energy sector was identified by commission investigations following the 2007 sector enquiry as suffering from a number of anticompetitive features, which prevented new entrants and competitive pricing.

After a number of significant antitrust investigations into the German energy sector, in 2010 DG Competition turned its attention to E.On's activities in the German gas market. Here, the commission's investigation preliminarily indicated that E.On had booked the largest part of the available transport capacity at the entry points into its gas-transmission networks, and on a long-term basis. It was considered that these bookings may have prevented other gas suppliers from accessing the German gas market, thereby preventing open competition.

In response to these concerns, E.On proposed significant commitments by undertaking to release large capacity volumes at the entry points to its gas networks by October 2010, which corresponded to 15 percent of the pipeline capacity. In addition, E.On has committed to further reduce its bookings of entry capacity in the NetConnect Germany grid to 50 percent and in E.On's grid for low-calorific gas to 64 percent of the pipeline capacity from 2015. This was seen by the commission as providing the possibility for other companies to compete with E.On on the German market.

ii) France – EDF (2010)

France, along with Germany, was one of the Member States most resistant to energy sector liberalisation and commission investigations, following the 2007 enquiry which also identified a number of potential abuses taking place in the French energy market.

In the 2010 EDF decision, the commission considered the undertaking's activities in the French electricity market. In particular, the commission expressed concern that the scope, duration and exclusive nature of EDF's supply contracts might prevent the other electricity suppliers from entering and expanding in the French electricity market. The commission also identified as problematic the restrictions in place on customers which prevented them from reselling their electricity.

These were identified as prima facie abuses and, in response, EDF undertook to ensure that an average of 65 percent of the electricity that it had contracted with certain customers would return to the market every year, due to contracts ending or due to customers being entitled to opt out of their supply contracts for free. It also committed to ensure that customers of future supply contracts would either last for no longer than five years, or there would at least be an option of opting out for free at least every five years.

In addition, EDF undertook to offer customers the possibility to conclude non-exclusive contracts, allowing customers to partly source their electricity from other suppliers, as well as removing the restriction that customers could not resell electricity they had contracted to purchase from EDF.

iii) Italy – ENI (2010)

Lastly, the ENI investigation scrutinised the competitive situation at play in the Italian gas market. Here, there was a concern that ENI may have foreclosed competition in the Italian gas-supply market by implementing a refusal to supply strategy by not granting competitors access to capacity available on the transport network, or doing so in an impractical manner, and by strategically limiting investment in ENI's international transmission pipeline system. These practices were interpreted to act as a restriction on competition and as harming consumers in Italy.

In response to these concerns, ENI proposed large divestments of its shares in three international transport pipelines, referred to as the TAG, the TENP and the Transgas pipeline, which the commission understood as ensuring that third-party requests to access the gas pipeline would be dealt with by an entity

independent of ENI, thereby removing the potential conflict of interest resulting from the vertical integration of ENI.

Each of these three recent examples goes a long way to illustrating the willingness of the commission to use the Article 9 procedure in a number of different energy markets with their own particular features. They also illustrate the significance and variety of commitments secured from undertakings, whether that amounts to capacity reduction, the reform of contractual obligations for energy supply, or the divestment of assets.

Liberalisation through competition enforcement – some concerns

In light of the dramatic impact of the commission's use of the antitrust investigation and the Article 9 commitments procedure, it is worth considering whether this is the best way of indirectly achieving the delayed objectives of the energy sector liberalisation process.

It is clear that Regulation 1/2003, and Article 9 in particular, is not designed to facilitate liberalisation per se, even if the goals of competition enforcement and liberalisation are often aligned. This difference in policy focus means there are some serious implications of the use of antitrust enforcement as an engine for liberalisation.

First, while the commission's antitrust investigations in the energy sector are expressly motivated by the attempted reforms of the energy sector through the liberalisation packages, it is unclear whether antitrust enforcement is made to match this mission.

Antitrust investigations are by their nature narrow enquiries into specific potential abuses. It is questionable as to whether focusing on the microcosm of specific antitrust fears with respect to one market player is an appropriate means by which to achieve liberalisation in a particular energy market. Introducing such reform ideally requires a sophisticated understanding of economic incentives and effects beyond the targeted undertaking, as well as considerable cost and demand information in the particular market.¹⁵

Second, there is also an apparent risk that the imposition of commitments on one significant undertaking only advantages another equally significant undertaking in a marketplace that is already highly concentrated. Antitrust enforcement lacks the capacity to adopt a systematic approach to energy sector liberalisation, by creating the same conditions for all undertakings in the market, rather than just selecting "the lowest hanging fruit" in terms of competition enforcement. Consequently, it is unclear in certain cases whether onerous

Under Article 9 the commission can secure far-reaching commitments with profound impacts on the target undertaking

commitments packages are in every case truly beneficial to consumers, or merely re-distributing dominance and market strength.

