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Abuse of Dominance in Energy Markets

4th EU Energy Law & Policy Master Class

Claeys & Casteels

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The statute

- Article 102 TFEU prohibits any abuse, by one or more undertakings, of a dominant position within the common market or in a substantial part of it, in so far as it may affect trade between Member States
- Such abuse may, in particular, consist in:
  - (a) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions;
  - (b) limiting production, markets or technical development to the prejudice of consumers;
  - (c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
  - (d) making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

Dominance and market definition

- Dominance exists in relation to relevant markets which have a product/service dimension and a geographic dimension
- Products/services and geographic areas belong to same relevant market when they are substitutes, i.e. impose significant competitive constraints on each other
- Hypothetical monopolist test:
  - Can a hypothetical monopolist of a given set of products profitably raise prices (by 5-10%) above the competitive level?
  - If not, the products and areas that constrain the hypothetical monopolist are added to the candidate market
- Relevant markets to be defined in every case based on specific merits (taking into account precedent practice), but also driven by strategic objectives (of enforcer or company concerned)

Relevant energy markets

- For both electricity and gas: distinction between relevant product markets for production, transmission and distribution (classic value chain)
- Distinction due to different demand and supply characteristics and lack of substitution among those levels:
  - Production level generally subject to certain degree of competition (between sources, fuels)
  - Transmission level generally regarded as natural monopolies (no or few parallel networks)
  - Distribution level subject to increasing competition under effect of market opening and ex ante regulation
- Geographical markets traditionally defined as national:
  - Historically, little exchanges across international borders due to State monopolies
  - But liberalisation (and ex ante regulation) lead to increased market integration and thus to wider (regional) markets – single EU market goal

Dominance

- Position of economic strength enabling company to prevent effective competition on relevant market by affording it the power to behave to an appreciable extent independently of its competitors, customers and ultimately consumers
- Dominance equals substantial market power, which can be presumed if a company has more than 40% market share on relevant market (established ECJ case law)
- Presumption is rebuttable by other factors (e.g. number of and distance to competitors, entry barriers, financial strength)
- But these other factors can also lead to dominance for companies with less than 40% market shares

Collective dominance

- Collective dominance arises when two or more undertakings are able to adopt a common policy on the market and thereby jointly exercise market power
- For collective dominance to be found, the following conditions must be satisfied:
  - The operators must have a common understanding of the market conduct that is desirable;
  - Operators must be able to monitor each others' conduct in order to observe whether the common understanding is adhered to;
  - Operators must be able to effectively punish deviators for instance by engaging in a price war; and
  - The reaction of competitors and consumers must not jeopardise the results expected from the common understanding

Abuse

- Objective concept relating to behaviour of undertaking in dominant position:
  - *Influence on structure of market where, as a result of the very presence of the undertaking in question, the degree of competition is weakened, and which, …*
  - *through recourse to methods different from those which condition normal competition in products or services on basis of the transaction of commercial operators, …*
  - *has the effect of hindering the maintenance of the degree of competition still existing in the market or the growth of that competition*
- No intention needed; abuses can not be stated *per se,* but require demonstration of (at least potential) anti-competitive effects by enforcement authority

Types of abuse in recent energy cases (overview)

- Exclusionary abuses: prevent competitors from access to market/customers
  - Exclusive dealing (wholesale/transport)
  - Refusals to deal/grant access to essential input (margin squeeze)
  - Capacity hoarding, strategic underinvestment
  - Market partitioning
- Exploitative abuses: extract benefits from competitors, customers or consumers beyond competitive level
  - Exclusive dealing (supply/purchase/sale)
  - Market manipulation to increase wholesale/retail prices
  - Discrimination

