

# **Antitrust and Regulatory Risks in the Energy Sector**

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# Decision Making Powers and Enforcement Priorities in the Energy Sector

A review of EU action over time in creating a competitive, internal market in gas and electricity

- The new institutional set-up following the third package (ACER, national regulatory authorities, national competition authorities, DG Comp and DG Energy, ENTSO-E and ENTSO-G)
- The new enforcement powers of the national energy regulators
- Overview of recent enforcement cases and the enforcement priorities of the European Commission national authorities in 2012
- The interaction of the third energy package with anti-trust rules
- How will national energy regulators interact with the relevant national competition authorities (e.g. when the energy regulator believes that there is a competition restriction)?

# A short timeline

1988 UK privatisation started, with independent regulators

1996-8 EU's First Liberalisation Package

2000-1 California crisis due to partial deregulation and retail price caps

2002 UK's liberalised energy the "poster boy" for the world (*The Economist*)...

2002 EU's Second Liberalisation Package

2002-5 Failures to implement EU legislation (infraction proceedings); national governments interfere in various ways: price caps, shutting interconnectors; guaranteeing LNG imports from US; no level playing field – low x-border flows

2005 EU Sector Inquiry Commenced

2007 EU Sector Inquiry Final Report

2009 EU Third Liberalisation Package (implemented 2011-2013)

2007-2011 in parallel, dawn raids and competition investigations across the EU lead to 10 major decisions (infringement or major commitments - including divestments: *E.On*, *RWE*, *ENI*)

# Identifying the Problems

## **National Government incentives are contra-internal market**

- Priority to “protect”: energy is not Coca Cola – shortage (esp. electricity) causes dramatic results (economic, social, etc.)
- First two “packages” of EC legislation failed to achieve this:
  - 22 infraction proceedings ongoing in 2009
  - Government intervention distorts (e.g. One Member State doubling LNG prices in winter; W.European storage not available due to legislation; reported shutting down of electricity interconnection due to national risk)

A true internal market, when supported by minimal intervention on an emergency basis, can achieve this security of supply for all but takes a collective “leap of faith”

# Uniformity of Aims over Time

- Liberalisation and competition

“By opening up European energy markets to competition - a process which started ten years ago - Europe's citizens and industries have gained many benefits: more choice, more competition to keep prices down, better service and improved security of supply.” (DG Energy statement of aim (see also DG Comp sector report 2007))

- Independent (light touch, economic) regulation

“It must be remembered that even if a government were superior in intelligence and knowledge to any single individual in the nation, it must be inferior to all the individuals of the nation taken together.” (J.S. Mill)

# Commission's 2005-7 sector Inquiry

- Identified “classic” competition issues arising from behaviours : immediately initiated action using the competition rules in Articles 101 and 102 TFEU
- Found a structural “conflict of interest” from vertical issues exploited via a number of mechanisms (8 forms of “manipulation” cited): again initiated action using competition rules, typically 102 TFEU
- No real internal market: insufficient interconnection, perverse incentives, government intervention: remedy could not be found in competition rules, hence third package of EU Internal Market Legislation

# Competition rules are insufficient: international consensus

## DG competition – Speech by Neelie Kroes Brussels 19/9/07

“ There are people out there who argue that the [legislative] package was not needed, and that firm enforcement of the competition rules can fill in the gap. I’m flattered by this, but I have to disagree...

...as you can see the Commission is very active in enforcing the competition rules in these markets. But no matter how strict we are, competition tools cannot solve all the problems – they can only be used to sanction anti-competitive behaviour. Competition enforcement is a necessary but not sufficient means to liberalise the markets. So legislation is a necessary second leg to our response to the problems in these sectors.”

## Example 2

“BG is both a seller of gas, and owner of the transportation system which its competitors have no alternative but to use... this dual role gives rise to an inherent conflict of interest which makes it impossible to provide the necessary conditions for self-sustaining competition.