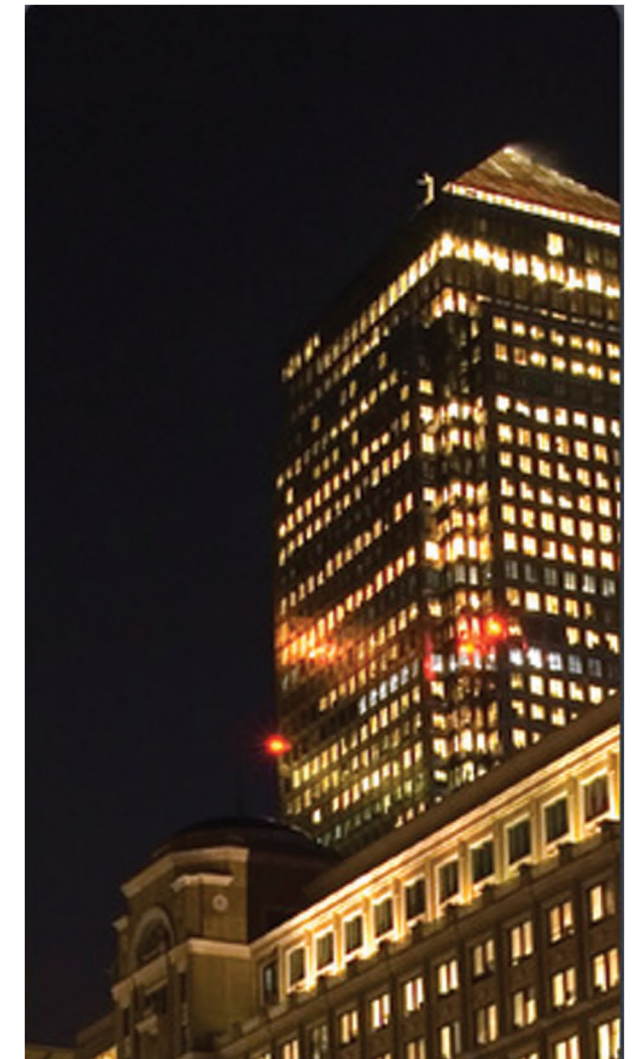
Third, under Article 9 the commission can secure far-reaching commitments that often have profound impacts on both the target undertaking and the particular energy market. These commitments are arrived at without a conclusive finding of dominance or a finding of an abuse, which are the two key steps for the more traditional Article 7 procedure.¹⁶ Therefore, the preliminary concerns of the commission in such instances are arrived at according to a significantly lower standard of proof and are based on preliminary concerns, short of actually finding an abuse per se.¹⁷ It is arguable that such an abridged investigative procedure is unsatisfactory in terms of its thoroughness, especially given the disproportionate impact of the commitments that result from such preliminary concerns.¹⁸

Fourth, given that the investigation process is an incomplete one giving rise only to preliminary concerns, it is unclear whether the commitments that are agreed upon as a result of that investigation correctly remedy the potential abuses. Such remedies or commitments are proposed by the targeted undertaking, they must satisfy the commission, as well as passing muster with national regulators and interested stakeholders, namely the targeted undertaking's competitors. This process allows for other factors to inform the design of the commitments package beyond the mere objective of removing a potential threat of an abuse of dominance by the targeted undertaking.

For example, in proposing certain commitments, the target will always have the rational motivation to protect or safeguard its interests, rather than merely address the commission's competition concerns. In addition, the role that competitors have in agreeing with a particular commitments package also creates the potential for considerations beyond competition enforcement playing a role in the process. Competitors are likely to select measures that provide them with an advantage, rather than those that protect consumer interests.

How can the commission's antitrust enforcement policy be tweaked to introduce liberalisation more effectively?¹⁹

Despite these concerns, it is clear that the commission's use of the antitrust investigative process through Article 9 is an attempt to introduce incremental and long overdue reform and liberalisation to the European energy sector, which is seen by many as one of the few remaining sanctuaries of Member State protectionism from open competition. This commission activism goes some way to achieving the objectives of liberalisation through competition enforcement, and bypasses the politically sensitive legislative route through which the first, second and third liberalisation packages have been introduced.



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However, there are a number of ways in which the concerns surrounding the use of antitrust enforcement in the energy sector could be reduced to some extent.