Market foreclosure through long-term contracts

- Main elements of the analysis
  - Market position of the contractual partners
  - Exclusivity or quasi-exclusivity enforced by dominant party
  - Duration of (quasi-exclusive) obligations
  - Efficiencies to justify any of above elements?
- Bundeskartellamt: decision against Ruhrgas in 2006
  - Maximum duration 2 years for more than 80% coverage
  - Maximum of 4 years for coverage between 50 and 80%
  - No maximum duration below 50%

Distrigaz: gas supply in Belgium

Theory of harm

- Long-term quasi- exclusive contracts with few main industrial gas customers
- Foreclosure of Belgian wholesale gas market
- Resale restrictions reinforce lack of liquidity

Commitments

- Imposed on 11 October 2007
- 65% of overall gas volumes to be put on market every year
- No new contract > 5 years
- Resale restrictions lifted
- Valid for 4 years

EDF: electricity supply in France

Theory of harm

- Long term exclusive contracts with industrial customers
- Foreclosure of French electricity market
- Resale restrictions reinforce lack of liquidity

Commitments

- Imposed on 17 March 2010
- 60% of volumes to be put on the market every year
- No new contract > 5 years, unless termination clause without penalties
- Non-exclusive offers to be made to customers
- No resale restrictions allowed
- Valid for 10 years unless market shares fall below 40%

Issues for Discussion

- *Are there different standards under Art. 101 and 102 TFEU? Could the same result have been imposed unilaterally on the companies rather than settled based on their proposals?*

- *When is market access impeded? At 20%, 30%, 50% market coverage?*

- *Why worry about contract duration? Supply and investment security considerations?*

- *Will the prohibition of resale restrictions prevent large industrial users and buying groups from obtaining attractive offerings from producers?*

Refusal to deal and essential facilities

- Refusal to give access to a facility may be abusive when:
  - Access to a facility indispensable to operate on a neighbouring market, technically possible, against appropriate compensation
  - Refusal excludes effective competition on that neighbouring market
  - Refusal not objectively justified and harms consumers
- It is widely recognised that gas and electricity networks are natural monopolies
- Access to network systems is indispensable in order to compete on supply markets

Network foreclosure

- Networks are commonly regards as gateways to the market. When gatekeepers are vertically integrated, they may have incentives to use networks to distort competition in their own favour on supply markets
- Refusal to supply has been identified in various (novel) forms:
  - Capacity hoarding
  - Margin squeeze (constructive refusal)
  - Inadequate capacity management
  - Strategic limitation of investments
  - Long term capacity bookings by the incumbent shipper
- Four cases in the gas sector concluded with binding commitments imposed on RWE, ENI, GDF, E.ON

RWE / ENI: gas transport in Germany + Italy

Theory of harm

- RWE and ENI were vertically integrated incumbents
- Refusal to supply:
  - Primary capacity hoarding (both)
  - Inadequate capacity management (RWE)
  - Margin squeeze (RWE)
  - Strategic underinvestment (ENI)
- Lead to market foreclosure and harm for competition and consumers

Commitments

- Divestiture of the RWE gas transmission network to independent third party (imposed on 18 March 2009)
- Divestiture of ENI's share in the international gas transmission networks TENP, TAG and Transitgas (imposed on 29 Sept. 2010)

GDF / E.ON: gas transport in France + Germany

Theory of harm

- Refusal to supply by way of long-term bookings of almost all technically available capacities on gas transmission networks
- Lead to perpetuation of dominance on downstream markets

Commitments

- Formally imposed on GDF on 3 Dec. 2009 and E.ON on 4 May 2010
- Objective: Make downstream markets contestable and increase investment incentives
- Immediate release of significant capacities at mix of entry points (GDF 10%, E.ON 15%)
- Long term cap: at least 50% of long term capacity must be made available to third parties over next ten years

Issues for Discussion

- *Why is it an abuse for a firm to utilize its own capacity for serving its own needs?*

- *How to determine with sufficient certainty whether a firm has engaged in "strategic underinvestment"?*

- *How does a dominant company ensure that it has invested sufficiently to avoid abusive conduct?*