[...] separate trading and transportation units still under the ownership of BG would not be sufficient”

1992 MMC Inquiry into British Gas (see also EC Sector Inquiry 2007 using same terminology)

## Example 3

“remedies in essential facilities cases necessarily require some form of regulation.”

In other words, [...] no remedy of mandated access can eliminate the underlying monopoly.”

*Hausman*, Professor of Economics, MIT - 1999

# The limbs of the EU solution

## **An elegant (and extensive) solution:**

1. Increase use of existing competition powers
2. New legislation:
  - restructure ownership (break the “inherent conflict of interest”)
  - take powers away from Central Government (political interference avoided)
  - new powers to NRAs (model of independent economic regulation embedded, plus more ‘tools’)
  - a new EU body (ACER), and TSO cooperation via ENTSO(E+G) to address ongoing cross-border (largely technical?) issues
3. Overall, a split between economic and technical issues on the one hand, and “energy policy” on the other

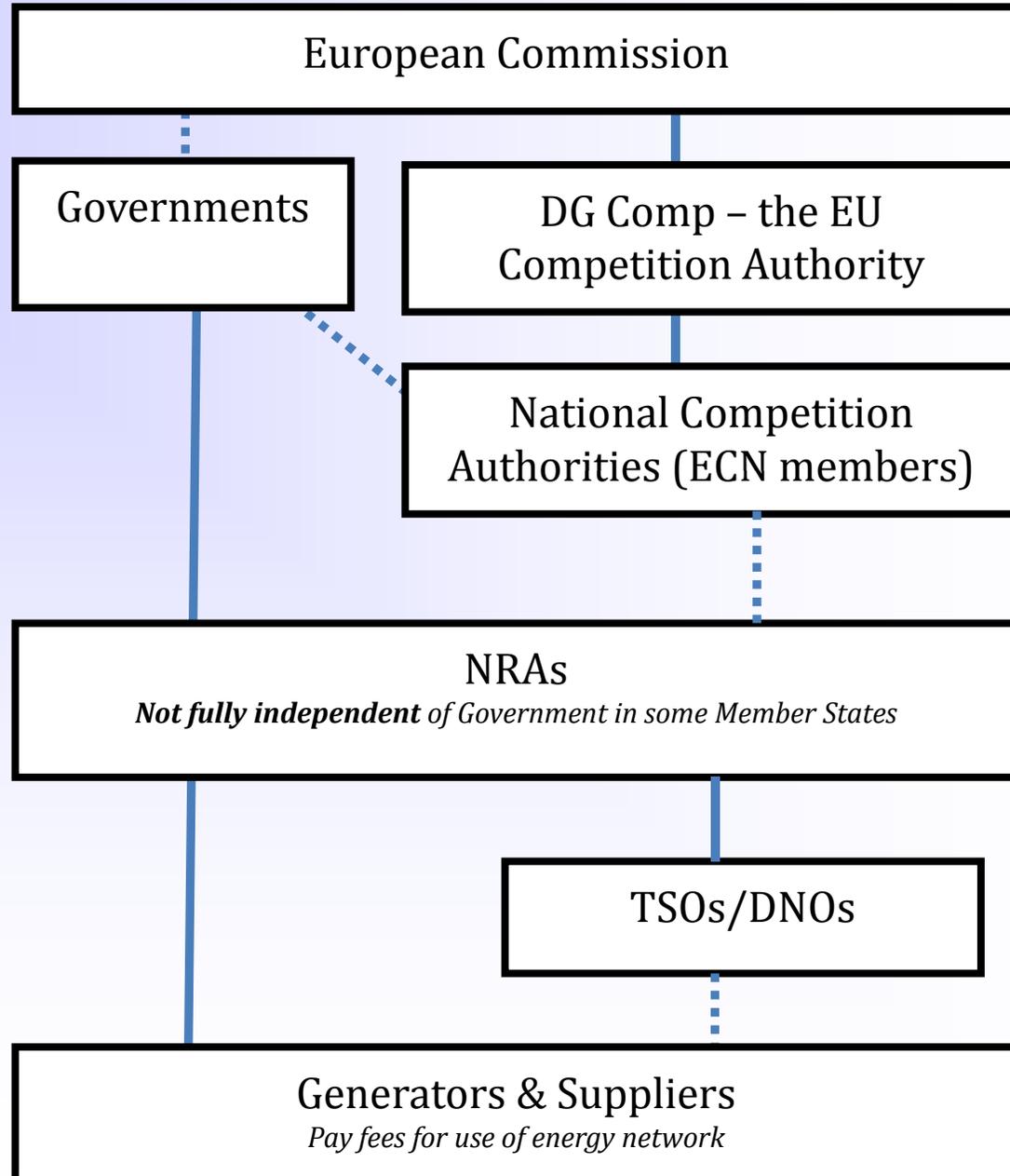
# The EU Third Energy Package

- Changes to the Landscape

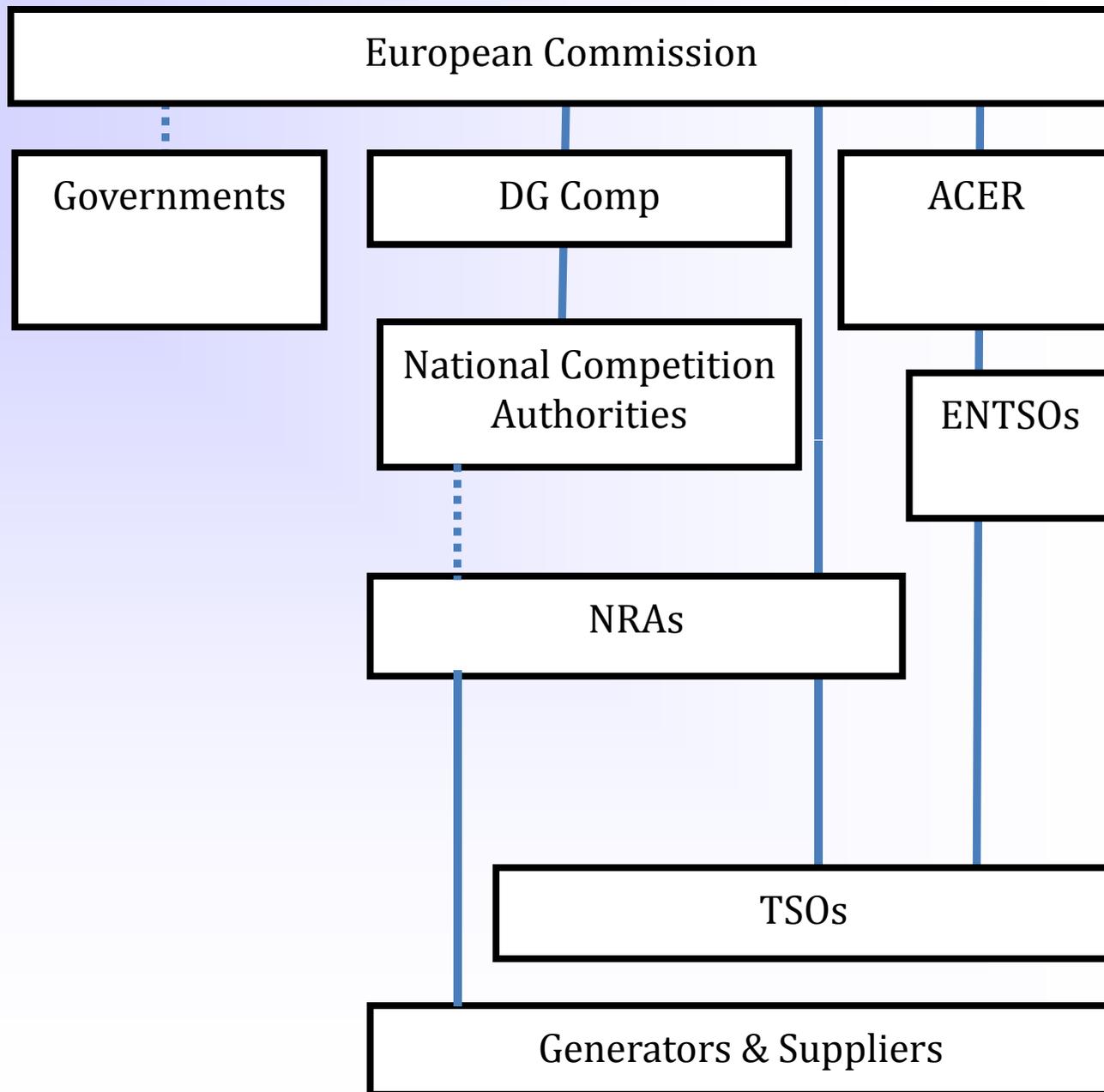
# 3<sup>rd</sup> Energy Package

- Two Directives setting out common rules for the internal market:
  - Directive 2009/72/EC – electricity
  - Directive 2009/73/EC – gas
- Three Regulations:
  - (EC) No 713/2009 - establishment of the Agency for the Cooperation of Energy Regulators (“ACER”)
  - (EC) No 714/2009 - conditions for access to the network for cross-border exchange of electricity