First, the monitoring of the implementation and maintenance of commitments ought to be strengthened to ensure that they remove the threat of abuses taking place in the long run. This might involve more input or involvement on the part of national energy regulators and the recently established Agency for the Cooperation of Energy Regulators. These organisations could ensure the efficacy of the measures by carrying out a comprehensive and long-term monitoring and reporting function to scrutinise the adherence and impact of the commitments to ensure that any divestments and capacity reductions genuinely introduce more competition. This involvement would also assist the trustee usually appointed to oversee the introduction of commitments packages in such situations. Such a practice would inform and sharpen future commission decision-making in terms of the commitments sought from undertakings, and their impact on competition in the energy sector.

Second, it might be considered that there be additional reporting requirements placed upon both the targeted undertaking and concerned stakeholders, including both competitors and consumer groups, to gauge the impact of the commitments on both competitors' behaviour and the prices and conditions faced by consumers or end-users. Once again, this would focus on the impact of commitments packages on an energy market in terms of the competitive landscape and price outcomes in the wake of their adoption.

Finally, there should be increased co-operation and information-sharing between the commission and national energy regulators and competition authorities, to ensure that the commission is well-armed with detailed industry knowledge to inform future decisions to carry out antitrust investigations and commitments agreed under Article 9. ■

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Footnotes

- 1 Thanks are due for the input from Maud Garnier, Patrick Barth and Rob McGruer at Hill & Knowlton.
- 2 <http://www.euractiv.com/en/energy/brussels-weighs-legal-action-internal-energy-market-news-502584>
- 3 <http://www.eu2011.hu/news/new-chapter-european-energy-policy>
- 4 Council Regulation (EC) No. 139/2004 of 20 January 2004 on the control of concentrations between undertakings (the EC Merger Regulation) – <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2004:024:0001:0022:EN:PDF>
- 5 Council Regulation (EC) No. 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty – <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CONSLEG:2003R0001:20061018:EN:PDF>
- 6 Article 102 of the Consolidated Version of the Treaty on the Functioning of the European Union – <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2008:115:0047:0199:EN:PDF>
- 7 See note 3.
- 8 Article 7 specifies that where the Commission makes a finding of an infringement of Article 81 (now 101) or 82 (now 102), it may by decision require the undertaking to bring such infringement to an end, and may impose any behavioural or structural remedies that are proportionate and necessary – <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CONSLEG:2003R0001:20061018:EN:PDF>
- 9 Commission Decision of 26 November 2008 in case COMP/39.388 – German electricity wholesale market; Commission Decision of 26 November 2008 in case COMP/39.389 – German electricity balancing market; Commission Decision of 18 March 2009 in case COMP/39.402 – RWE gas foreclosure.
- 10 Commission Decision of 8 July 2009 in case COMP/39.401 – E.ON/GDF (Art. 101 prohibition decision); Commission Decision of 3 December 2009 in case COMP/39.316 – GDF foreclosure; Commission Decision of 17 March 2010 in case COMP/39.386 – Long term electricity contracts in France; Commission Decision of 4 May 2010 in case COMP/39.317 – E.ON gas foreclosure; COMP/39.442 – French electricity wholesale market (inspections, 11.03.2009 – IP/09/104); COMP/B-1/39.736 – SIEMENS/AREVA (opening of proceedings, 21 May 2010, Art. 101 & 102).
- 11 Commission Decision of 29 September 2010 in case COMP/39.315 – ENI.
- 12 Commission Decision of 11 October 2007 in case COMP/37.966 – DISTRIGAZ (*); COMP/39.387 – Long term electricity contracts in Belgium (opening of proceedings, 18 July 2007 – IP/07/313, closure of proceedings, 28 January 2011).
- 13 Commission Decision of 14 April 2010 in case COMP/39.351 – Swedish Interconnectors.
- 14 COMP/39.727 – CEZ & others (inspections in the Czech electricity sector, 24 November 2009 – MEMO/09/518).
- 15 This point was made in the a report prepared by the Institut d'Economie Industrielle in 1999 for the European Commission in the context of competition policy's intervention in networked industries.
- 16 See note 8.
- 17 This point is outlined in "Energy Liberalization in Antitrust Straightjacket: A Plant Too Far?", by Malgorzata Sadowska, forthcoming in World Competition: Law and Economics Review, Vol. 34, Issue 3, September 2011.
- 18 Similar points are made by Dr. John Temple Lang in his article "The Use of Competition Law Powers for Regulatory Purposes, Regulatory Policy Institute, Oxford, Annual Competition Policy Conference, July 2007.
- 19 Thanks are due to Malgorzata Sadowska for her kind suggestions and comments.