- *Could the Commission have imposed the remedies that it accepted as commitments? In particular the network sales?*

E.ON: Manipulation of balancing markets in Germany

Theory of harm

- Inflating balancing costs in order to favour own related power generation operators
- Preventing imports of balancing power by refusing to pre-quality suppliers
- Cross-border element: discrimination in favour of domestic balancing energy

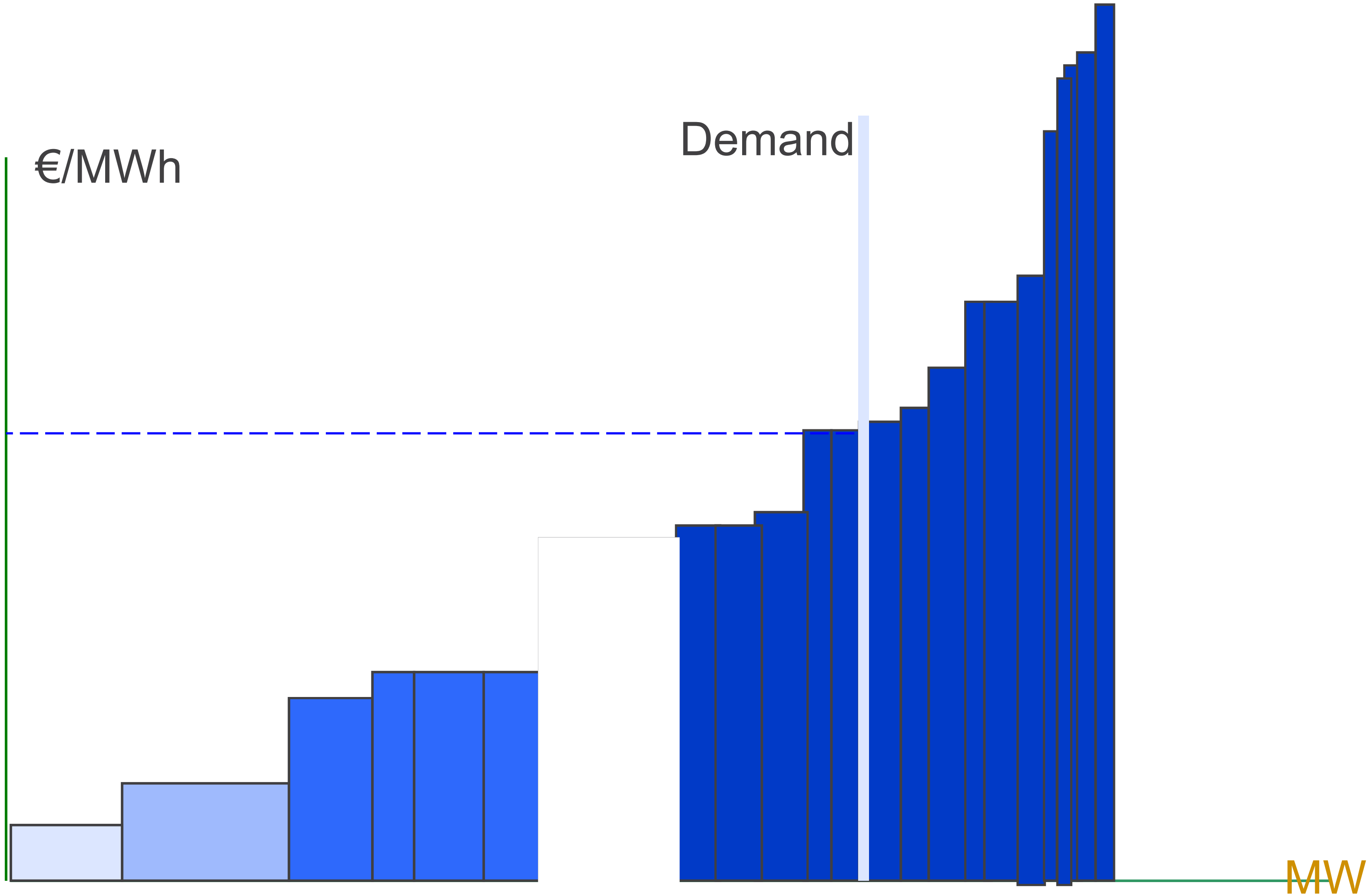
Commitments

- Divestiture of E.ON's German electricity transmission network, formally imposed on 26 Nov. 2008
- Network sale to Tennet (NL) completed, cleared by DG COMP in Feb. 2010