  - (EC) No 715/2009 - conditions for access to the natural gas transmission networks

# Previous regulatory framework



New  
regulatory  
framework



# Structural Changes – the industry

- **Unbundling of network and Supply/Generation Interests**
  - Three principal mechanisms:
    - Ownership Unbundling (FOU)
    - Independent System Operator (ISO)
    - Independent Transmission Operator (ITO)
    - ISO and ITO are not “transferrable” to other MS’s. They are highly (intrusively) regulated
- **Comment: intrusive regulation/regulatory risk is unattractive to boards and ultimately to shareholders (see Centrica break-up in early 1990’s; E.On/RWE/ENI commitments to divest)**
- **Cross-border collaboration by transmission system operators (TSOs)**
  - ENTSOs define cross-border network codes

# Structural Changes - regulators

- Independent Regulatory Watchdogs
  - ACER & NRAs with powers to cooperate and enforce
- ENTSOs define codes (cross-border issues only) – a “future proofing” of minutiae (or a Trojan Horse?)
- Ongoing oversight role for the European Commission (due to *Meroni* non-derogation)
  - Oversight of ACER
  - Network Codes subject to *comitology* procedure
  - European Competition Authorities apply a proactive enforcement policy

# The EU Third Energy Package – New Powers New Problems

# The detail reveals a problem

Articles 37(4) of the Electricity Directive and Articles 41(4) of the Gas Directive provide these core powers:

“[...] regulatory authorities shall have at least the following powers:

(a) to issue binding decisions on [electricity and natural gas] undertakings;

(b) to carry out investigations into the functioning of the [electricity and gas] markets, and to decide upon and impose any necessary and proportionate measures to promote effective competition and ensure the proper functioning of the market.

[...]

(d) to impose effective, proportionate and dissuasive penalties on [electricity and natural gas] undertakings not complying with their obligations under this Directive or any relevant legally binding decisions of the regulatory authority or of the Agency, or to propose to a competent court to impose such penalties. This shall include the power to impose or propose the imposition of penalties of up to 10 % of the annual turnover of the [relevant undertaking]

[...]”

# The 'problem' is an NRA function and NCA function 'overlap'

## 'Cooperation'

NRAs to inform NCAs of findings based on monitoring activity and cooperate with them (cf UK: NRA=NCA)

## But Articles 101-106 TFEU are directly applicable

- See *Deutsche Telekom* (C-280/08 P) where NRA got it 'wrong' under 102 TFEU
- See *Masterfoods* (Case C-344/98):

“It is also clear from the case-law of the Court that the Member States' duty under Article 5 of the EC Treaty to take all appropriate measures, whether general or particular, to ensure fulfilment of the obligations arising from Community law and to abstain from any measure which could jeopardise the attainment of the objectives of the Treaty is binding on all the authorities of Member States including, for matters within their jurisdiction, the courts...”
- And see Council Regulation (EC) No 1/2003 Art 3(2). A one-way portal for unilateral conduct, but no such gateway for Article 101 TFEU.