E.ON: Manipulation of power generation and wholesale market in Germany (1)

- By limiting production, dominant power generators can force recourse to more expensive plants in the merit order and thereby manipulate market outcome to the prejudice of consumers
- This is how it works:

Merit order for power generation



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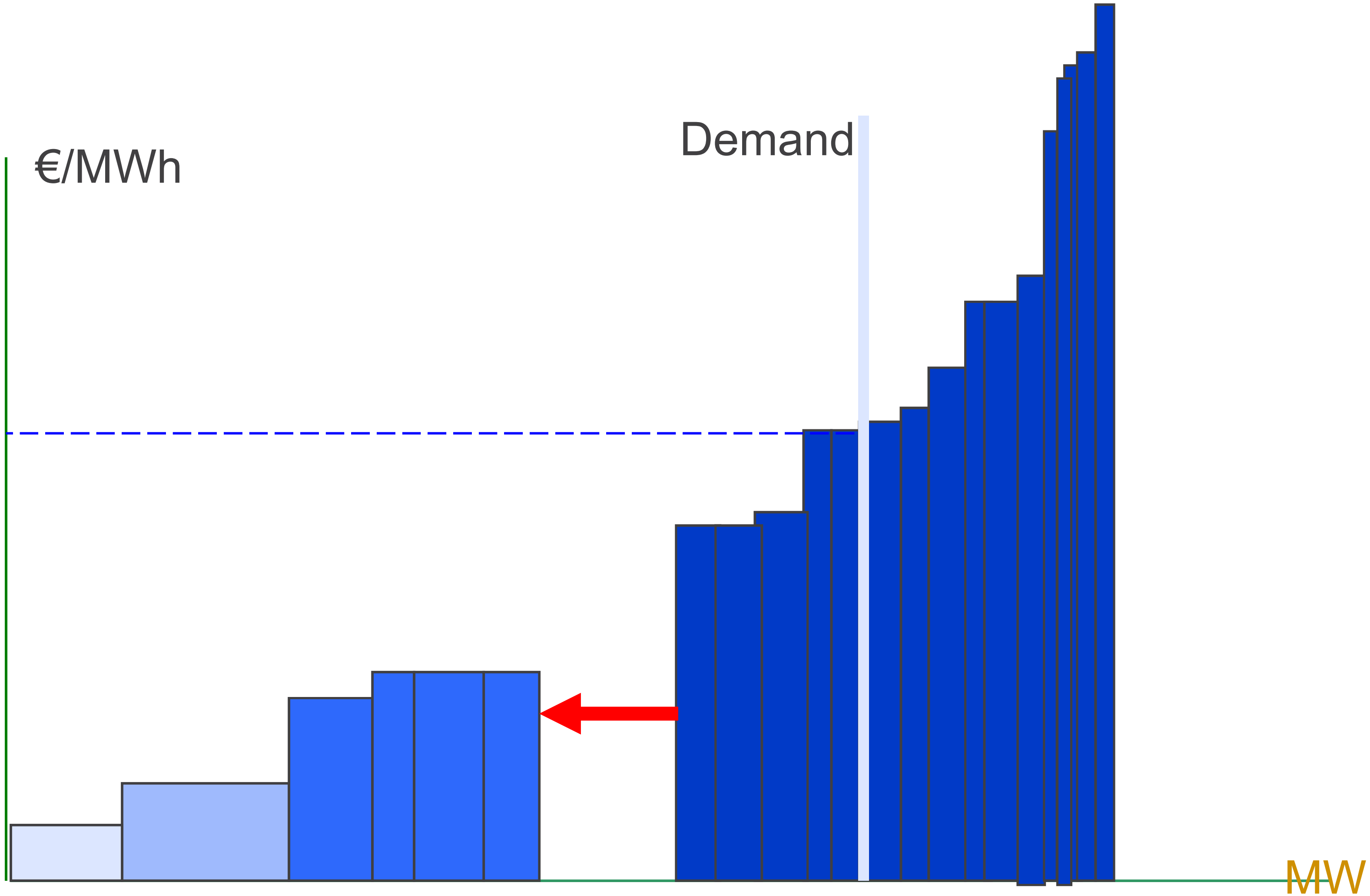
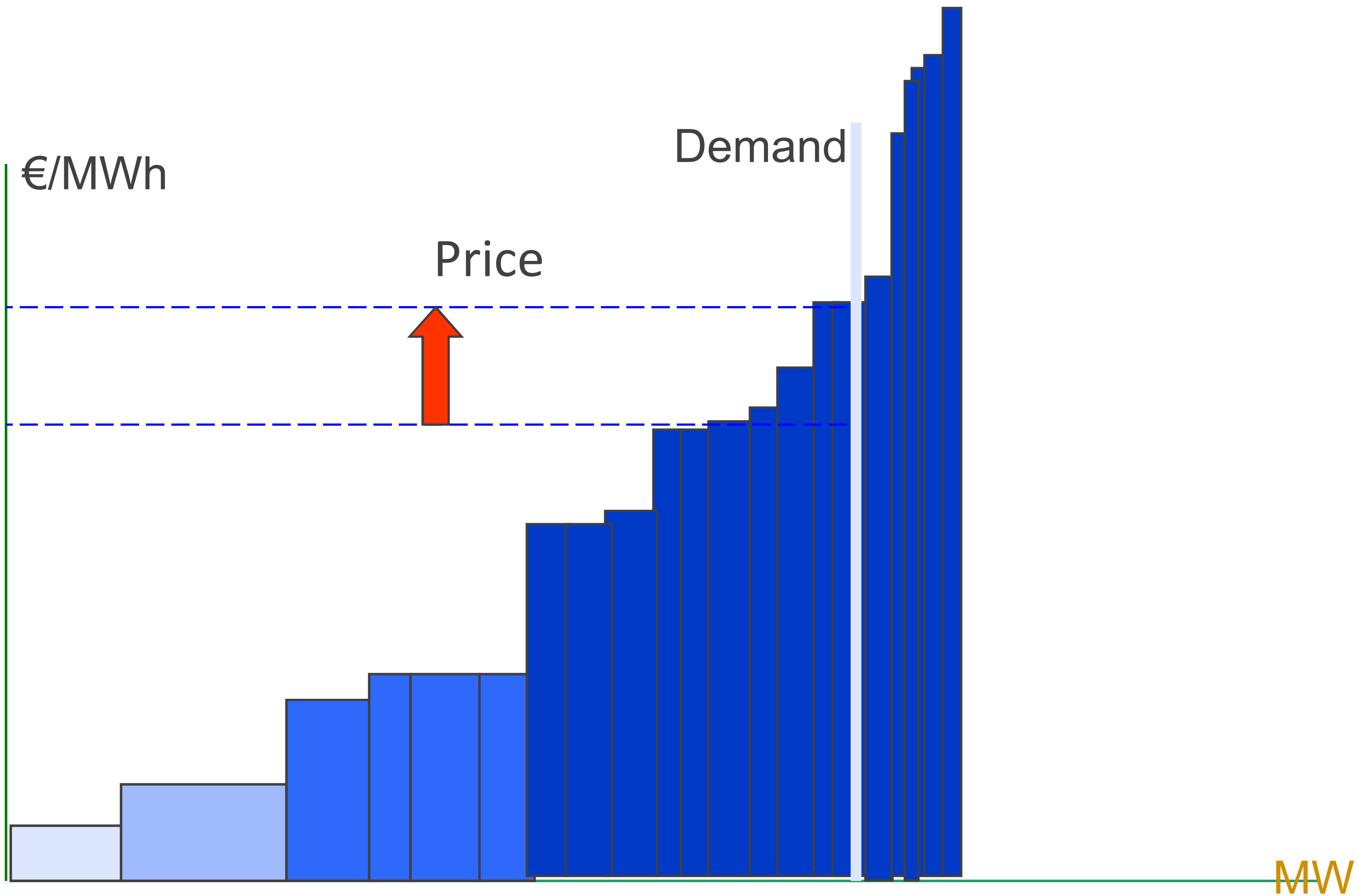
Artificial carve out of specific plant(s)