# What is wrong with this?

1. Given the broad range of powers and functions, the NRAs are necessarily engaging in consideration of competition issues (the Directives say this)
2. If they take action that fails to go far enough, they risk breach of the *Masterfoods* principles
3. If they go too far, they end up like the NRA in *Deutsche Telekom*, causing a breach of Article 102 TFEU
4. In respect of agreements, Regulation 1/2003 EC (as well as Article 10 TFEU and the direct applicability of the Article 101) means that to take action that conflicts with EU law may at best be unlawful (and can be struck down) or at worst give rise to *Francovich* damages
5. An interesting comparison with the UK Competition Commission in market investigation scenarios: it would have to hand back to NCA

# The Commission's (the only?) Answer

[http://ec.europa.eu/energy/gas\\_electricity/interpretative\\_notes/doc/implementation\\_notes/2010\\_01\\_21\\_the\\_regulatory\\_authorities.pdf](http://ec.europa.eu/energy/gas_electricity/interpretative_notes/doc/implementation_notes/2010_01_21_the_regulatory_authorities.pdf)

See “Duty to ensure compliance with European Union law” (page 14)

“It follows from this provision that, without prejudice to the rights of the European Commission as guardian of the Treaty on the functioning of the European Union, the NRA is granted a general competence — and the resulting obligation — as regards ensuring general compliance with European Union law...and the *acquis communautaire*”.

And later:

“The Commission’s services are of the opinion that the powers that Article 37(4) of the Electricity Directive and Article 41(4) of the Gas Directive grant to the NRA are very similar to those granted to competition authorities. The possibility of imposing a penalty of up to 10 % of a company’s turnover supports this view.”

Of course, that is not what the Third Package says in terms, and this *legerdemain* by the Commission may well fail - a mess!

Gaze into the crystal ball

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# Some of the priorities at EU Level

Energy cited as one of 3 key sectors by Alexander Italianer at the 2011 Annual Competition Policy Conference

## **EU Cases in past 5-7 years**

- (i) Structural issues (monopoly networks with conflict of interest - hoarding, underinvestment, refusal of access, discrimination)
  - RWE (exclusionary abuse)
  - E.On (exploitation in electricity balancing; exclusion in gas)
  - ENI (hoarding/underinvestment)
  - Swedish Interconnectors (pushing constraints to national boundaries)
  
- (ii) Contractual arrangements (long term contracts for large %, protection of home markets)
  - Simple Collusion: E.On/GdF;
  - Long term contracts: EdF
  - Territorial restrictions: ENI/ENEL/GdF and Electrabel/EdF

# National trends

**Widespread action: Romanian, German, British, French, Polish, Czech, Spanish and Italian amongst those taking competition action in past 3 years.**

**Trends include examination of long term or territorial contracts (gas or elec) and of exploitation in balancing markets for electricity**

**Germany: no need to prohibit Long-Term Gas Supply Contracts**

[http://www.bundeskartellamt.de/wEnglisch/download/pdf/Presse/2010/100615\\_PM\\_LTC\\_E.pdf](http://www.bundeskartellamt.de/wEnglisch/download/pdf/Presse/2010/100615_PM_LTC_E.pdf)

- Note the overlap with regulated access requirements, plus the regulatory reduction of market trading areas

**Germany: Energy Suppliers agree to abandon Resale Prohibitions/take or pay**

[http://www.bundeskartellamt.de/wEnglisch/download/pdf/Presse/2010/100707\\_PR\\_WVV\\_final\\_E.pdf](http://www.bundeskartellamt.de/wEnglisch/download/pdf/Presse/2010/100707_PR_WVV_final_E.pdf)

**Poland: UOKiK opens formal Proceedings On 4 July 2011, against long term lock-in contracts**

# Thank you

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