Resulting price increase



E.ON: Manipulation of electricity generation and wholesale market in Germany (2)

Theory of harm

- Withdrawal of profitable (but not profit maximising) power generation capacity
- Significant increase in spot prices and similar impact on forward prices, due to link to spot price
- Deter investments in new generation plants by third parties offering long-term supply contracts or participation in existing power plants

Commitments

- Divestiture of 5,000 MW (approx. 10%) of E.ON's total power generation capacity (imposed on 26 Nov. 2008)
- Sale of required capacities completed throughout 2009/2010 (some of them as swaps)

Issues for Discussion

- *Is market manipulation a new form of abuse?*
- *Is it a form of unfair pricing? If not, what is the benchmark?*
- *Could the Commission have imposed the structural remedies without them being put on the table by the company concerned?*
- *Does the infringement necessarily derive from the very structure of the undertaking?*

Svenska Kraftnät: Lack of electricity market integration in Sweden

Theory of harm

- Cheap hydro generation located north, nearly all consumption located south
- To keep Sweden as one price zone, Swedish TSO (SVK) curtailed almost 2/3 of available transmission capacity to neighbouring countries
- Discrimination between transmission to consumers located inside and Sweden without objective justification
- Segmentation of the internal market, Reduces net consumer welfare, distorts generation and network investments signals

Commitments

- Formally imposed on 14 April 2010
- Subdivide the Swedish network into two or more bidding zones
- Cease curtailing trading capacity Reinforce West-Coast-Corridor network by 30 November 2011
- In the interim period apply counter trade to reduce curtailing

Interplay with ex ante regulation

- Sector-specific obligations and authorities were put in place to prevent such abusive conduct

- Efficient ex ante regulation would avoid high fines and drastic sanctions e.g. divestments

- Are these rules not suited or not applied strictly enough? Is there industry or political capture?

Recent shift of geographic focus to CEE

- Case against Czech incumbent (CEZ) regarding possible foreclosure of Czech electricity generation and wholesale market (formally opened in July 2011)
- Inspections in ten CEE countries (September 2011) regarding restrictions of competition in gas supply markets by Gazprom
- Numerous cases of international arbitration regarding legality of long-term gas supply agreements (e.g. destination clauses, price formula)
- Several investigations into restrictions for foreign energy traders (incl. role of power exchanges)

Recent focus on procedural infringements

- All three cases leading to fines so far occurred in energy and water sectors (even without substantive infringement):
- Fine of 38 Mio. Euro imposed on E.ON Energie in Jan. 2008 for breach of seal during DG COMP inspection under Art. 102 (confirmed by General Court in Dec. 2010, under appeal)
- Fine of 8 Mio. Euro imposed on Suez Environnement and Lyonnaise des Eaux in May 2011 for breach of seal during DG COMP inspection
- Fine of 2.5 Mio Euro imposed on Czech energy company EPH for obstruction of IT based search during DG COMP inspection

Any Questions?

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